

DXP ENTERPRISES INC  
Form 10-K  
March 08, 2019

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, 2018

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 every Interactive Data File required to be submitted 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 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.

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

Large accelerated filer Accelerated filer

Non-accelerated filer      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, 2018 was \$608.7 million based on the closing sale price as reported on the NASDAQ National Market System.

Number of shares of registrant's Common Stock outstanding as of February 28, 2019: 17,581,662.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for our 2019 annual meeting of shareholders are incorporated by reference into Part III hereof.

The 2019 proxy statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

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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 ("SC"), Supply Chain Services ("SCS") and Innovative Pumping Solutions ("IPS"). Sales, operating income, and other financial information for 2018, 2017 and 2016, and identifiable assets at the close of such years for our business segments are presented in Note 19 – Segment and Geographical Reporting to the Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

Our total sales have increased from \$125 million in 1996 to \$1.2 billion in 2018 through a combination of internal growth and business acquisitions. At December 31, 2018, we operated from 166 locations in 35 states in the U.S., nine provinces in Canada, one location in Dubai and one state in Mexico, serving customers engaged in a variety of industrial end markets. We have grown sales and profitability by adding additional products, services, and 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](http://www.dxpe.com) and emails may be sent to [info@dxpe.com](mailto:info@dxpe.com). The reference to our website address does not constitute incorporation by reference of the information contained on the website and such information should not be considered part of this Report.

Industry Overview

The industrial distribution market is highly fragmented. Based on 2018 sales as reported by Industrial Distribution magazine, we were the 20<sup>th</sup> 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”.

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

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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 by business segments as of December 31, 2018. 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.

| Segment | 2018 Sales (in thousands) | % of Sales | End-Markets   | Locations                                   | Employees |
|---------|---------------------------|------------|---|---|-----------|
| SC      | 750.0                     | 61.67%     | Oil & Gas, Food & Beverage, General Industrial, Chemical & Petrochemical, Transportation, Aerospace | 151 service centers, 4 distribution centers | 1,576     |
| IPS     | 291.7                     | 23.98%     | Oil & Gas<br>Food & Beverage,<br>Mining & Transportation  | 11 fabrication facilities                   | 572       |
| SCS     | 174.5                     | 14.35%     | Oil & Gas Mining Utilities  | 83 customers facilities                     | 337       |

## 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, 2018, our Service Centers’ products and services were distributed from 151 service centers and 4 distribution centers. DXP Service Centers provide a wide range of MRO products in the rotating equipment, bearing, power transmission, hose, fluid power, metal working, industrial supply and safety product 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 11.0% 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, 2018, the Service Centers segment had approximately 1,576 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.



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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
- 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, 2018, the Innovative Pumping Solutions segment operated out of 11 facilities, nine of which are located in the United States and two in Canada.

Approximately 4.4% of the IPS segment's long-lived assets are located in Canada and the remainder are located in the U.S. Approximately 7.3% of the IPS segment's 2018 revenues were recognized in Canada and 92.7% were in the U.S.

At December 31, 2018, the IPS segment had approximately 572 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 \$124.2 million and \$104.1 million at December 31, 2018 and 2017, respectively.

#### 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 canceled 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

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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.

• SmartSource<sup>SM</sup>, 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.

At December 31, 2018, the Supply Chain Services segment operated supply chain installations in 83 of our customers' facilities.

All of the SCS segment's long-lived assets are in the U.S. and all of the SCS segment's 2018 revenues were recognized in the U.S.

At December 31, 2018, the Supply Chain Services segment had approximately 337 employees, all of whom were full-time.

## 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.

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**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 (H<sub>2</sub>S) 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.

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 19 - Segment and Geographical Reporting of the Notes to Consolidated Financial Statements.

### Recent Acquisition

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 35 acquisitions across our three business segments.

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 \$11.7 million for ASI at closing plus an additional earnout provision for up to \$4.6 million. The purchase was financed with \$10.8 million of cash on hand as well as issuing \$0.9 million of DXP's common stock, and the potential earnout extends for a three period.

### Disposition

On October 3, 2016, the Company sold Vertex Corporate Holdings, Inc. ("Vertex") for approximately \$31 million in cash. The sale was 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 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. Additionally, we are

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partially self-insured for our group health plan, worker's compensation, auto liability and general liability insurance. The cost of claims for the group health plan has increased over the past three years. This trend is expected to continue.

Government Regulation and Environmental Matters

We are subject to various laws and regulations relating to our business and operations, and various health and safety regulations 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, 2018, DXP had 2,740 employees, all of whom were full-time.

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 8, 2019. All of our executive officers hold office at the pleasure of DXP's Board of Directors.

| NAME            | AGE | TITLE  |
|-----------------|-----|--|
| David R. Little | 67  | Chairman of the Board, President and Chief Executive Officer |
| Kent Yee        | 43  | Senior Vice President/Chief Financial Officer                |
| Gene Padgett    | 48  | Senior Vice President/Chief Accounting Officer               |
| David C. Vinson | 68  | Senior Vice President/Innovative Pumping Solutions           |
| John J. Jeffery | 51  | Senior Vice President/Supply Chain Services                  |
| Todd Hamlin     | 47  | Senior Vice President/Service Centers                        |
| Chris Gregory   | 44  | Senior Vice President/Information Technology                 |

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.

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 44 transactions



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including more than \$1.5 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.

Gene Padgett. Mr. Padgett was appointed Senior Vice President/Chief Accounting Officer in May 2018. Prior to joining the Company, Mr. Padgett spent ten years with Spectra Energy in several positions with increasing responsibility including General Manager of U.S. and Canadian Tax, Director of U.S. Operations Accounting and General Manager Corporate Accounting. Prior to Spectra Energy, he spent seven years with Duke Energy in various roles covering Corporate Accounting, Accounting Research and Policy and working as a divisional controller. Mr. Padgett started his career at PricewaterhouseCoopers.

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.

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

Edgar Filing: DXP ENTERPRISES INC - Form 10-K

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended (the “Exchange Act”), are available free of charge through our Internet website ([www.dxpe.com](http://www.dxpe.com)) as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with SEC at <http://www.sec.gov>. Additionally, we make the following available free of charge through our Internet website [ir.dxpe.com](http://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

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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.

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.

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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.

As discussed in Item 9A, "Managements Report on Internal Controls Over Financial Reporting," we continue to have material weaknesses in our internal controls during 2018. If we fail to successfully remediate these 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

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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.

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 SmartSource<sup>SM</sup> 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.



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### 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.

### 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, 2018, our combined goodwill and intangible assets amounted to \$261.3 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.

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.

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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.

### 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 7 of our facilities while the remainder of our facilities are leased. At December 31, 2018, we had approximately 166 facilities which contained 151 services centers, 4 distribution centers and 11 fabrication facilities.

At December 31, 2018, the Service Centers segment operated out of 151 service center facilities. Of these facilities, 122 were located in the U.S. in 35 states, 27 were located in nine 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 Texas, Montana and Nebraska. At December 31, 2018, the Innovative Pumping Solutions segment operated out of 11 fabrication facilities located in five states in the U.S. and two provinces in Canada. At December 31, 2018, the Supply Chain Services segment operated supply chain installations in 83 of our customers' facilities in 23 U.S. states.

At December 31, 2018, our owned facilities ranged from 5,000 square feet to 45,000 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

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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.

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.

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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 ticker symbol "DXPE".

On February 13, 2019, we had approximately registered 373 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 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 a customized peer group of three companies that includes: NOW Inc.<sup>(1)</sup>, MRC Global Inc. and Applied Industrial Technologies Inc. The graph assumes that the value of the investment in DXP's common stock and in each index was \$100 at December 31, 2013 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.

<sup>(1)</sup> NOW Inc was excluded from the peer group calculation for 2013 as it was formed during 2014.

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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, 2018:

| 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  | 169,293                                  | \$ 31.05                     | 272,210  | (1) |
| Equity compensation plans not approved by shareholders | N/A  | N/A  | N/A                                      | N/A                          | N/A  |     |
| Total  | N/A  | N/A  | 169,293                                  | \$ 31.05                     | 272,210  | (1) |

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

## Unregistered Shares

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 2018, 2017 and 2016 the Company withheld 12,122, 30,500 and 12,507 shares, respectively, to satisfy tax withholding obligations in connection with vesting of employee equity awards.



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## 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, 2018 has been derived from our audited Consolidated Financial Statements. This information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and notes thereto included elsewhere in this Report.

|   | Years Ended December 31                  |             |           |                     |                     |
|---|--|-------------|-----------|---------------------|---------------------|
|   | 2018                                     | 2017        | 2016      | 2015 <sup>(2)</sup> | 2014 <sup>(1)</sup> |
|   | (in thousands, except per share amounts) |             |           |                     |                     |
| Consolidated Statements of Earnings Data:           |  |             |           |                     |                     |
| Sales   | \$1,216,197                              | \$1,006,782 | \$962,092 | \$1,247,043         | \$1,499,662         |
| Gross Profit  | 332,208                                  | 271,581     | 264,802   | 351,986             | 432,840             |
| Operating income (loss)                             | 68,451                                   | 33,490      | 19,332    | (27,916 )           | (12,628 )           |
| Net income (loss)                                   | 35,521                                   | 16,529      | 7,151     | (39,070 )           | (45,238 )           |
| Net (loss) attributable to non-controlling interest | (111 )                                   | (359 )      | (551 )    | (534 )              | —                   |
| Net income (loss) attributable to DXP               | \$35,632                                 | \$16,888    | \$7,702   | \$(38,536 )         | \$(45,238 )         |
| Earnings per share:                                 |  |             |           |                     |                     |
| Basic earnings (loss) <sup>(3)</sup>                | 2.02                                     | 0.97        | 0.51      | (2.68 )             | (3.10 )             |
| Diluted earnings (loss) <sup>(3)</sup>              | 1.94                                     | 0.93        | 0.49      | (2.68 )             | (3.10 )             |

<sup>(1)</sup> The impairment expense in 2014, 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.

<sup>(2)</sup> The impairment expense in 2015, 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.

<sup>(3)</sup> See Note 13 - Earnings per Share Data of the Notes to Consolidated Financial Statements for the calculation of basic and

diluted earnings per share.

|                                    | Years Ended December 31 |           |           |           |           |
|------------------------------------|-------------------------|-----------|-----------|-----------|-----------|
|                                    | 2018                    | 2017      | 2016      | 2015      | 2014      |
|                                    | (in thousands)          |           |           |           |           |
| Consolidated Balance Sheet Data:   |                         |           |           |           |           |
| Cash <sup>(1)</sup>                | \$40,519                | \$25,579  | \$1,590   | \$1,693   | \$47      |
| Net Working Capital <sup>(2)</sup> | 205,201                 | 170,892   | 140,430   | 166,667   | 209,387   |
| Total Assets                       | 699,962                 | 639,083   | 602,052   | 674,984   | 833,382   |
| Long-term Debt Obligations         | 245,309                 | 248,716   | 174,323   | 300,726   | 372,908   |
| Total Shareholders' Equity         | \$308,254               | \$268,546 | \$252,549 | \$198,870 | \$242,952 |

<sup>(1)</sup> Cash includes cash and cash equivalents plus restricted cash

<sup>(2)</sup> Net Working Capital equals current assets minus current liabilities excluding cash and short-term debt

## 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

DXP's products are marketed in the United States, Canada, Dubai and Mexico to 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

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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.

## Operating Environment Overview\*

|   | 2018       | 2017       | 2016       |
|---|------------|------------|------------|
| Active Drilling Rigs**                  |            |            |            |
| U.S                                     | 1,032      | 875        | 510        |
| Canada                                  | 191        | 207        | 128        |
| International                           | 988        | 948        | 955        |
| Worldwide                               | 2,211      | 2,030      | 1,593      |
| Gross Domestic Product (in billions)    | \$20,500.6 | \$19,485.4 | \$18,707.2 |
| West Texas Intermediate ** (per barrel) | \$65.23    | \$50.80    | \$43.29    |
| Purchasing Managers Index               | 54.3       | 59.3       | 54.5       |

\* The information contained in this table has been obtained from third party publicly available sources.

\*\* Averages for the years indicated.

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 SC segment of \$213.5 million, the IPS segment of \$67.7 million and the SCS 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 SC, 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.

During 2018, the growth rate of the general economy improved from 2017 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, 2018 increased \$209.4 million, or 20.8%, to approximately \$1.2 billion from \$1.0 billion for the prior corresponding period. Sales from a business acquired in 2018 accounted for \$47.5 million of 2018 sales. Excluding the 2018 sales of the business acquired, on a same store sales basis, sales for 2018 increased by \$161.9 million, or 16.1% from the prior corresponding period. This same store sales increase is the result of sales increases in our IPS, SC and SCS segments

of \$87.6 million, \$61.3 million and \$13.0 million respectively. The majority of the 2018 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

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executing our internal growth strategy and, to the extent we complete any acquisitions, our ability to integrate such acquisitions effectively.

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

## Consolidated Results of Operations

|  | Years Ended December 31,                                 |       |           |       |         |       |
|--|--|-------|-----------|-------|---------|-------|
|  | 2018   | %     | 2017      | %     | 2016    | %     |
|  | ( in millions, except percentages and per share amounts) |       |           |       |         |       |
| Sales  | \$1,216.2  | 100.0 | \$1,006.8 | 100.0 | \$962.1 | 100.0 |
| Cost of sales                                    | 884.0  | 72.7  | 735.2     | 73.0  | 697.3   | 72.5  |
| Gross profit                                     | \$332.2  | 27.3  | \$271.6   | 27.0  | \$264.8 | 27.5  |
| Selling, general & administrative expense        | 263.8  | 21.7  | 238.1     | 23.6  | 245.5   | 25.5  |
| Operating income                                 | \$68.4   | 5.6   | \$33.5    | 3.3   | \$19.3  | 2.0   |
| Other income                                     | (1.2 )   | (0.1) | (0.5 )    | —     | (5.9 )  | (0.6) |
| Interest expense                                 | 20.9   | 1.7   | 17.1      | 1.7   | 15.6    | 1.6   |
| Income before income taxes                       | \$48.7   | 4.0   | \$16.9    | 1.7   | \$9.6   | 1.0   |
| Provision for income taxes                       | 13.2   | 1.1   | 0.4       | —     | 2.5     | 0.3   |
| Net income                                       | \$35.5   | 2.9   | \$16.5    | 1.6   | \$7.1   | 0.7   |
| Net loss attributable to noncontrolling interest | (0.1 )   | —     | (0.4 )    | —     | (0.6 )  | (0.1) |
| Net income attributable to DXP Enterprises, Inc. | \$35.6   | 2.9   | \$16.9    | 1.7   | \$7.7   | 0.8   |
| Per share  |  |       |           |       |         |       |
| Basic earnings per share                         | \$2.02   |       | \$0.97    |       | \$0.51  |       |
| Diluted earnings per share                       | \$1.94   |       | \$0.93    |       | \$0.49  |       |

## Year Ended December 31, 2018 compared to Year Ended December 31, 2017

SALES. Sales for the year ended December 31, 2018 increased \$209.4 million, or 20.8%, to approximately \$1,216.2 million from \$1,006.8 million for the year ended December 31, 2017. Sales from a business acquired on January 1, 2018 accounted for \$47.5 million of the increase in sales. Excluding the 2018 sales of the business acquired, sales for the year ended December 31, 2018 increased by \$161.9 million, or 16.1% from prior year's corresponding period. This sales increase is the result of an increase in our SC, IPS and SCS segments of \$108.8 million, \$87.6 million and \$13.0 million, respectively. The fluctuations in sales is further explained in our business segment discussions below.

|                              | Years Ended December 31        |             |           |         |
|------------------------------|--------------------------------|-------------|-----------|---------|
|                              | 2018                           | 2017        | Change    | Change% |
| Sales by Business Segment    | (in thousands, except change%) |             |           |         |
| Service Centers              | \$750,044                      | \$641,275   | \$108,769 | 17.0 %  |
| Innovative Pumping Solutions | 291,697                        | 204,030     | 87,667    | 42.9 %  |
| Supply Chain Services        | 174,456                        | 161,477     | 12,979    | 8.0 %   |
| Total DXP Sales              | \$1,216,197                    | \$1,006,782 | \$209,415 | 20.8 %  |

Service Centers Segment. Sales for the Service Centers segment increased by \$108.8 million, or 17.0% for the year ended December 31, 2018, compared to the year ended December 31, 2017. Excluding \$47.5 million of Service Centers segment sales for year ended December 31, 2018 from a business acquired, Service Centers segment sales for the period increased \$61.3 million, or 9.6% from prior year's corresponding period. This sales increase is primarily the

result of increased sales of rotating equipment, bearings and metal working products to customers engaged in the late upstream, midstream or downstream oil and gas markets or manufacturing equipment for these markets in connections with increased capital spending by oil and gas producers. If crude oil and natural gas prices and the drilling rig count remain at levels experienced during the year ended December 31, 2018, this level of sales to the oil and gas industry might continue, or improve, during 2019.

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Innovative Pumping Solutions Segment. Sales for the IPS segment increased by \$87.6 million, or 42.9% for the year ended December 31, 2018, compared to the year ended December 31, 2017. This increase was primarily the result of an increase in capital spending by oil and gas producers and related businesses stemming from an increase in the drilling rig count and the price of oil during the year ended December 31, 2018. This level of IPS sales might continue, or improve, during 2019 if crude oil and natural gas prices and the drilling rig count remain at levels experienced during 2018.

Supply Chain Services Segment. Sales for the SCS segment increased by \$13.0 million, or 8.0%, for the year ended December 31, 2018, compared to the year ended December 31, 2017. The increase in sales is primarily related to increased sales to customers in the oil and gas and aerospace 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.

GROSS PROFIT. Gross profit as a percentage of sales for the year ended December 31, 2018 increased by approximately 34 basis points from the prior year's corresponding period. Excluding the impact of business acquired, gross profit as a percentage of sales increased by approximately 77 basis points. The increase in the gross profit percentage excluding the business acquired, is primarily the result of an approximate 314 basis points increase in the gross profit percentage in our IPS segment. These fluctuations are explained in the segment discussions below.

Service Centers Segment. As a percentage of sales, the gross profit percentage for the Service Centers decreased approximately 24 basis points but increased approximately 61 basis points, adjusting for the business acquired, from the prior year's corresponding period. This was primarily as a result of sales mix and price increases from vendors. Operating income for the Service Centers segment increased \$17.5 million, or 27.6%. The increase in operating income is primarily the result of the improved sales.

Innovative Pumping Solutions Segment. As a percentage of sales, 2018 gross profit percentage for the IPS segment increased approximately 314 basis points from the prior year's corresponding period primarily as a result of increased utilization and capacity within IPS' engineered-to-order business and an overall improvement in the pricing environment driven by an increase in capital spending by oil and gas producers and a corresponding tightening in market conditions for IPS related work. Additionally, gross profit margins for individual orders have continued to improve because of the increase in sales of built to order customer specific products. Operating income for the IPS segment increased \$22.5 million, or 197.1% , primarily as a result of the above mentioned increase in sales.

Supply Chain Services Segment. Gross profit as a percentage of sales decreased approximately 47 basis points for the year ended December 31, 2018, compared to the prior year's corresponding period. This was primarily as a result of sales mix and contractual lag effects of price increases from vendors. Operating income for the year ended December 31, 2018 increase \$0.8 million compared to the prior year's corresponding period mainly due to an increase in gross profit of \$2.2 million primarily offset by an increase in SG&A of \$1.5 million.

SELLING, GENERAL AND ADMINISTRATIVE ("SG&A"). Selling, general and administrative expense for year ended December 31, 2018 increased by approximately \$25.7 million, or 10.8%, to \$263.8 million from \$238.1 million for prior year's corresponding period. Selling, general and administrative expense from a business that was acquired accounted for \$3.0 million of the increase. Excluding the 2018 expenses from the business acquired, SG&A for the year ended December 31, 2018 increased by \$22.7 million, or 9.5%. The overall increase in SG&A adjusting for the business acquired is the result of increased payroll, incentive compensation and related taxes and 401(k) expenses primarily due to increased headcount. The remaining increase in SG&A expense for the year ended December 31, 2018 is primarily a result of the increase in sales. As a percentage of sales, the year ended December 31, 2018 expense

decreased 134 basis points to 22.3% from 23.6% for the prior year's corresponding period, adjusting for the business acquired, primarily as a result of the percentage increase in sales exceeding the percentage increase in SG&A.

**OPERATING INCOME.** Operating income for the year ended December 31, 2018 increased by \$35.0 million, or 104.4%, to \$68.5 million from \$33.5 million in the prior year's corresponding period. The operating income from the business acquired in 2018 increased the overall operating income for the year ended December 31, 2018 in the amount of \$5.0 million. Excluding the operating income from the business acquired, operating income increased \$30.0 million, or 89.5% from the prior year's corresponding period. This increase in operating income is primarily related to the increase in sales discussed above.

**INTEREST EXPENSE.** Interest expense for year ended December 31, 2018 increased by \$3.9 million, or 22.8%, from prior year's corresponding period primarily as a result of increased interest rates and fees associated with the repricing of our credit facilities. Under our senior secured Term Loan B, DXP borrows at a spread over LIBOR. LIBOR increased 95 basis points from January through December 31, 2018. However, DXP repriced the Term Loan B on June 25, 2018 reducing the spread on LIBOR from 5.50% to 4.75%, reducing the impact of increases in LIBOR which DXP should benefit in fiscal 2019.



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**INCOME TAXES.** Our effective tax rate from continuing operations was a tax expense of 27.1% for the year ended December 31, 2018 compared to a tax expense of 2.2% for the year ended December 31, 2017. Compared to the U.S. statutory rate for the year ended December 31, 2018, the effective tax rate was increased by state taxes, foreign taxes, and nondeductible expenses and partially offset by research and development tax credits and other tax credits. 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.

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 \$1,006.8 million 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.

|                              | Years Ended December 31        |           |          |         |
|------------------------------|--------------------------------|-----------|----------|---------|
|                              | 2017                           | 2016      | Change   | Change% |
| Sales by Business Segment    | (in thousands, except change%) |           |          |         |
| Service Centers              | \$641,275                      | \$621,007 | \$20,268 | 3.26 %  |
| Innovative Pumping Solutions | 204,030                        | 187,124   | 16,906   | 9.03 %  |
| Supply Chain Services        | 161,477                        | 153,961   | 7,516    | 4.88 %  |
| Total DXP Sales              | \$1,006,782                    | \$962,092 | \$44,690 | 4.65 %  |

**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.

**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.

**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.** 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.

**Service Centers Segment.** 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.** 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.** 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.

**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.

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.

The rate of inflation, as measured by changes in the producer price index, affects different commodities, the cost of products purchased and ultimately the pricing of our different products and product classes to our customers. Our pricing related to inflation did not have a measurable impact on our sales revenue for the year. Historically, price changes from suppliers have been consistent with inflation and have not had a material impact on the results of our operations.

#### Non-GAAP Financial Measures and Reconciliations

In an effort to provide investors with additional information regarding our results of operations as determined by GAAP, we disclose non-GAAP financial measures. The non-GAAP financial measures we provide in this report should be viewed in addition to, and not as an alternative for, results prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

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Our primary non-GAAP financial measure is organic sales ("Organic Sales") and earnings before interest, taxes, depreciation and amortization ("EBITDA"). The non-GAAP financial measures presented may differ from similarly titled non-GAAP financial measures presented by other companies, and other companies may not define these non-GAAP financial measures in the same way. These measures are not substitutes for their comparable U.S. GAAP financial measures, such as net sales, net income/(loss), diluted earnings per common share ("EPS"), or other measures prescribed by U.S. GAAP, and there are limitations to using non-GAAP financial measures.

Management uses these non-GAAP financial measures to assist in comparing our performance on a consistent basis for purposes of business decision making by removing the impact of certain items that management believes do not directly reflect our underlying operations. Management believes that presenting our non-GAAP financial measures (i.e., Organic Sales and EBITDA) is useful to investors because it (i) provides investors with meaningful supplemental information regarding financial performance by excluding certain items, (ii) permits investors to view performance using the same tools that management uses to budget, make operating and strategic decisions, and evaluate historical performance, and (iii) otherwise provides supplemental information that may be useful to investors in evaluating our results. We believe that the presentation of these non-GAAP financial measures, when considered together with the corresponding U.S. GAAP financial measures and the reconciliations to those measures, provides investors with additional understanding of the factors and trends affecting our business than could be obtained absent these disclosures.

Organic Sales is defined as net sales excluding, when they occur, the impact of acquisitions and divestitures. Organic Sales is a tool that can assist management and investors in comparing our performance on a consistent basis by removing the impact of certain items that management believes do not directly reflect our underlying operations.

EBITDA is defined as the sum of consolidated net income in such period, plus to the extent deducted from consolidated net income: (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; in addition to these adjustments, we exclude, when they occur, the impacts of impairment losses and losses/(gains) on the sale of a business. EBITDA is a tool that can assist management and investors in comparing our performance on a consistent basis by removing the impact of certain items that management believes do not directly reflect our underlying operations.

A reconciliation of the non-GAAP financial measures, to its most comparable GAAP financial measure is included below.

The following table set forth the reconciliation of net sales to organic net sales (in thousands):

## Reconciliation of Net Sales to Organic Net Sales

| Fiscal 2018                  | Net Sales    | Acquisition Sales | Divestiture Sales | Organic Sales |
|------------------------------|--------------|-------------------|-------------------|---------------|
| Service Centers              | \$ 750,044   | \$ 47,486         | \$ —              | —\$ 702,558   |
| Innovative Pumping Solutions | 291,697      | —                 | —                 | 291,697       |
| Supply Chain Services        | 174,456      | —                 | —                 | 174,456       |
| Total Sales                  | \$ 1,216,197 | \$ 47,486         | \$ —              | —\$ 1,168,711 |
| Fiscal 2017                  |              |                   |                   |               |
| Service Centers              | \$ 641,275   | \$ —              | \$ —              | —\$ 641,275   |
| Innovative Pumping Solutions | 204,030      | —                 | —                 | 204,030       |

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|                       |             |      |      |              |
|-----------------------|-------------|------|------|--------------|
| Supply Chain Services | 161,477     | —    | —    | 161,477      |
| Total Sales           | \$1,006,782 | \$ — | \$ — | —\$1,006,782 |

Year-over-year growth rates

|                              |      |     |   |      |   |
|------------------------------|------|-----|---|------|---|
| Service Centers              | 17.0 | % — | — | 9.6  | % |
| Innovative Pumping Solutions | 43.0 | % — | — | 43.0 | % |
| Supply Chain Services        | 8.0  | % — | — | 8.0  | % |
| Total Sales                  | 20.8 | % — | — | 16.1 | % |

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We use EBITDA internally to evaluate and manage the Company's operations because we believe it provides useful supplemental information regarding the Company's ongoing economic performance. We have chosen to provide this information to investors to enable them to perform more meaningful comparisons of operating results.

The following table set forth the reconciliation of EBITDA to the most comparable GAAP financial measure (in thousands):

|   | Year Ended December 31, |          |          |
|---|-------------------------|----------|----------|
|   | 2018                    | 2017     | 2016     |
| GAAP net income attributable to DXP Enterprises, Inc. | \$35,632                | \$16,888 | \$7,702  |
| Loss attributable to non-controlling interest         | (111 )                  | (359 )   | (551 )   |
| Provision for income taxes                            | 13,185                  | 363      | 2,523    |
| Depreciation and amortization                         | 26,164                  | 27,786   | 29,994   |
| Interest expense                                      | 20,937                  | 17,054   | 15,564   |
| EBITDA  | \$95,807                | \$61,732 | \$55,232 |
| EBITDA margin as % of sales                           | 7.9                     | % 6.1    | % 5.7    |

## Liquidity and Capital Resources

## General Overview

As of December 31, 2018, we had cash and cash equivalents of \$40.5 million and bank and other borrowings of \$240.4 million. We have a \$85 million Asset-Based Loan facility that is due to mature in August 2022, under which we had no borrowings outstanding as of December 31, 2018.

Our primary source of capital is cash flow from operations, supplemented as necessary by bank borrowings or other sources of debt. As a distributor of MRO products and services, we require significant amounts of working capital to fund inventories and accounts receivables. Additional cash is required for capital items for information technology, warehouse equipment, leasehold improvements, pump manufacturing equipment and safety services equipment. We also require cash to pay our lease obligations and to service our debt.

The following table summarizes our net cash flows used in and provided by operating activities, net cash used in investing activities and net cash (used in) provided by financing activities for the periods presented (in thousands):

|                                 | Years Ended December 31, |          |           |           |
|---------------------------------|--------------------------|----------|-----------|-----------|
|                                 | 2018                     | 2017     | Change    | Change(%) |
| Net cash provided by (used in): |                          |          |           |           |
| Operating activities            | \$35,840                 | \$12,544 | \$23,296  | 186 %     |
| Investing activities            | (17,576 )                | (2,811 ) | (14,765 ) | 525 %     |
| Financing activities            | (2,921 )                 | 14,188   | (17,109 ) | (121 )%   |
| Effect of foreign currency      | (403 )                   | 68       | (471 )    | (693 )%   |
| Net change in cash              | 14,940                   | 23,989   | (9,049 )  | (38 )%    |

## Operating Activities

The Company generated \$35.8 million of cash in operating activities during the year ended December 31, 2018 compared to generating of \$12.5 million cash during the prior year's corresponding period. The \$23.3 million increase in the amount of cash generated between the two periods was primarily driven by an increase in profitability that exceeded investments in working capital.

### Investing Activities

For the year ended December 31, 2018, net cash used in investing activities was \$17.6 million compared to \$2.8 million in the corresponding period in 2017. This increase was primarily driven by the cash component of the purchase of ASI for \$10.8 million and investments in capital equipment. This was partially offset by proceeds from the sale of a building. For the year ended

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December 31, 2018, purchases of property, plant and equipment was approximately \$9.3 million compared to \$2.8 million in the corresponding period in 2017.

Capital expenditures during 2018 were primarily related to building improvements, manufacturing equipment, and patterns. Capital expenditures for 2019 are expected to be within the range of capital expenditures during 2018 and 2017.

## Financing Activities

For the year ended December 31, 2018, net cash used in financing activities was \$2.9 million, compared to net cash generated by financing activities of \$14.2 million for the corresponding period in 2017. The activity in the period was primarily attributed to the Company making principal repayments on the Term Loan.

During the year ended December 31, 2018, the amount available to be borrowed under our credit facility decreased to \$79.3 million compared to \$82.0 million at December 31, 2017. This was the result of in letters of credit outstanding as of \$5.7 million at December 31, 2018.

We believe this is adequate funding to support working capital needs within the business.

At December 31, 2018, our total long-term debt, including the current portion, less principal repayments and less unamortized debt issuance fees, was \$240.4 million, or 43.8% of total capitalization (total long-term debt including current portion plus shareholders' equity) of \$548.6 million. Approximately \$246.9 million of this outstanding debt bears interest at various floating rates. See Item 7A. Quantitative and Qualitative Disclosure about Market Risk

## Free Cash Flow

We believe free cash flow is an important liquidity metric because it measures, during a given period, the amount of cash generated that is available to fund acquisitions, make investments, repay debt obligations, repurchase company shares, and for certain other activities. Our free cash flow, which is calculated as cash provided by operations less net purchase of property and equipment, was \$29.1 million, \$9.7 million and \$44.6 million for fiscals 2018, 2017 and 2016, respectively.

Free cash flow is not a measure of liquidity under generally accepted accounting principles in the United States, and may not be defined and calculated by other companies in the same manner. Free cash flow should not be considered in isolation or as an alternative to net cash provided by operating activities. Free cash flow reconciles to the most directly comparable GAAP financial measure of cash flows from operations as follows:

|  | Years Ended December |          |          |
|--|----------------------|----------|----------|
|  | 31,                  |          |          |
|  | 2018                 | 2017     | 2016     |
| Net cash provided by operating activities                    | \$35,840             | \$12,544 | \$48,244 |
| Less: Purchase of property and equipment                     | 9,323                | 2,811    | 4,868    |
| Add: Proceeds from the disposition of property and equipment | 2,558                | —        | 1,206    |
| Free cash flow   | \$29,075             | \$9,733  | \$44,582 |

## ABL Facility and Senior Secured Term Loan B

Asset-Based Loan Facility:

On August 29, 2017, DXP entered into a five year, \$85.0 million Asset Based Loan and Security Agreement (the “ABL Revolver”). The ABL Revolver provides for asset-based revolving loans in an aggregate principal amount of up to \$85.0 million, subject to increase in certain circumstances.

As of December 31, 2018, there were no amounts of ABL Loans outstanding under the ABL Revolver.

The Company's consolidated Fixed Charge Coverage Ratio was 3.53 to 1.00 as of December 31, 2018. DXP was in compliance with all such covenants that were in effect on such date under the ABL Revolver as of December 31, 2018.

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

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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 0.25% at December 31, 2018.

The interest rate for the ABL facility was 4.0% at December 31, 2018.

**Term Loan B:**

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 3.75% for the Base Rate Loans (as defined in the Term Loan B Agreement), or LIBOR plus a margin of 4.75% 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 7.3% as of December 31, 2018.

**Financial Covenants:**

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. As of December 31, 2018, the Company’s consolidated Fixed Charge Coverage Ratio was 3.53 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, 2018, is either equal to or less than as indicated in the table below:

| Fiscal Quarter     | Secured Leverage Ratio |
|--------------------|------------------------|
| 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              |

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|  |           |
|--|-----------|
| 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.

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As of December 31, 2018, the Company's consolidated Secured Leverage Ratio was 2.24 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,<br>2018 | December 31,<br>2017 | Increase<br>(Decrease) |
|--|----------------------|----------------------|------------------------|
| Current portion of long-term debt        | \$ 3,407             | \$ 3,381             | \$ 26                  |
| Long-term debt, less debt issuance costs | 236,979              | 238,643              | (1,664 )               |
| Total long-term debt                     | 240,386              | 242,024              | (1,638 )               |

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.

Borrowing Capacity (in thousands):

The following table summarizes the amount of borrowing capacity under our ABL Revolver as follows:

|                              | December 31,<br>2018 | December 31,<br>2017 | Increase<br>(Decrease) |
|------------------------------|----------------------|----------------------|------------------------|
| Total borrowing capacity     | \$ 85,000            | \$ 85,000            | \$ —                   |
| ABL                          | —                    | —                    | —                      |
| Outstanding letter of credit | (5,679 )             | (2,993 )             | (2,686 )               |
| Total amount available       | \$ 79,321            | \$ 82,007            | \$ (2,686 )            |

### Contractual Obligations

The impact that our contractual obligations as of December 31, 2018 are expected to have on our liquidity and cash flow in future periods is as follows (in thousands):

|  | Payments Due by Period |              |              |                         | Total     |
|--|------------------------|--------------|--------------|-------------------------|-----------|
|  | Less<br>than 1<br>Year | 1-3<br>Years | 3-5<br>Years | More<br>than 5<br>Years |           |
| Long-term debt, including current portion <sup>(1)</sup> | \$3,434                | \$5,000      | \$239,375    | \$—                     | \$247,809 |
| Operating lease obligations                              | 22,096                 | 33,825       | 18,379       | 11,022                  | 85,322    |
| Estimated interest payments <sup>(2)</sup>               | 17,903                 | 35,194       | 25,930       | —                       | 79,027    |
| Total  | \$43,433               | \$74,019     | \$283,684    | \$11,022                | \$412,158 |

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

<sup>(2)</sup> Assumes interest rates in effect at December 31, 2018. 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, 2018, 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.

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### Indemnification

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

### DISCUSSION OF CRITICAL ACCOUNTING POLICIES

The Consolidated Financial Statements of DXPE are prepared in accordance with United States generally accepted accounting principles (“US GAAP”), which require management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying amount of assets and liabilities that are not readily apparent from other sources. Management has discussed the development, selection and disclosure of these estimates with the Audit Committee of the Board of Directors of DXP. Management believes that the accounting estimates employed and the resulting amounts are reasonable; however, actual results may differ from these estimates. Making estimates and judgments about future events is inherently unpredictable and is subject to significant uncertainties, some of which are beyond our control. Should any of these estimates and assumptions change or prove to have been incorrect, it could have a material impact on our results of operations, financial position and cash flows.

A summary of significant accounting policies is included in Note 2 - Summary of Significant Accounting and Business Policies to the Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data, which is incorporated herein by reference. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably possible could materially impact the financial statements. Management believes the following critical accounting policies reflect the significant estimates and assumptions used in the preparation of the Consolidated Financial Statements.

#### 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, 2018, the allowance was approximately 5.0% of the gross accounts receivable remaining unchanged from 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.



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### 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.

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 quantitative test for that reporting unit. Goodwill is deemed to be impaired if the carrying amount of a reporting unit's net assets including goodwill exceeds its estimated fair value. For 2018 and 2017, the Company's annual tests of goodwill for impairment, including qualitative assessments of all of its reporting units of goodwill, determined that a quantitative analysis was not necessary.

The Company determines fair value using widely accepted valuation techniques, including discounted cash flows and market multiples analyses. 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 and 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.

### Impairment of Long-Lived Assets, Excluding Goodwill

The Company tests long-lived assets or asset groups for recoverability 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 2018, 2017 and 2016.

#### Revenue Recognition

In our Innovative Pumping Solutions segment, we make a substantial portion of our sales to customers pursuant to long-term contracts to fabricate tangible assets to customer specifications that can range from three to eighteen months or more. We account for these long-term contracts under the percentage-of-completion method of accounting, which is an input method as defined by ASC 606, Revenue Recognition. Under this method, we recognize sales and profit based upon the cost-to-cost method, in which sales and profit are recorded based upon the ratio of costs incurred to estimated total costs to complete the asset. The percentage-of-completion method of accounting involves the use of various estimating techniques to project costs at completion and, in some cases, includes estimates of recoveries asserted against the customer for changes in specifications (change orders). Due to the size,

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length of time and nature of many of our contracts, the estimation of total contract costs and revenues through completion is complicated and subject to many variables relative to the outcome of future events over a period of several months. We are required to make numerous assumptions and estimates relating to items such as expected engineering requirements, complexity of design and related development costs, product performance, availability and cost of materials, labor productivity and cost, overhead, manufacturing efficiencies and the achievement of contract milestones, including product deliveries, technical requirements, or schedule.

Management performs detailed quarterly reviews of all of our open contracts. Based upon these reviews, we record the effects of adjustments in profit estimates each period. If at any time management determines that in the case of a particular contract total costs will exceed total contract revenue, we record a provision for the entire anticipated contract loss at that time. Due to the significance of judgment in the estimation process described above, it is likely that materially different profit margins and/or cost of sales amounts could be recorded if we used different assumptions or if the underlying circumstances were to change. The percentage-of-completion method requires that we estimate future revenues and costs over the life of a contract. Revenues are estimated based upon the original contract price, with consideration being given to exercised contract options, change orders and in some cases projected customer requirements. Contract costs may be incurred over a period of several months, and the estimation of these costs requires significant judgment based upon the acquired knowledge and experience of program managers, engineers, and finance professionals. Estimated costs are based primarily on anticipated purchase contract terms, historical performance trends, business base and other economic projections. The complexity of certain designs as well as technical risks and uncertainty as to the future availability of materials and labor resources could affect the company's ability to accurately estimate future contract costs.

Our earnings could be reduced by a material amount resulting in a charge to earnings if (a) total estimated contract costs are significantly higher than expected due to changes in customer specifications prior to contract amendment, (b) total estimated contract costs are significantly higher than previously estimated due to cost overruns or inflation, (c) there is a change in engineering efforts required during the development stage of the contract or (d) we are unable to meet contract milestones or product specifications. Management continues to monitor and update program cost estimates quarterly for all open contracts. A significant change in an estimate on several of these contracts could have a material effect on our financial position and results of operations.

### 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 for the acquisition completed in fiscal 2018. However, if actual results are not consistent with our estimates or assumptions, we may be exposed to losses or gains that could be material.

Many of our acquisitions may include as additional compensation, contingent consideration. Contingent consideration is a financial liability recorded at fair value upon acquisition. The amount of contingent consideration to be paid is based on the occurrence of future events, such as the achievement of certain revenue or earnings milestones of the target after consummation. Accordingly, the estimate of fair value contains uncertainties as it involves judgment about the likelihood and timing of achieving these milestones as well as the discount rate used. Changes in fair value of the contingent consideration obligation result from changes to the assumptions used to estimate the probability of success for each milestone, the anticipated timing of achieving the milestones and the discount period and rate to be applied. A change in any of these assumptions could produce a different fair value, which could have a material impact on the results from operations. The impact of changes in key assumptions is described in Note 5 - Fair Value of Financial Assets and Liabilities.

#### 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. We are required to assess the likelihood that our deferred tax assets, which may include net operating loss carryforwards,

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tax credits or temporary differences that are expected to be deductible in future years, will be recoverable from future taxable income. In making that assessment, we consider the nature of the deferred tax assets and related statutory limits on utilization, recent operating results, future market growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies. If, based upon available evidence, recovery of the full amount of the deferred tax assets is not likely, we provide a valuation allowance on amounts not likely to be realized. Changes in valuation allowances are included in our tax provision in the period of change. Assessments are made at each balance sheet date to determine how much of each deferred tax asset is realizable. These estimates are subject to change in the future, particularly if earnings of a particular subsidiary are significantly higher or lower than expected, or if management takes operational or tax planning actions that could impact the future taxable earnings of a subsidiary.

### Accounting for Uncertainty in Income Taxes

In the normal course of business, we are audited by federal, state and foreign tax authorities, and are periodically challenged regarding the amount of taxes due. These challenges relate primarily to the timing and amount of deductions and the allocation of income among various tax jurisdictions. 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. Our effective tax rate in a given period could be impacted if, upon final resolution with taxing authorities, we prevail on positions for which unrecognized tax benefits have been accrued, or are required to pay amounts in excess of accrued unrecognized tax benefits.

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 2013. 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

**Compensation - Stock Compensation.** In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 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 adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements.

**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 adopted this ASU early on 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. Therefore the adoption of this standard did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

**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. The Company adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements. As discussed in Note 15 - Business Acquisitions, the Company acquired Application Specialties, Inc. in January 2018. Application Specialties, Inc. met the definition of a business under the new guidance and goodwill was recorded.

**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

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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. The Company adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements.

**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 adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Financial Statements.

**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, was effective for fiscal years, and interim periods within those years, beginning after December 15, 2017.

The Company elected the modified retrospective method and adopted the new revenue guidance effective January 1, 2018, with no impact to the opening retained earnings.

Our accounting for contracts with customers under the new revenue recognition standard was consistent with the Company's previous revenue recognition model, whereby revenue is recognized primarily on the date products are shipped to the customer. The ASU also requires expanded qualitative and quantitative disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, significant judgments and accounting policy.

The adoption of the new standard did not have a material impact on the Company's Consolidated Financial Statements. See Note 4 - Revenue Recognition.

### Accounting Pronouncements Not Yet Adopted

**Intangibles-Goodwill and Other.** In August 2018, the FASB issued ASU No. 2018-15, Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract based on a consensus of the FASB's Emerging Issues Task Force (EITF) that requires implementation costs incurred by customers in cloud computing arrangements (CCAs) to be deferred and recognized over the term of the arrangement, if those costs would be capitalized by the customer in a software licensing arrangement under the internal-use software guidance in ASC 350-40, "Intangibles-Goodwill and Other-Internal-Use Software". The ASU does not affect the accounting by cloud service providers, other software vendors or customers' accounting for software licensing arrangements. The ASU will require companies to recognize deferred implementation costs to expense over the 'term of the hosting arrangement'. Under the ASU, the term of the hosting arrangement comprises the noncancellable period of the CCA plus any optional renewal periods that are reasonably certain to be exercised by the customer or for which exercise of the option is controlled by the vendor. The guidance is

effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, and we will continue to assess the standard and make a determination later.

**Fair Value Measurement.** In August 2018, the FASB issued ASU 2018-13: Fair Value Measurement: Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement which eliminates, adds and modifies certain disclosure requirements for fair value measurements as part of its disclosure framework project. Entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but public companies will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. The guidance is effective for all entities for fiscal years beginning after December 15, 2019 and for interim periods within those fiscal years, but entities are permitted to early adopt either the entire standard or only the provisions that eliminate or modify the disclosure requirements. The new standard will not have an impact on our results of operations, but it will significantly modify our disclosures around fair value measurements.

**Leases - Targeted Improvements.** In July 2018, the FASB issued ASU No. 2018-11, Leases: Targeted Improvements (Topic 842). ASU 2018-11 provides additional relief in the comparative reporting requirements for initial adoption of ASC 842 as described below. Under ASU 2018-11, adopters will take a prospective approach, rather than a retrospective approach as initially prescribed,



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when transitioning to ASU 2016-02. Instead of recording the cumulative impact of all comparative reporting periods presented within retained earnings, adopters will now assess the facts and circumstances of all leasing contracts as of January 1, 2019 (for public companies with calendar year-end reporting dates) and January 1, 2020 (for non-public companies with calendar year-end reporting dates). We intend to apply this adoption approach for our transition January 1, 2019.

**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 undergoing the implementation process for the new standard. We intend to apply most of the practical expedients and we have elected to apply the current period transition approach as introduced by ASU 2018-11. We expect the new standard to have a significant effect on our consolidated balance sheet by adding \$68 million ROU assets and the corresponding lease liabilities for our inventory of operating leases. We do not expect the new standard to have a material impact on our results of operations.

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

Our market risk results primarily from volatility in interest rates and fluctuations in the Canadian dollar.

#### Interest Rate Risk

We are exposed to risk resulting from changes in interest rates as a result of our issuance of variable rate debt. To reduce our interest rate risk we may enter into financial derivative instruments, including, but not limited to, interest rate swaps and rate lock agreements to manage and mitigate our exposure. As of December 31, 2018, we had no interest rate hedges in place. Based on a sensitivity analysis as of December 31, 2018, it was estimated that if short-term interest rates average 100 basis points higher (lower) in 2019 than in 2018, interest expense, would fluctuate by \$2.5 million before tax. Comparatively, based on a sensitivity analysis as of December 31, 2017, had short-term interest rates averaged 100 basis points higher (lower) in 2017 than in 2016, it was estimated that interest expense would have fluctuated by approximately \$2.5 million. These amounts were estimated by considering the effect of the hypothetical interest rates on variable-rate debt outstanding each year.

#### Foreign Currency Risk

We are exposed to foreign currency risk from our Canadian operations. To mitigate risks associated with foreign currency fluctuations, contracts may be denominated in or indexed to the U.S. dollar and/or local inflation rates, or investments may be naturally hedged through debt and other liabilities denominated or issued in the foreign currency. To monitor our currency exchange rate risks, we use sensitivity analysis, which measures the effect of devaluation of

the Canadian dollar. An average 10% devaluation in the Canadian dollar exchange rate during 2018 would have resulted in an estimated net loss on the translation of local currency earnings of approximately \$0.1 million on our Consolidated Statement of Operations.

Also see "Risk Factors," included in Item 1A of this Report for additional risk factors associated with our business.

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ITEM 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

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

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of DXP Enterprises, Inc. and subsidiaries (the “Company”) as of December 31, 2018 and 2017, the related consolidated statements of operations and comprehensive income, equity and cash flows for the years then ended, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2018 and 2017, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 8, 2019 expressed an adverse opinion on the Company’s internal control over financial reporting due to material weaknesses.

Change in Accounting Principle

As discussed in Note 4 to the consolidated financial statements, the Company changed its method of accounting for recognizing revenue due to the adoption of Accounting Standards Codification Topic No. 606.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Moss Adams LLP

Houston, TX  
March 8, 2019

We have served as the Company’s auditor since 2017.



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Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated statements of operations and comprehensive income, equity and cash flows of DXP Enterprises, Inc. and subsidiaries (collectively, the “Company”) for the year ended December 31, 2016. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of DXP Enterprises, Inc. and subsidiaries for the year ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

/s/ Hein & Associates LLP

Houston, Texas  
March 31, 2017

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Report of Independent Registered Public Accounting Firm

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

Opinion on Internal Control over Financial Reporting

We have audited DXP Enterprises, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In our opinion, because of the effect of the material weaknesses identified below on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of DXP Enterprises, Inc. and subsidiaries as of December 31, 2018 and 2017, the related consolidated statements of operations and comprehensive income, equity and cash flows for the years then ended, and the related notes (collectively referred to as the "consolidated financial statements") and our report dated March 8, 2019 expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph relating to the adoption of Accounting Standards Codification Topic No. 606.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting included in Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management's assessment in Item 9A:

Ineffective control environment and monitoring to support the financial reporting process.

The Company's control environment did not sufficiently promote effective internal control over financial reporting; specifically, the following factors relating to the control environment:

The Company did not maintain effective management review controls over the monitoring and review of certain accounts, thus we were not able properly conclude these account reconciliations and analyses were performed at an appropriate level of detail.

The Company did not effectively design, document nor monitor (review, evaluate and assess) the risks associated with the key internal control activities that provide the accounting information contained in the Company's financial statements.

We considered the material weaknesses in determining the nature, timing, and extent of audit tests applied in our audits of the Company's consolidated financial statements as of and for the year ended December 31, 2018, and our opinion on such consolidated financial statements was not affected.



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Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

/s/ Moss Adams LLP

Houston, TX  
March 8, 2019

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DXP ENTERPRISES, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)  
 (in thousands, except per share amounts)

|  | Years Ended December 31, |             |           |
|--|--------------------------|-------------|-----------|
|  | 2018                     | 2017        | 2016      |
| Sales  | \$1,216,197              | \$1,006,782 | \$962,092 |
| Cost of sales  | 883,989                  | 735,201     | 697,290   |
| Gross profit   | \$332,208                | \$271,581   | \$264,802 |
| Selling, general and administrative expense            | 263,757                  | 238,091     | 245,470   |
| Income from operating                                  | \$68,451                 | \$33,490    | \$19,332  |
| Other income, net                                      | (1,192)                  | (456)       | (5,906)   |
| Interest expense                                       | 20,937                   | 17,054      | 15,564    |
| Income before income taxes                             | \$48,706                 | \$16,892    | \$9,674   |
| Provision for income taxes                             | 13,185                   | 363         | 2,523     |
| Net income   | \$35,521                 | \$16,529    | \$7,151   |
| Net loss attributable to noncontrolling interest       | (111)                    | (359)       | (551)     |
| Net income attributable to DXP Enterprises, Inc.       | \$35,632                 | \$16,888    | \$7,702   |
| Preferred stock dividend                               | 90                       | 90          | 90        |
| Net income attributable to common shareholders         | \$35,542                 | \$16,798    | \$7,612   |
| Net income   | \$35,521                 | \$16,529    | \$7,151   |
| Cumulative translation adjustment, net of income taxes | 224                      | (1,217)     | (7,658)   |
| Comprehensive income (loss)                            | \$35,745                 | \$15,312    | \$(507)   |
| Earnings per share:                                    |                          |             |           |
| Basic  | \$2.02                   | \$0.97      | \$0.51    |
| Diluted  | \$1.94                   | \$0.93      | \$0.49    |
| Weighted average common shares outstanding:            |                          |             |           |
| Basic  | 17,553                   | 17,400      | 15,042    |
| Diluted  | 18,393                   | 18,240      | 15,882    |

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

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DXP ENTERPRISES, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except share and per share amounts)

|  | December 31,<br>2018 | December 31,<br>2017 |
|--|----------------------|----------------------|
| <b>ASSETS</b>  |                      |                      |
| Current assets:  |                      |                      |
| Cash   | \$ 40,304            | \$ 22,047            |
| Restricted cash  | 215                  | 3,532                |
| Accounts receivable, net of allowances for doubtful accounts of \$10,126 and \$9,015                 | 191,829              | 167,272              |
| Inventories  | 114,830              | 91,413               |
| Costs and estimated profits in excess of billings  | 32,514               | 26,915               |
| Prepaid expenses and other current assets  | 4,938                | 5,296                |
| Federal income taxes receivable  | 960                  | 1,440                |
| Total current assets   | \$ 385,590           | \$ 317,915           |
| Property and equipment, net  | 51,330               | 53,337               |
| Goodwill   | 194,052              | 187,591              |
| Other intangible assets, net   | 67,207               | 78,525               |
| Other long-term assets   | 1,783                | 1,715                |
| Total assets   | \$ 699,962           | \$ 639,083           |
| <b>LIABILITIES AND EQUITY</b>  |                      |                      |
| Current liabilities:   |                      |                      |
| Current maturities of long-term debt   | \$ 3,407             | \$ 3,381             |
| Trade accounts payable   | 87,407               | 80,303               |
| Accrued wages and benefits   | 21,275               | 18,483               |
| Customer advances  | 3,223                | 2,189                |
| Billings in excess of costs and estimated profits  | 10,696               | 4,249                |
| Other current liabilities  | 17,269               | 16,220               |
| Total current liabilities  | \$ 143,277           | \$ 124,825           |
| Long-term debt, net of current maturities and unamortized debt issuance costs                        | 236,979              | 238,643              |
| Other long-term liabilities  | 2,819                | —                    |
| Deferred income taxes  | 8,633                | 7,069                |
| Total long-term liabilities  | \$ 248,431           | \$ 245,712           |
| Total liabilities  | \$ 391,708           | \$ 370,537           |
| Commitments and Contingencies (Note 16)  |                      |                      |
| Shareholders' Equity:  |                      |                      |
| Series A preferred stock, \$1.00 par value; 1,000,000 shares authorized                              | 1                    | 1                    |
| Series B convertible preferred stock, \$1.00 par value; 1,000,000 shares authorized                  | 15                   | 15                   |
| Common stock, \$0.01 par value, 100,000,000 shares authorized; 17,401,297 and 17,315,573 outstanding | 174                  | 174                  |
| Additional paid-in capital   | 156,190              | 153,087              |
| Retained earnings  | 169,735              | 134,193              |
| Accumulated other comprehensive loss   | (19,267)             | (19,491)             |
| Total DXP Enterprises, Inc. equity   | \$ 306,848           | \$ 267,979           |
| Noncontrolling interest  | 1,406                | 567                  |
| Total equity   | \$ 308,254           | \$ 268,546           |
| Total liabilities and equity   | \$ 699,962           | \$ 639,083           |

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

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DXP ENTERPRISES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)

|  | Years Ended December 31, |           |            |
|--|--------------------------|-----------|------------|
|  | 2018                     | 2017      | 2016       |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                       |                          |           |            |
| Net income attributable to DXP Enterprises, Inc.                                   | \$35,632                 | \$16,888  | \$7,702    |
| Less: net loss attributable to non-controlling interest                            | (111 )                   | (359 )    | (551 )     |
| Net income   | \$35,521                 | \$16,529  | \$7,151    |
| Reconciliation of net income to net cash provided by operating activities:         |                          |           |            |
| Depreciation   | 9,578                    | 10,520    | 11,933     |
| Amortization of intangible assets  | 16,586                   | 17,266    | 18,061     |
| Bad debt expense   | 2,368                    | 3,416     | 180        |
| Amortization of debt issuance costs  | 1,743                    | 1,548     | 1,856      |
| Fair value adjustment on contingent consideration                                  | 313                      | —         | —          |
| Write off of debt issuance costs   | 60                       | 578       | —          |
| Gain on sale of property and equipment   | (1,330 )                 | —         | —          |
| Gain on sale of subsidiary   | —                        | —         | (5,635 )   |
| Stock compensation expense   | 2,549                    | 1,708     | 3,580      |
| Tax loss related to vesting of restricted stock                                    | —                        | —         | 619        |
| Deferred income taxes  | 1,004                    | (3,827 )  | 2,687      |
| Other long-term liabilities  | 2,610                    | —         | —          |
| Changes in operating assets and liabilities  |                          |           |            |
| Trade accounts receivable  | (22,487 )                | (20,539 ) | 12,080     |
| Costs and estimated profits in excess of billings                                  | (5,640 )                 | (8,419 )  | 3,457      |
| Inventories  | (20,838 )                | (7,544 )  | 5,453      |
| Prepaid expenses and other assets  | 188                      | (3,287 )  | 620        |
| Accounts payable and accrued expenses  | 7,093                    | 3,189     | (8,595 )   |
| Billings in excess of costs & estimated profits                                    | 6,522                    | 1,406     | (5,203 )   |
| Net cash provided by operating activities  | \$35,840                 | \$12,544  | \$48,244   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                       |                          |           |            |
| Purchase of property and equipment   | (9,323 )                 | (2,811 )  | (4,868 )   |
| Proceeds from the sale of property and equipment                                   | 2,558                    | —         | 1,206      |
| Proceeds from sale of subsidiary   | —                        | —         | 31,476     |
| Acquisition of business  | (10,811 )                | —         | —          |
| Net cash provided by (used in) investing activities                                | \$(17,576)               | \$(2,811) | \$27,814   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                       |                          |           |            |
| Proceeds from debt   | —                        | 728,822   | 517,689    |
| Principal debt payments  | (3,381 )                 | (702,402) | (643,568 ) |
| Debt issuance costs  | (60 )                    | (11,208 ) | (801 )     |
| Non-controlling interest holder contributions (distributions), net of tax benefits | 950                      | —         | (335 )     |
| Preferred dividends paid   | (90 )                    | (90 )     | (90 )      |
| Proceeds from issuance of common shares, net                                       | —                        | —         | 51,889     |
| Payment for employee taxes withheld from stock awards                              | (340 )                   | (934 )    | (238 )     |
| Tax (loss) related to vesting of restricted stock                                  | —                        | —         | (619 )     |
| Net cash provided by (used in) financing activities                                | \$(2,921 )               | \$14,188  | \$(76,073) |
| Effect of foreign currency on cash   | (403 )                   | 68        | (88 )      |

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|                                     |          |          |          |
|-------------------------------------|----------|----------|----------|
| Net Change In Cash                  | \$14,940 | \$23,989 | \$(103 ) |
| Cash at Beginning of Year           | 25,579   | 1,590    | 1,693    |
| Cash at End of Year                 | \$40,519 | \$25,579 | \$1,590  |
| SUPPLEMENTAL CASH FLOW INFORMATION: |          |          |          |
| Cash paid for interest              | \$19,134 | \$15,205 | \$13,708 |
| Cash paid for income taxes          | \$8,301  | \$714    | \$4,780  |

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

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CONSOLIDATED STATEMENTS OF EQUITY

(in thousands, except share amounts)

|  | Series<br>A<br>preferred<br>Stock | Series<br>B<br>preferred<br>Stock | Common<br>Stock | Paid-in<br>Capital | Retained<br>earnings | Treasury<br>stock | Non<br>controlling<br>interest | Accum<br>Other<br>Comp<br>(Loss) | Total<br>equity |
|--|-----------------------------------|-----------------------------------|-----------------|--------------------|----------------------|-------------------|--------------------------------|----------------------------------|-----------------|
| Balances at January 1,<br>2016   | \$ 1                              | \$ 15                             | \$ 146          | \$ 110,306         | \$ 109,783           | \$(12,577)        | \$ 1,812                       | \$(10,616)                       | \$ 198,870      |
| Dividends paid   | —                                 | —                                 | —               | —                  | (90 )                | —                 | —                              | —                                | (90 )           |
| Compensation expense for<br>restricted stock                             | —                                 | —                                 | —               | 3,580              | —                    | —                 | —                              | —                                | 3,580           |
| Tax related items for share<br>based awards                              | —                                 | —                                 | —               | (857 )             | —                    | —                 | —                              | —                                | (857 )          |
| Issuance of 2,722,858<br>shares of common stock                          | —                                 | —                                 | 27              | 51,861             | —                    | —                 | —                              | —                                | 51,888          |
| Issuance of 264,297 shares<br>of treasury stock                          | —                                 | —                                 | —               | (12,577 )          | —                    | 12,577            | —                              | —                                | —               |
| Non-controlling interest<br>holder contributions, net<br>of tax benefits | —                                 | —                                 | —               | —                  | —                    | —                 | (335 )                         | —                                | (335 )          |
| Cumulative translation<br>adjustment                                     | —                                 | —                                 | —               | —                  | —                    | —                 | —                              | (7,658 )                         | (7,658 )        |
| Net income   | —                                 | —                                 | —               | —                  | 7,702                | —                 | (551 )                         | —                                | 7,151           |
| Balances at December 31,<br>2016   | \$ 1                              | \$ 15                             | \$ 173          | \$ 152,313         | \$ 117,395           | \$—               | \$ 926                         | \$(18,274)                       | \$ 252,549      |
| Dividends paid   | —                                 | —                                 | —               | —                  | (90 )                | —                 | —                              | —                                | (90 )           |
| Compensation expense for<br>restricted stock                             | —                                 | —                                 | —               | 1,708              | —                    | —                 | —                              | —                                | 1,708           |
| Tax related items for share<br>based awards                              | —                                 | —                                 | —               | (934 )             | —                    | —                 | —                              | —                                | (934 )          |
| Issuance of shares of<br>common stock                                    | —                                 | —                                 | 1               | —                  | —                    | —                 | —                              | —                                | 1               |
| Cumulative translation<br>adjustment                                     | —                                 | —                                 | —               | —                  | —                    | —                 | —                              | (1,217 )                         | (1,217 )        |
| Net income   | —                                 | —                                 | —               | —                  | 16,888               | —                 | (359 )                         | —                                | 16,529          |
| Balances at December 31,<br>2017   | \$ 1                              | \$ 15                             | \$ 174          | \$ 153,087         | \$ 134,193           | \$—               | \$ 567                         | \$(19,491)                       | \$ 268,546      |
| Dividends paid   | —                                 | —                                 | —               | —                  | (90 )                | —                 | —                              | —                                | (90 )           |
| Compensation expense for<br>restricted stock                             | —                                 | —                                 | —               | 2,549              | —                    | —                 | —                              | —                                | 2,549           |
| Tax related items for share<br>based awards                              | —                                 | —                                 | —               | (340 )             | —                    | —                 | —                              | —                                | (340 )          |
| Non-controlling interest<br>holder contributions, net<br>of tax benefits | —                                 | —                                 | —               | —                  | —                    | —                 | 950                            | —                                | 950             |

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|                                    |      |       |        |            |            |     |          |            |            |
|------------------------------------|------|-------|--------|------------|------------|-----|----------|------------|------------|
| Issuance of shares of common stock | —    | —     | —      | 894        | —          | —   | —        | —          | 894        |
| Cumulative translation adjustment  | —    | —     | —      | —          | —          | —   | —        | 224        | 224        |
| Net income                         | —    | —     | —      | —          | 35,632     | —   | (111 )   | —          | 35,521     |
| Balances at December 31, 2018      | \$ 1 | \$ 15 | \$ 174 | \$ 156,190 | \$ 169,735 | \$— | \$ 1,406 | \$(19,267) | \$ 308,254 |

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



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DXP ENTERPRISES INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - THE COMPANY

DXP Enterprises, Inc. together with its subsidiaries (collectively “DXP,” “Company,” “us,” “we,” or “our”) was incorporated in Texas on July 26, 1996. DXP Enterprises, Inc. and its subsidiaries are engaged in the business of distributing maintenance, repair and operating (MRO) products, and service to energy and industrial customers. Additionally, DXP provides integrated, custom pump skid packages, pump remanufacturing and manufactures branded private label pumps to energy and industrial customers. The Company is organized into three business segments: Service Centers (“SC”), Supply Chain Services (“SCS”) and Innovative Pumping Solutions (“IPS”). See Note 19 - Segment and Geographical Reporting for discussion of the business segments.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING AND BUSINESS POLICIES

Basis of Presentation

The Company’s financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The accompanying consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and its 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, 2018, the total assets of the VIE were approximately \$5.4 million including approximately \$4.5 million of fixed assets. DXP is the primary customer of the VIE. Consolidation of the VIE decreased cost of sales by approximately \$0.7 million for the year ended December 31, 2018 and increased cost of sales by approximately \$0.6 million for the year ended December 31, 2017, respectively. The Company recognized a related income tax benefit of \$46 thousand and \$0.2 million related to the VIE for the years ended December 31, 2018 and December 31, 2017, respectively. As of December 31, 2018, the owners of the 52.5% of the equity not owned by DXP included employees of DXP.

All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the current year presentation; none affected net income.

Foreign Currency

The financial statements of the Company’s Canadian subsidiaries are measured using local currencies as their functional currencies. Assets and liabilities are translated into U.S. dollars at current exchange rates, while income and expenses are translated at average exchange rates. Translation gains and losses are reported in other comprehensive income (loss). Gains and losses on transactions denominated in foreign currency are reported in the consolidated statements of operations and comprehensive income (loss).

Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management 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. In the opinion of management, all adjustments necessary in order to make the financial statements

not misleading have been included. Actual results could differ from those estimates.

#### Cash and Cash Equivalents

The Company's presentation of cash includes cash equivalents. Cash equivalents are defined as short-term investments with maturity dates of 90 days or less at time of purchase. The Company places its cash and cash equivalents with institutions with high credit quality. However, at certain times, such cash and cash equivalents may be in excess of Federal Deposit Insurance Corporation ("FDIC") insurance limits. The Company has not historically experienced any losses when in excess of these limits.

#### 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.

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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. 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.

Changes in this allowance for 2018, 2017 and 2016 were as follows (in thousands):

|                               | Years Ended December 31, |                         |                         |
|-------------------------------|--------------------------|-------------------------|-------------------------|
|                               | 2018                     | 2017                    | 2016                    |
| Balance at beginning of year  | 9,015                    | 8,160                   | 9,364                   |
| Charged to costs and expenses | 2,368                    | 3,367                   | 180                     |
| Charged to other accounts     | (86 ) <sup>(2)</sup>     | 22 <sup>(3)</sup>       | (17 ) <sup>(2)</sup>    |
| Deductions                    | (1,171 ) <sup>(1)</sup>  | (2,534 ) <sup>(1)</sup> | (1,367 ) <sup>(1)</sup> |
| Balance at end of year        | \$10,126                 | \$9,015                 | \$8,160                 |

<sup>(1)</sup> Uncollectible accounts written off, net of recoveries

<sup>(2)</sup> Includes allowance for doubtful accounts from acquisitions and divestiture

<sup>(3)</sup> Primarily due to translation adjustments

### Inventories

Inventories consist principally of finished goods and are priced at net realizable value, cost being determined using the first-in, first-out ("FIFO") method. Provisions are provided against inventories for estimated obsolescence based upon the aging of the inventories and market trends and are applied as a reduction in cost of associated inventory.

### Property and Equipment

Property and equipment are carried on the basis of cost. Depreciation of property and equipment is computed using the straight-line method over their estimated useful lives. Maintenance and repairs of depreciable assets are charged against earnings as incurred. When properties are retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and gains or losses are credited or charged to earnings.

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

|                                   |  |
|-----------------------------------|--|
| Buildings                         | 20-39 years  |
| Building improvements             | 10-20 years  |
| Furniture, fixtures and equipment | 3-20 years   |
| Leasehold improvements            | Shorter of estimated useful life or related lease term |

### Impairment of Goodwill and Other 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.

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 quantitative test for that reporting unit. Should the reporting unit's carrying amount exceed the fair value, then an impairment charge for the excess would be recognized. The impairment charge is limited to the amount of goodwill allocated to the reporting unit, and goodwill will not be reduced below zero.

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### Impairment of Long-Lived Assets, Excluding Goodwill

The Company tests long-lived assets or asset groups for recoverability 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 of long-lived assets excluding goodwill, was required in 2018, 2017 and 2016.

### Revenue Recognition

The Company fabricates and assembles custom-made pump packages, remanufactures pumps and manufactures branded private label pumps within our Innovative Pumping Solutions segment. For binding agreements to fabricate tangible assets to customer specifications, the Company recognizes revenues over time when the customer is able to direct the use of and obtain substantially all of the benefits of the work performed. This typically occurs when the products have no alternative use for us and we have a right to payment for the work completed to date plus a reasonable profit margin. Contracts generally include cancellation provisions that require the customer to reimburse us for costs incurred through the date of cancellation. We recognize revenue for these contracts using the percentage of completion method, an "input method" as defined by the new standard. Under this method, revenues are recognized as costs are incurred and include estimated profits calculated on the basis of the relationship between costs incurred and total estimated costs at completion. If at any time expected costs exceed the value of the contract, the loss is recognized immediately. The typical time span of these contracts is approximately one to two years.

The Service Centers segment provides a wide range of maintenance, repair and operating (MRO) products, equipment and integrated services, including logistics capabilities, to industrial customers. The Supply Chain Services segment provides a wide range of MRO products and manages all or part of a customer's supply chain, including warehouse and inventory management services. Revenue is recognized upon the completion of our performance obligation(s) under the sales agreement. The majority of the Service Centers and Supply Chain Services segment revenues originate from the satisfaction of a single performance obligation, the delivery of products. Revenues are recognized when an agreement is in place, the performance obligations under the contract have been identified, and the price or consideration to be received is fixed and allocated to the performance obligation(s) in the contract. We believe our performance obligation has been satisfied when title passes to the customer or services have been rendered under the contract. Revenues are recorded net of sales taxes.

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

See further discussion of Note 4 - Revenue Recognition below.

### Shipping and Handling Costs

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

#### 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, 2018 and 2017 was approximately \$2.3 million and \$2.7 million, respectively.

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

Cost of sales includes product and product related costs, inbound freight charges, internal transfer costs and depreciation. Selling, general and administrative expense includes purchasing and receiving costs, inspection costs, warehousing costs, depreciation and amortization.

### 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.

### Comprehensive Income (Loss)

Comprehensive income (loss) includes net income and foreign currency translation adjustments. The Company's other comprehensive (loss) income is comprised of changes in the market value of an investment with quoted market prices in an active market for identical instruments and translation adjustments from translating foreign subsidiaries to the reporting currency. Comprehensive income for the year ended December 31, 2016 was reduced by an \$8.6 million charge recorded during the fourth quarter of 2016 to correct errors which accumulated during 2013, 2014 and 2015 due to the Company improperly recognizing an \$8.6 million deferred tax asset on unrealized foreign currency losses not expected to be realized within one year. We assessed the materiality of this misstatement and concluded the misstatement was not material to the results of operations or financial condition for the year ended December 31, 2016.

### Out-of-Period Items

Deferred tax liabilities related to intangibles for customer relationships acquired in Canada during 2012 and 2013 were reduced by \$2.2 million during the fourth quarter of 2017 to correct the tax rate used to establish the deferred tax liabilities at the dates of acquisition. The Company evaluated the misstatement of each period since these acquisitions were completed and concluded the effects were immaterial.

### NOTE 3 - RECENT ACCOUNTING PRONOUNCEMENTS

### Recently Adopted Accounting Pronouncements

Compensation - Stock Compensation. In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 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 adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements.



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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 adopted this ASU early on 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. Therefore the adoption of this standard did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

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. The Company adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements. As discussed in Note 15 - Business Acquisitions, the Company acquired Application Specialties, Inc. in January 2018. Application Specialties, Inc. met the definition of a business under the new guidance and goodwill was recorded.

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. The Company adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Consolidated Financial Statements.

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 adopted this ASU as of January 1, 2018, and it did not have a material impact on the Company's Financial Statements.

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, was effective for fiscal years, and interim periods within those years, beginning after December 15, 2017.

The Company elected the modified retrospective method and adopted the new revenue guidance effective January 1, 2018, with no impact to the opening retained earnings.

Our accounting for contracts with customers under the new revenue recognition standard was consistent with the Company's previous revenue recognition model, whereby revenue is recognized primarily on the date products are shipped to the customer. The ASU also requires expanded qualitative and quantitative disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, significant judgments and accounting policy.

The adoption of the new standard did not have a material impact on the Company's Consolidated Financial Statements. See Note 4 - Revenue Recognition.

#### Accounting Pronouncements Not Yet Adopted

**Intangibles-Goodwill and Other.** In August 2018, the FASB issued ASU No. 2018-15, Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract based on a consensus of the FASB's Emerging Issues Task Force (EITF) that requires implementation costs incurred by customers in cloud computing arrangements (CCAs) to be deferred and recognized over the term of the arrangement, if those costs would be capitalized by the customer in a software licensing arrangement under the internal-use software guidance in ASC 350-40, "Intangibles-Goodwill and Other-Internal-Use Software". The ASU does not affect the accounting by cloud service providers, other software vendors or customers' accounting for software licensing arrangements. The ASU will require companies to recognize

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deferred implementation costs to expense over the 'term of the hosting arrangement'. Under the ASU, the term of the hosting arrangement comprises the noncancellable period of the CCA plus any optional renewal periods that are reasonably certain to be exercised by the customer or for which exercise of the option is controlled by the vendor. The guidance is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, and we will continue to assess the standard and make a determination later.

**Fair Value Measurement.** In August 2018, the FASB issued ASU 2018-13: Fair Value Measurement: Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement which eliminates, adds and modifies certain disclosure requirements for fair value measurements as part of its disclosure framework project. Entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but public companies will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. The guidance is effective for all entities for fiscal years beginning after December 15, 2019 and for interim periods within those fiscal years, but entities are permitted to early adopt either the entire standard or only the provisions that eliminate or modify the disclosure requirements. The new standard will not have an impact on our results of operations, but it will significantly modify our disclosures around fair value measurements.

**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) as modified by subsequently issued ASUs 2018-01, 2018-10, 2018-11 and 2018-20. 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 was permitted.

In July 2018, the FASB issued ASU No. 2018-11, Leases: Targeted Improvements (Topic 842). ASU 2018-11 provides additional relief in the comparative reporting requirements for initial adoption of ASC 842. Prior to ASU 2018-11, a modified retrospective transition was required for financing or operating leases existing at or entered into after the beginning of the earliest comparative period presented in the financial statements. ASU 2018-11 provides an additional transition method to the existing transition method by allowing entities to initially apply the new leases standard at the adoption date (such as January 1, 2019, for calendar year-end public business entities) and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption without adjustment to the financial statements for periods prior to adoption.

The Company will adopt the standard effective January 1, 2019. We have elected to apply the current period transition approach as introduced by ASU 2018-11 for our transition at January 1, 2019 and we have elected to apply the following practical expedients and accounting policy elections.

We have elected a package of transition expedients that allows us to forgo reassessing certain conclusions reached under ASC 840 which must be elected together. All expedients in this package are applied together for all leases that commenced before the effective date, January 1, 2019, of ASC 842. As a result, in transitioning to ASC 842, for existing leases, we will continue to use judgments made under ASC 840 related to embedded leases, lease classification and accounting for initial direct costs.

In addition, we have chosen, as an accounting policy election by class of underlying asset, not to separate nonlease components from the associated lease component for three of our leased asset classes: Vehicles, Office Equipment and Manufacturing Equipment. As a result, for classes of Vehicles, Office Equipment and Manufacturing Equipment, we will account for each separate lease component and the nonlease components associated with that lease component as a single lease component.

For short-term leases as defined under ASC 842, we have elected short-term lease exception pursuant to ASC 842 to two classes of our assets to which the right of use relates: Buildings and Office Equipment. We will not recognize a lease liability or right of use asset on our consolidated balance sheets for Buildings and Office Equipment with an original lease term of twelve months or less. Instead, we will recognize the lease payments in profit or loss on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred and will disclose in the notes to the consolidated financial statements its short-term lease expense.

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The new standard did have a material impact on our consolidated balance sheets related to recording right-of-use assets and the corresponding lease liabilities for our inventory of operating leases. In January 2019, we recorded a ROU Asset and total lease obligations liability of approximately \$68 million, each, with an offset to Retained Earnings as a Cumulative Effect Adjustment. We do not expect the new standard to have a material impact on our consolidated statements of operations and cash flows.

### NOTE 4 - REVENUE RECOGNITION

In May 2014, the FASB issued ASU 2014-9, Revenue from Contracts with Customers, and issued subsequent amendments to the initial guidance in August 2015, March 2016, April 2016, May 2016, and December 2016 within ASU 2015-14, ASU 2016-8, ASU 2016-10, ASU 2016-12 and ASU 2016-20, respectively. The core principle of this new revenue recognition guidance is that a company will recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The new guidance defines a five-step process to achieve this core principle. The new guidance also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance provided for two transition methods, a full retrospective approach and a modified retrospective approach.

On January 1, 2018, the Company adopted ASC Topic 606 using the modified retrospective method with no impact to opening retained earnings and determined there were no changes required to its reported revenue amounts for prior periods as a result of the adoption. Results for reporting periods beginning after January 1, 2018 are presented under ASC Topic 606, while comparative prior period amounts were not adjusted and continue to be reported under the accounting standards in effect for those periods. The Company has enhanced its disclosures of revenue to comply with the new guidance.

#### Overview

The Company's primary source of revenue is the sale of products, and service to energy and industrial customers. The Company is organized into three business segments: Service Centers, Supply Chain Services and Innovative Pumping Solutions.

Revenues are recognized when a contract is in place, the performance obligations under the contract have been identified, and the price or consideration to be received is fixed and allocated to the performance obligation(s) in the contract. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASC 606. The Company recognizes revenue upon the satisfaction of our performance obligation(s) under its contracts. The timing of revenue recognition varies for the revenue streams described in more detail below. In general, the timing of revenue recognition includes recognition of revenue over time as services are being performed as well as recognition of revenue at a point in time, for delivery of products. Revenues are recorded net of sales taxes. The revenue streams described below cross reporting segments in some instances, but the categories presented have similar products, customer class and timing of cash flows and revenue recognition.

#### Inventory management services

The Supply Chain Services segment is engaged in providing a wide variety of inventory management services including Service Teams, Sales Engineers, Customer Service Support, Service Center Support and performance Reporting and Communication. These services represent a series of distinct services that are substantially the same and that have the same pattern of transfer to the customer over the contract period, and therefore qualify as a single

(combined) performance obligation that is satisfied over time. The customer simultaneously receives and consumes the benefits of our services as they are provided by us. Revenue associated with Inventory Management Services is recognized over the service period.

The transaction price for the inventory management services do not include any consideration that is variable in nature. Accordingly, the transaction price is based on the amount the Company has a right to invoice the customer under the terms of the contract and on the company's estimate of the standalone sales price for these services at the initiation of the contract. The standalone sales price is established based on the anticipated cost of performing these services, plus the Company's anticipated profit margin for inventory management services.

#### Product Sales

The majority of the Service Centers segment and the Supply Chain Services segment revenue originates from the satisfaction of a single performance obligation, the delivery of products. The IPS segment also sells its customers certain products and supplies, however, most of its revenue is generated through pump manufacturing and fabrication described below. We often establish product and service agreements with clients. However, these product and service agreements do not specify the individual goods or services that will ultimately be purchased by the customer. Rather, the product and service agreement establishes an agreement to stand-

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ready to provide future products and services when they are ordered and therefore is not a contract for revenue recognition purposes under ASC 606. The memorandum of understanding, purchase order or invoice, which lists the goods or services to be provided and the corresponding payment amounts, is the contract under which revenue is recognized.

The Company accounts for all shipping and handling services as fulfillment services in accordance with ASC 606; accordingly, shipping and handling activities is combined with the product deliverable rather than being accounted for as a distinct performance obligation within the terms of the agreement.

The product sales are generally offered to our customers on a cost plus a fixed mark-up percentage basis which varies based on the category of the item being sold. The transaction price for product sales does not include any consideration that is variable in nature. Accordingly, the transaction price is based on the amount the Company has a right to invoice the customer under the terms of the contract. The Company recognizes revenues associated with product sales upon satisfaction of a single performance obligation, delivery, in accordance with the shipping terms, at the contract price, net of sales taxes.

Customized pump production

The Company fabricates and assembles custom-made pump packages, remanufactures pumps and manufactures branded private label pumps within our Innovative Pumping Solutions (IPS) segment. For binding agreements to fabricate tangible assets to customer specifications, the Company recognizes revenues over time when the customer is able to direct the use of and obtain substantially all of the benefits of the work performed. This typically occurs when the products have no alternative use for us and we have an enforceable right to payment for the work completed to date plus a reasonable profit margin. Contracts generally include cancellation provisions that require the customer to reimburse us for costs incurred through the date of cancellation. We recognize revenue over time for these contracts using costs incurred to date relative to total estimated costs at completion to measure progress toward satisfying our performance obligations, an "input method" as defined by the new standard. 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. Incurred cost represents work performed, which corresponds with, and thereby best depicts, the transfer of control of goods and services to customers. If at any time expected costs exceed the value of the contract, the loss is recognized immediately in the period it is identified. The typical time span of these contracts is approximately three to eighteen months.

Staffing services

Within the Service Centers segment, the Company also provides certain customers with safety personnel who are deployed to customer locations to provide emergency response services. The staffing services is a single performance obligation from which clients are able to benefit independently and is billed to the client on a day-rate basis. As our customer simultaneously receives and consumes the benefit as the service is provided, revenue from staffing services is recognized over time as the service is performed based on the day-rate specified in the contract. The transaction price for staffing does not include any variable consideration.

The following table presents our revenue disaggregated by major category and segment for the years ended December 31, 2018, 2017 and 2016, respectively:

| Years Ended December 31, | Service<br>Centers | Innovative<br>Pumping<br>Solutions | Supply<br>Chain<br>Services | Total |
|--------------------------|--------------------|------------------------------------|-----------------------------|-------|
|--------------------------|--------------------|------------------------------------|-----------------------------|-------|

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2018

|   |           |           |           |             |
|---|-----------|-----------|-----------|-------------|
| Product sales (recognized at a point in time)                 | 685,309   | —         | 160,770   | \$846,079   |
| Inventory management services (recognized over contract life) | —         | —         | 13,686    | 13,686      |
| Staffing services (day-rate basis)                            | 64,735    | —         | —         | 64,735      |
| Customized pump production (recognized over time)             | —         | 291,697   | —         | 291,697     |
| Total revenue   | \$750,044 | \$291,697 | \$174,456 | \$1,216,197 |

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|   |           |           |           |             |
|---|-----------|-----------|-----------|-------------|
| 2017  |           |           |           |             |
| Product sales (recognized at a point in time)                 | 575,328   | —         | 147,927   | \$723,255   |
| Inventory management services (recognized over contract life) | 0         | —         | 13,550    | 13,550      |
| Staffing services (day-rate basis)                            | 65,947    | —         | —         | 65,947      |
| Customized pump production (recognized over time)             | —         | 204,030   | —         | 204,030     |
| Total revenue   | \$641,275 | \$204,030 | \$161,477 | \$1,006,782 |

|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| 2016  |           |           |           |           |
| Product sales (recognized at a point in time)                 | 565,157   | —         | 140,019   | \$705,176 |
| Inventory management services (recognized over contract life) | —         | —         | 13,942    | 13,942    |
| Staffing services (day-rate basis)                            | 55,850    | —         | —         | 55,850    |
| Customized pump production (recognized over time)             | —         | 187,124   | —         | 187,124   |
| Total revenue   | \$621,007 | \$187,124 | \$153,961 | \$962,092 |

## Contract Assets and Liabilities

Under our customized pump production contracts in our IPS segment, amounts are billed as work progresses in accordance with agreed-upon contractual terms, upon various measures of performance, including achievement of certain milestones, completion of specified units, or completion of a contract. Generally, billing occurs subsequent to revenue recognition, resulting in contract assets. Our contract assets are presented as “cost and estimated profits in excess of billings” on our Consolidated Balance Sheets. However, we sometimes receive advances or deposits from our customers before revenue is recognized, resulting in contract liabilities that are presented as “Billings in excess of costs and estimated profits” on our Consolidated Balance Sheets. See Note 7 - Costs and Estimated Profits on Uncompleted Contracts.

During the twelve months ended December 31, 2018, \$21.3 million of the balances that were previously classified as contract liabilities at the beginning of the period shipped. Contract assets and liability changes were primarily due to normal activity and timing differences between our performance and customer payments.

## Practical expedients and elections

We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within selling, general and administrative expense.

We do not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less and contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed. We do not assess whether a contract has a significant financing component if at contract inception, the period between when we transfer a promised good to a customer and when the customer pays is expected to be one year or less.

See Note 19 - Segment and Geographical Reporting for disaggregation of revenue by reporting segments. The Company believes this disaggregation best depicts how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

## NOTE 5 - FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Authoritative guidance for financial assets and liabilities measured on a recurring basis applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. Fair value, as defined in the authoritative guidance, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance affects the fair value measurement of an investment with quoted market prices in an active market for identical instruments, which must be classified in one of the following categories:

Level 1 Inputs

Level 1 inputs come from quoted prices (unadjusted) in active markets for identical assets or liabilities.

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## Level 2 Inputs

Level 2 inputs are other than quoted prices that are observable for an asset or liability. These inputs include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from, or corroborated by, observable market data by correlation or other means.

## Level 3 Inputs

Level 3 inputs are unobservable inputs for the asset or liability which require the Company's own assumptions.

Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

Our acquisitions may include contingent consideration as part of the purchase price. The fair value of the contingent consideration is estimated as of the acquisition date based on the present value of the contingent payments to be made using a weighted probability of possible payments. The unobservable inputs used in the determination of the fair value of the contingent consideration include managements assumptions about the likelihood of payment based on the established benchmarks and discount rates based on an internal rate of return analysis. The fair value measurement includes inputs that are Level 3 measurement as discussed above, as they are not observable in the market. Should actual results increase or decrease as compared to the assumption used in our analysis, the fair value of the contingent consideration obligations will increase or decrease, up to the contracted limit, as applicable. Changes in the fair value of the contingent earn-out consideration are measured each reporting period and reflected in our results of operations.

As of December 31, 2018, we recorded a \$4.3 million liability for contingent consideration associated with the acquisition of ASI in other current and long-term liabilities. See further discussion at [Note 15 - Business Acquisitions](#).

For the Company's assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3), the following table provides a reconciliation of the beginning and ending balances for each category therein, and gains or losses recognized during the twelve months ended December 31, 2018:

## Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

|   | Contingent<br>Liability for<br>Accrued<br>Consideration<br>(in thousands) |
|---|---|
| Beginning balance at January 1, 2018              | —   |
| Acquisitions and settlements                      |   |
| Acquisition of ASI (Note 15)                      | 4,006   |
| Settlements                                       | —   |
| Total remeasurement adjustments:                  |   |
| Changes in fair value recorded in profit and loss | 313   |
| Ending balance at December 31, 2018               | \$ 4,319  |
|   | 313   |

The amount of total (gains) or losses for the year included in earnings or changes to net assets, attributable to changes in unrealized (gains) or losses relating to assets or liabilities still held at year-end.

\* Included in other current and long-term liabilities

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## Quantitative Information about Level 3 Fair Value Measurements

The significant unobservable inputs used in the fair value measurement of the Company's contingent consideration liabilities designated as Level 3 are as follows:

| (in thousands, unaudited)                   | Fair Value at     |                   | Valuation Technique  | Significant Unobservable Inputs                  |
|---|-------------------|-------------------|----------------------|--|
|   | December 31, 2018 | December 31, 2017 |                      |  |
| Contingent consideration: (ASI acquisition) | \$ 4,319          |                   | Discounted cash flow | Annualized EBITDA and probability of achievement |

## Sensitivity to Changes in Significant Unobservable Inputs

As presented in the table above, the significant unobservable inputs used in the fair value measurement of contingent consideration related to the acquisition of ASI are annualized EBITDA forecasts developed by the Company's management and the probability of achievement of those EBITDA results. The discount rate used in the calculation was 7.3%. Significant increases (decreases) in these unobservable inputs in isolation would result in a significantly (lower) higher fair value measurement.

Other financial instruments not measured at fair value on the Company's consolidated balance sheets at December 31, 2018 but which require disclosure of their fair values include: cash and cash equivalents, trade accounts receivable, trade accounts payable and accrued expenses, accrued payroll and related benefits, and the revolving line of credit and term loan debt under our syndicated credit agreement facility. The Company believes that the estimated fair value of such instruments at December 31, 2018 and December 31, 2017 approximates their carrying value as reported on the consolidated balance sheets.

## NOTE 6 - INVENTORIES

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

|                      | December 31, 2018 | December 31, 2017 |
|----------------------|-------------------|-------------------|
| Finished goods       | \$ 110,182        | \$ 92,694         |
| Work in process      | 17,344            | 11,593            |
| Obsolescence reserve | (12,696)          | (12,874)          |
| Inventories          | \$ 114,830        | \$ 91,413         |

## NOTE 7 – COSTS AND ESTIMATED PROFITS ON UNCOMPLETED CONTRACTS

Costs and estimated profits in excess of billings arise in the consolidated balance sheets when revenues have been recognized but the amounts cannot be billed under the terms of the contracts. Such amounts are recoverable from customers upon various measures of performance, including achievement of certain milestones, completion of specified units, or completion of a contract.

Costs and estimated profits on uncompleted contracts and related amounts billed for 2018 and 2017 were as follows (in thousands):

|   | December 31, |          |
|---|--------------|----------|
|   | 2018         | 2017     |
| Costs incurred on uncompleted contracts | \$53,595     | \$37,899 |

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|                             |          |          |
|-----------------------------|----------|----------|
| Estimated earnings, thereon | 6,847    | 2,665    |
| Total                       | \$60,442 | \$40,564 |
| Less: billings to date      | 38,662   | 17,881   |
| Net                         | \$21,780 | \$22,683 |

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Such amounts were included in the accompanying consolidated balance sheets for 2018 and 2017 under the following captions (in thousands):

|   | December 31, |          |
|---|--------------|----------|
|   | 2018         | 2017     |
| Costs and estimated profits in excess of billings | \$32,514     | \$26,915 |
| Billings in excess of costs and estimated profits | (10,696 )    | (4,249 ) |
| Translation Adjustment                            | (38 )        | 17       |
| Net   | \$21,780     | \$22,683 |

## NOTE 8 - PROPERTY AND EQUIPMENT

The carrying values of property and equipment were as follows (in thousands):

|                                      | December 31, December 31, |           |
|--------------------------------------|---------------------------|-----------|
|                                      | 2018                      | 2017      |
| Land                                 | \$ 1,960                  | \$ 2,346  |
| Buildings and leasehold improvements | 15,051                    | 16,724    |
| Furniture, fixtures and equipment    | 100,449                   | 94,475    |
| Less – Accumulated depreciation      | (66,130 )                 | (60,208 ) |
| Total Property and Equipment         | \$ 51,330                 | \$ 53,337 |

Depreciation expense was \$9.6 million, \$10.5 million, and \$11.9 million for the years ended December 31, 2018, 2017, and 2016, respectively. Capital expenditures by segment are included in Note 19 - Segment and Geographical Reporting.

## NOTE 9 - GOODWILL AND OTHER INTANGIBLE ASSETS

The following table presents the changes in the carrying amount of goodwill and other intangible assets during the year ended December 31, 2018 (in thousands):

|                                  | Goodwill  | Other Intangible Assets | Total     |
|----------------------------------|-----------|-------------------------|-----------|
| Balances as of December 31, 2017 | \$187,591 | \$78,525                | \$266,116 |
| Translation adjustment           | —         | (917 )                  | (917 )    |
| Acquisition of ASI               | 6,461     | 6,185                   | 12,646    |
| Amortization                     | —         | (16,586 )               | (16,586 ) |
| Balances as of December 31, 2018 | \$194,052 | \$67,207                | \$261,259 |

The following table presents the changes in the carrying amount of goodwill and other intangible assets during the year ended December 31, 2017 (in thousands):

|                                  | Goodwill  | Other Intangible Assets | Total     |
|----------------------------------|-----------|-------------------------|-----------|
| Balances as of December 31, 2016 | \$187,591 | \$94,831                | \$282,422 |
| Translation adjustment           | —         | 960                     | 960       |
| Amortization                     | —         | (17,266 )               | (17,266 ) |
| Balances as of December 31, 2017 | \$187,591 | \$78,525                | \$266,116 |





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The following table presents the goodwill balance by reportable segment as of December 31, 2018 and 2017 (in thousands):

|                              | As of December 31, |           |
|------------------------------|--------------------|-----------|
|                              | 2018               | 2017      |
| Service Centers              | \$160,934          | \$154,473 |
| Innovative Pumping Solutions | 15,980             | 15,980    |
| Supply Chain Services        | 17,138             | 17,138    |
| Total                        | \$194,052          | \$187,591 |

The following table presents a summary of amortization of other intangible assets ( in thousands):

|                        | As of December 31, 2018 |                          |                      | As of December 31, 2017 |                          |                      |
|------------------------|-------------------------|--------------------------|----------------------|-------------------------|--------------------------|----------------------|
|                        | Gross Carrying Amount   | Accumulated Amortization | Carrying Amount, net | Gross Carrying Amount   | Accumulated Amortization | Carrying Amount, net |
| Customer relationships | \$168,255               | \$(101,200)              | \$67,055             | \$162,200               | \$(83,806)               | \$78,394             |
| Non-compete agreements | 784                     | (632)                    | 152                  | 949                     | (818)                    | 131                  |
| Total                  | \$169,039               | \$(101,832)              | \$67,207             | \$163,149               | \$(84,624)               | \$78,525             |

Gross carrying amounts as well as accumulated amortization are partially affected by the fluctuation of foreign currency rates. Other intangible assets are amortized according to estimated economic benefits over their estimated useful lives.

Customer relationships are amortized over their estimated useful lives. Amortization expense is recognized according to estimated economic benefits and was \$16.6 million, \$17.3 million, and \$18.1 million for the years ended December 31, 2018, 2017, and 2016, respectively. The estimated future annual amortization of intangible assets for each of the next five years and thereafter are as follows (in thousands):

|            |          |
|------------|----------|
| 2019       | \$15,479 |
| 2020       | 12,674   |
| 2021       | 10,792   |
| 2022       | 10,091   |
| 2023       | 8,665    |
| Thereafter | 9,506    |
| Total      | \$67,207 |

The weighted average remaining estimated life for customer relationships and non-compete agreements are 5.5 years and 3.2 years, respectively.

## NOTE 10 – LONG-TERM DEBT

Long-term debt consisted of the following (in thousands):

|  | December 31, 2018             |            | December 31, 2017             |            |
|--|-------------------------------|------------|-------------------------------|------------|
|  | Carrying Value <sup>(1)</sup> | Fair Value | Carrying Value <sup>(1)</sup> | Fair Value |
| ABL Revolver                           | \$—                           | —          | \$—                           | —          |
| Term Loan B                            | 246,875                       | 245,949    | 249,375                       | 251,869    |
| Promissory note payable <sup>(2)</sup> | 1,841                         | 1,841      | 2,722                         | 2,722      |
| Total Debt                             | 248,716                       | 247,790    | 252,097                       | 254,591    |

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|                          |           |           |           |           |
|--------------------------|-----------|-----------|-----------|-----------|
| Less: Current maturities | (3,407 )  | (3,398 )  | (3,381 )  | (3,406 )  |
| Total Long-term Debt     | \$245,309 | \$244,392 | \$248,716 | \$251,185 |

(1) Carrying value amount do not include unamortized debt issuance costs of \$8.3 million and \$10.1 million for year ended December 31, 2018 and December 31, 2017.

(2) Note payable in monthly installments at 2.9% through January 2021, collateralized by equipment.

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August 2017 Credit Agreements

On August 29, 2017, the Company entered into two credit agreements (the "August 2017 Credit Agreements") that provided for an \$85.0 million asset-backed revolving line of credit (the "ABL Revolver") and a \$250.0 million senior secured term loan B (the "Term Loan B"). Under the ABL Revolver, the Company may request \$10.0 million incremental revolving loan commitments in an additional aggregate amount not to exceed \$50.0 million, subject to pro forma compliance with certain net secured leverage ratio tests.

The applicable rate for the ABL Revolver is LIBOR plus a margin ranging from 1.25% to 1.75% per annum. The applicable rate for the Term Loan B was LIBOR plus 5.50% subject to a LIBOR floor of 1.00%. The maturity date of the ABL Revolver is August 29, 2022 and the maturity date of the Term Loan B is August 29, 2023.

On June 25, 2018, the Company entered into Amendment No. 1 (the "Repricing Amendment") to the Senior Secured Term Loan B Agreement. The Repricing Amendment, among other things, reduced the applicable rate for the term loans to LIBOR plus 4.75% (subject to a LIBOR floor of 1.00%) from LIBOR plus 5.50% for the Eurodollar Rate Loans and reduced the base rate plus a margin of 3.75% for the Base Rate Loans from 4.50%. The Repricing Amendment also includes a "soft call" prepayment penalty of 1.0% for a period of six months commencing with the date of the Repricing Amendment for certain prepayments, refinancing, and amendments.

The Company accounted for the Repricing Amendment as a modification of debt. Approximately, \$60,000 of prior deferred debt issuance costs were accelerated and recorded as additional interest expense in the consolidated statements of operations and comprehensive income, attributable to prior syndicate lenders who reduced or eliminated their positions during the amendment process. The Company also incurred \$0.9 million of third party fees in connection with the Repricing Amendment, which was also recorded as additional interest expense in the consolidated statements of operations and comprehensive income.

As of December 31, 2018, the Company had no amount outstanding under the ABL Revolver and had \$79.3 million of borrowing capacity, including the impact of letters of credit.

Debt Issuance Cost Amortization

Fees paid to DXP's lenders to secure a firm commitment on a term loan and revolving line of credit are presented as a direct deduction from the carrying amount of the debt liability. For the term loan, fees paid by DXP are amortized over the life of the loan as additional interest. Fees paid to secure a firm commitment from our lender on a revolving line of credit are amortized on a straight-line basis over the entire term of the arrangement. The total unamortized debt issuance costs reported on the consolidated balance sheets as of December 31, 2018 and 2017 was \$8.3 million and \$10.1 million, respectively. In connection with the repricing amendment of the Term Loan B and extinguishment of the previously existing credit facility we recorded a \$0.1 million and \$0.6 million write-off of debt issuance costs, which was included in interest expense during 2018 and 2017.

Interest on Borrowings

The interest rates on our borrowings outstanding at December 31, 2018 and 2017, including the amortization of debt issuance costs, were as follows:

December  
31,

|                                | 2018 | 2017 |
|--------------------------------|------|------|
| ABL Revolver                   | 4.0% | 2.9% |
| Term Loan B                    | 7.3% | 7.1% |
| Promissory Note                | 2.9% | 2.9% |
| Weighted average interest rate | 7.2% | 7.0% |

The Company was in compliance with all financial covenants under the August 2017 Credit Agreements as of December 31, 2018.

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## NOTE 11 - INCOME TAXES

The components of income before income taxes were as follows (in thousands):

|                           | Years Ended December 31, |          |          |
|---------------------------|--------------------------|----------|----------|
|                           | 2018                     | 2017     | 2016     |
| Domestic                  | \$46,270                 | \$13,183 | \$11,079 |
| Foreign                   | 2,436                    | 3,709    | (1,405 ) |
| Total income before taxes | \$48,706                 | \$16,892 | \$9,674  |

The provision for income taxes consisted of the following (in thousands):

|            | Years Ended December 31, |          |          |
|------------|--------------------------|----------|----------|
|            | 2018                     | 2017     | 2016     |
| Current -  |                          |          |          |
| Federal    | \$7,295                  | \$1,400  | \$(902 ) |
| State      | 2,257                    | 698      | 136      |
| Foreign    | 2,629                    | 2,092    | 602      |
|            | 12,181                   | 4,190    | (164 )   |
| Deferred - |                          |          |          |
| Federal    | 2,389                    | 686      | 4,174    |
| State      | 123                      | (464 )   | 120      |
| Foreign    | (1,508 )                 | (4,049 ) | (1,607 ) |
|            | 1,004                    | (3,827 ) | 2,687    |
|            | \$13,185                 | \$363    | \$2,523  |

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

|   | Years Ended December 31, |          |          |
|---|--------------------------|----------|----------|
|   | 2018                     | 2017     | 2016     |
| Income taxes computed at federal statutory rate     | \$10,228                 | \$5,912  | \$3,386  |
| State income taxes, net of federal benefit          | 1,880                    | 152      | 166      |
| Foreign imputed interest                            | 160                      | 255      | 140      |
| Meals and entertainment                             | 346                      | 422      | 361      |
| Gain on sale of Vertex                              | —                        | —        | (1,971 ) |
| Domestic production activity deduction              | —                        | (98 )    | —        |
| Research and development tax credit                 | (480 )                   | (641 )   | (886 )   |
| Foreign tax credit                                  | (346 )                   | —        | (383 )   |
| Valuation allowance                                 | —                        | (791 )   | —        |
| Tax reform deferred tax remeasurement               | 81                       | (1,294 ) | —        |
| Canadian acquisition deferred tax liability true up | —                        | (2,180 ) | —        |
| Foreign rate difference                             | 150                      | (297 )   | 112      |
| Other   | 1,166                    | (1,077 ) | 1,598    |
|   | \$13,185                 | \$363    | \$2,523  |

On December 22, 2017, the Tax Cuts and Jobs Act ("The Act") was enacted into law. The majority of the provisions signed into law in 2017 did not take effect until January 1, 2018. The Act is a comprehensive tax reform legislation that contains significant changes to corporate taxation, of which the reduction in the corporate tax rate from 35% to 21% and the imposition of Global Intangible Low - Taxable Income ("GILTI") had the most impact to the Company.

The Company analyzed other provisions of The Act such as limitation on business interest expense, limitation on net operating losses to 80% of taxable income each year, limitation on officer compensation, mandatory repatriation and transition tax, Base Erosion & Anti-Abuse Tax ("BEAT"), and Foreign-Derived Intangible Income Deduction ("FDII") and determined these provisions to have minimal to no impact on the Company.

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In accordance with SAB 118 issued by the Securities and Exchange Commission on December 22, 2017, companies are allowed a one year measurement period to complete the accounting related to The Act. Specifically, SAB 118 permits companies to record a provisional amount which can be remeasured during the measurement period due to obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the enacted date. As a result, we remeasured our net deferred income tax liabilities by a provisional \$1.3 million benefit and a corresponding provisional decrease in the net deferred tax liability as of December 31, 2017. The net deferred tax liability remeasurement analysis was completed as of December 31, 2018, impacting the Company's provision for income taxes less than \$0.1 million.

As of December 31, 2018, the Company has completed its accounting for the income tax effects of The Act. The Act subjects a U.S. shareholder to current tax on GILTI earned by certain foreign subsidiaries. Pursuant to FASB Staff Q&A, Topic 740, No. 5 Accounting for Global Intangible Low-Taxed Income, the Company has adopted an accounting policy to recognize the tax effects of GILTI in the year tax is incurred. The Company recorded a GILTI inclusion of \$2.3 million, which is partially offset with GILTI foreign tax credits, resulting in a net liability of \$0.1 million as of December 31, 2018.

Deferred tax liabilities and assets were comprised of the following (in thousands):

|   | December 31, |           |
|---|--------------|-----------|
|   | 2018         | 2017      |
| Deferred tax assets:  |              |           |
| Goodwill  | \$—          | \$2,668   |
| Allowance for doubtful accounts                                       | 1,948        | 1,707     |
| Inventories   | 2,944        | 2,365     |
| Accruals  | 576          | —         |
| Research and development credit carryforward                          | 775          | 1,115     |
| Foreign tax credit carryforward                                       | 64           | 64        |
| Charitable contribution carryforward                                  | —            | 559       |
| Net operating loss carryforward                                       | 610          | 136       |
| Capital loss carryforward   | 12,564       | 12,225    |
| Deferred compensation   | 538          | 475       |
| Other accruals  | —            | 266       |
| Other   | 137          | 65        |
| Total deferred tax assets   | 20,156       | 21,645    |
| Less valuation allowance  | (12,564)     | (12,220)  |
| Total deferred tax asset, net of valuation deferred tax liabilities : | 7,592        | 9,425     |
| Goodwill  | (1,053 )     | —         |
| Intangibles   | (7,820 )     | (8,695 )  |
| Accruals  | —            | (61 )     |
| Property and equipment  | (6,807 )     | (6,860 )  |
| Unremitted foreign earnings   | (421 )       | (354 )    |
| Cumulative translation adjustment                                     | —            | (67 )     |
| Other   | (124 )       | (457 )    |
| Net deferred tax liability  | \$(8,633)    | \$(7,069) |

The Company records a valuation allowance when it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets depends on the ability to generate sufficient taxable income of the appropriate character in the future and in the appropriate taxing jurisdictions. If the

Company was to determine that it would be able to realize the deferred tax assets in the future in excess of their net recorded amount, the Company would make an adjustment to the valuation allowance, which would reduce the provision for income taxes. At December 31, 2018, the Company had \$51.3 million of capital loss carryforward, which will expire in 2021. The Company has recorded a valuation allowance for all of this carryforward amount. The valuation allowance represents a provision for uncertainty as to the realization of the tax benefits of these carryforwards.



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Total deferred tax assets at December 31, 2016 were reduced by an \$8.6 million charge recorded during the fourth quarter of 2016 to correct errors of \$1.3 million, \$2.7 million and \$4.6 million which were recorded during 2013, 2014 and 2015, respectively, due to the Company improperly recognizing a deferred tax asset related to cumulative translation adjustment losses. The Company evaluated the misstatement of each period and concluded the effects were immaterial. Therefore, the Company decided to correct the accumulated \$8.6 million error in the fourth quarter of 2016. We assessed the materiality of this misstatement and concluded the misstatement was not material to the results of operations or financial condition for the year ended December 31, 2016.

To the extent penalties and interest would be assessed on any underpayment of income tax, such accrued amounts are classified as a component of income tax provision (benefit) in the consolidated financial statements consistent with the Company's policy. For the year ended December 31, 2018, the Company recorded \$0.2 million tax expense for interest and penalties related to uncertain tax positions.

The Company is subject to taxation in the United States, various states, and foreign jurisdictions. The Company has significant operations in the United States and Canada and to a lesser extent in various other international jurisdictions. Tax years that remain subject to examination vary by legal entity but are generally open in the United States for the tax years ending after 2012 and outside the United States for the tax years ending after 2010.

## NOTE 12 - SHARE-BASED COMPENSATION

## Restricted Stock

We issued equity-based awards from the 2016 Omnibus Plan.

## 2016 Omnibus Incentive Plan

On June 20, 2016, our shareholders approved the 2016 Omnibus Incentive Plan ("2016 Omnibus Plan"), which authorized grants of restricted stock awards, restricted stock units ("RSUs"), performance awards, options, investment rights, and cash-based awards. This plan authorizes the issuance of up to 500,000 shares of our common stock.

Under the 2016 Omnibus Plan approved by our shareholders, directors, consultants and employees may be awarded shares of DXP's common stock. The shares of restricted stock awards granted to employees that are outstanding as of December 31, 2018 vest in accordance with one of the following vesting schedules: 100% one year after the grant date; 50% each year for two years after the grant; 33.3% each year for three years after the grant date; 20% each year for five years after the grant date; or 10% each year for ten years after the date of grant. The shares of restricted stock awards 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. Once restricted stock vests, new shares of the Company's stock are issued. At December 31, 2018, 272,210 shares were available for future grant.

Changes in restricted stock awards for the twelve months ended December 31, 2018 were as follows:

|                                 | Number<br>of<br>Shares | Weighted<br>Average<br>Grant<br>Price |
|---------------------------------|------------------------|---------------------------------------|
| Non-vested at December 31, 2017 | 77,901                 | \$ 30.36                              |
| Granted                         | 131,413                | \$ 31.92                              |

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|                                 |           |          |
|---------------------------------|-----------|----------|
| Forfeited                       | (2,400 )  | \$ 46.68 |
| Vested                          | (37,621 ) | \$ 31.68 |
| Non-vested at December 31, 2018 | 169,293   | \$ 31.05 |

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Changes in restricted stock awards for the twelve months ended December 31, 2017 were as follows:

|                                 | Number<br>of<br>Shares | Weighted<br>Average<br>Grant<br>Price |
|---------------------------------|------------------------|---------------------------------------|
| Non-vested at December 31, 2016 | 143,380                | \$ 26.76                              |
| Granted                         | 18,672                 | \$ 34.07                              |
| Forfeited                       | (298 )                 | \$ 59.60                              |
| Vested                          | (83,853 )              | \$ 24.92                              |
| Non-vested at December 31, 2017 | 77,901                 | \$ 30.36                              |

Changes in restricted stock awards for the twelve months ended December 31, 2016 were as follows:

|                                 | Number<br>of<br>Shares | Weighted<br>Average<br>Grant<br>Price |
|---------------------------------|------------------------|---------------------------------------|
| Non-vested at December 31, 2015 | 137,507                | \$ 54.58                              |
| Granted                         | 108,553                | \$ 17.07                              |
| Forfeited                       | (39,000 )              | \$ 65.41                              |
| Vested                          | (63,680 )              | \$ 46.65                              |
| Non-vested at December 31, 2016 | 143,380                | \$ 26.76                              |

Compensation expense, associated with restricted stock awards, recognized in the years ended December 31, 2018, December 31, 2017 and December 31, 2016 was \$2.1 million, \$1.7 million, and \$2.0 million, respectively. Related income tax benefits recognized in earnings in the years ended December 31, 2018, December 31, 2017 and December 31, 2016 were approximately \$0.5 million, \$0.7 million and \$0.8 million, respectively. Unrecognized compensation expense under the DXP Enterprises, Inc. 2016 Omnibus Plan at December 31, 2018, December 31, 2017 and December 31, 2016 was \$3.6 million, \$1.6 million and \$2.7 million, respectively. As of December 31, 2018, the weighted average period over which the unrecognized compensation expense is expected to be recognized is 20.6 months.



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## NOTE 13 - EARNINGS PER SHARE DATA

Basic earnings per share is computed based on weighted average shares outstanding and excludes dilutive securities. Diluted earnings per share is computed including the impacts of all potentially dilutive securities.

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated (in thousands, except per share data):

|   | December 31, |          |         |
|---|--------------|----------|---------|
|   | 2018         | 2017     | 2016    |
| Basic:  |              |          |         |
| Weighted average shares outstanding               | 17,553       | 17,400   | 15,042  |
| Net income attributable to DXP Enterprises, Inc.  | \$35,632     | \$16,888 | \$7,702 |
| Convertible preferred stock dividend              | (90 )        | (90 )    | (90 )   |
| Net income attributable to common shareholders    | \$35,542     | \$16,798 | \$7,612 |
| Per share amount                                  | \$2.02       | \$0.97   | \$0.51  |
| Diluted:  |              |          |         |
| Weighted average shares outstanding               | 17,553       | 17,400   | 15,042  |
| Assumed conversion of convertible preferred stock | 840          | 840      | 840     |
| Total dilutive shares                             | 18,393       | 18,240   | 15,882  |
| Net income attributable to common shareholders    | \$35,542     | \$16,798 | \$7,612 |
| Convertible preferred stock dividend              | 90           | 90       | 90      |
| Net income attributable to DXP Enterprises, Inc.  | \$35,632     | \$16,888 | \$7,702 |
| Per share amount                                  | \$1.94       | \$0.93   | \$0.49  |

Basic earnings per share have been computed by dividing net earnings by the weighted average number of common shares outstanding during the period and excludes dilutive securities. Diluted earnings per share reflects the potential dilution that could occur if the preferred stock was converted into common stock. Restricted stock is considered a participating security and is included in the computation of basic earnings per share as if vested. The Preferred Stock is convertible into 840,000 shares of common stock.

## NOTE 14 – CAPITAL STOCK

The Company has Series A and Series B preferred stock of 1,122 shares and 15,000 shares outstanding as of December 31, 2018, 2017 and 2016, respectively. The preferred stock did not have any activity during 2018, 2017 and 2016.

## Series A Preferred Stock

The holders of Series A preferred stock are entitled to one-tenth of a vote per share on all matters presented to a vote of shareholders generally, voting as a class with the holders of common stock, and are not entitled to any dividends or distributions other than in the event of a liquidation of the Company, in which case the holders of the Series A preferred stock are entitled to \$100 liquidation preference per share.

## Series B Preferred Stock

Each share of the Series B convertible preferred stock is convertible into 56 shares of common stock and a monthly dividend per share of \$.50. The holders of the Series B convertible stock are entitled to a \$100 liquidation preference per share after payment of the distributions to the holders of the Series A preferred stock and to one-tenth of a vote per share on all matters presented to a vote of shareholders generally, voting as a class with the holders of the common stock.

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The activity related to outstanding common stock and common stock held in treasury was as follows:

|  | December 31,            |        |        |
|--|-------------------------|--------|--------|
|  | 2018                    | 2017   | 2016   |
| Common Stock:  | Quantity (in thousands) |        |        |
| Balance, beginning of period                                       | 17,316                  | 17,197 | 14,390 |
| Issuance of shares for compensation net of withholding             | 85                      | 119    | 84     |
| Issuance of common stock related to equity distribution agreements | —                       | —      | 2,723  |
| Balance, end of period   | 17,401                  | 17,316 | 17,197 |

There were not any treasury shares outstanding for the years ended 2018, 2017 and 2016.

## NOTE 15 - BUSINESS ACQUISITIONS

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. The Company paid approximately \$11.7 million in cash and stock. The purchase price also includes approximately \$4.6 million in contingent consideration. The purchase was financed with \$10.8 million of cash on hand as well as issuing \$0.9 million of the Company's common stock. ASI provides the Company's metal working division with new geographic territory and enhances DXP's end market mix. For the twelve months December 31, 2018, ASI contributed sales of \$47.5 million and earnings before taxes of approximately \$5.0 million.

As part of our purchase agreement, we may pay up to an additional \$4.6 million of contingent consideration over three years based on the achievement of certain earnings benchmarks established for calendar years 2018, 2019 and 2020. The purchase price includes the estimated fair value of the contingent consideration recorded at the present value of approximately \$4.3 million. The estimated fair value of the contingent consideration was determined using a probability-weighted discounted cash flow model. We determined the fair value of the contingent consideration obligations by calculating the probability-weighted payments based on our assessment of the likelihood that the benchmarks will be achieved. The probability-weighted payments were then discounted using a discount rate based on an internal rate of return analysis using the probability-weighted cash flows. The fair value measurement includes earnings forecasts which are a Level 3 measurement as discussed in Note 5 - Fair Value of Financial Assets and Liabilities. The fair value of the contingent consideration is reviewed quarterly over the earn-out period to compare actual earnings before interest, taxes, depreciation and amortization ("EBITDA") achieved to the estimated EBITDA used in our forecasts.

As of December 31, 2018, approximately \$1.5 million of the actual cash due toward the contingent consideration earned is recorded in current liabilities. We may pay up to an additional \$2.8 million over the remaining earn-out period based on the achievement of certain EBITDA benchmarks. The estimated fair value of the contingent consideration is recorded at the present value of \$4.3 million at December 31, 2018. Changes in the estimated fair value of the contingent earn-out consideration, up to the total contractual amount, are reflected in our results of operations in the periods in which they are identified. Changes in the fair value of the contingent consideration may materially impact and cause volatility in our future operating results. Changes in our estimates for the contingent consideration are discussed in Note 5 - Fair Value of Financial Assets and Liabilities to our consolidated financial statements.





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The total acquisition consideration is equal to the sum of all cash payments, the fair value of stock issued, and the present value of any contingent consideration. The following table summarizes the total acquisition consideration for the ASI Purchase at closing (in thousands):

|  | Total<br>Consideration |
|--|------------------------|
| Purchase Price Consideration   |                        |
| Cash payments  | \$ 10,811              |
| Fair value of stock issued   | 894                    |
| Present value of estimated fair value of contingent earn-out consideration | 4,006                  |
| Total purchase price consideration   | \$ 15,711              |

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed during 2018 in connection with the ASI acquisition described above (in thousands):

|                                       | Total      |
|---------------------------------------|------------|
| Cash                                  | \$—        |
| Accounts Receivable, net              | 6,142      |
| Inventory                             | 2,729      |
| Other Current Assets                  | 18         |
| Property and equipment                | 216        |
| Goodwill and intangibles              | \$11,856   |
| Assets acquired                       | \$20,961   |
| Current liabilities assumed           | \$(5,175 ) |
| Non-current liabilities assumed (75 ) | (75 )      |
| Net assets acquired                   | \$15,711   |

## NOTE 16 - COMMITMENTS AND CONTINGENCIES

The Company leases equipment, automobiles and office facilities under various operating leases. The future minimum rental commitments as of December, 2018, for non-cancelable leases are as follows (in thousands):

|            |          |
|------------|----------|
| 2019       | \$22,096 |
| 2020       | 18,555   |
| 2021       | 15,270   |
| 2022       | 11,452   |
| 2023       | 6,927    |
| Thereafter | 11,022   |
| Total      | \$85,322 |

Rental expense for operating leases was \$18.5 million, \$27.7 million and \$27.6 million for the years ended December, 2018, 2017 and 2016, respectively.

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

NOTE 17 - EMPLOYEE BENEFIT PLANS

The Company offers a 401(k) plan which is eligible to substantially all employees in the United States. For the year ended December 31, 2018, the Company elected to match employee contributions at a rate of 50 percent of up to 4 percent of salary deferral. The Company contributed \$1.8 million, \$0.2 million, and \$0.4 million to the 401(k) plan in the years ended December 31, 2018, 2017, and 2016, respectively. In 2016 the Company suspended indefinitely the employee match program. The Company

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contributed \$0.4 million in the first quarter of 2016 to the 401(k) plan. No other contributions were made during the remainder of 2016. The Company reinstated the employee match program in October 2017 contributing \$0.2 million to the 401(k) plan for 2017.

**NOTE 18 - OTHER COMPREHENSIVE INCOME**

Other comprehensive income generally represents all changes in shareholders' equity during the period, except those resulting from investments by, or distributions to, shareholders.

During 2012 and 2013, the Company acquired four entities that operate in Canada. These Canadian entities maintain financial data in Canadian dollars. Upon consolidation, the Company translates the financial data from these foreign subsidiaries into U.S. dollars and records cumulative translation adjustments in other comprehensive income. The Company recorded \$0.2 million, \$(1.2) million, and \$(7.7) million in translation adjustments, net of tax, in other comprehensive income during the years ended December 31, 2018, 2017 and 2016, respectively. Comprehensive income for the year ended December 31, 2016 was reduced by an \$8.6 million charge recorded during the fourth quarter of 2016 to correct errors which accumulated during 2013, 2014 and 2015 due to the Company improperly recognizing an \$8.6 million deferred tax asset on unrealized foreign currency losses not expected to be realized within one year. We assessed the materiality of this misstatement and concluded the misstatement was not material to the results of operations or financial condition for the year ended December 31, 2016.

**NOTE 19 – SEGMENT AND GEOGRAPHICAL REPORTING**

The Company's reportable business segments are: Service Centers, Innovative Pumping Solutions and Supply Chain Services. The Service Centers segment is engaged in providing maintenance, MRO products and equipment, including logistics capabilities, to industrial customers. The Service Centers segment provides a wide range of MRO products in the rotating equipment, bearing, power transmission, hose, fluid power, metal working, fastener, industrial supply, safety products and safety services categories. The Innovative Pumping Solutions segment fabricates and assembles custom-made pump packages, remanufactures pumps and manufactures branded private label pumps. The Supply Chain Services segment provides a wide range of MRO products and manages all or part of a customer's supply chain, including warehouse and inventory management.

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.

The following table sets out financial information related to the Company's segments (in thousands):

| Years Ended December 31,   | Service<br>Centers | Innovative<br>Pumping<br>Solutions | Supply<br>Chain<br>Services | Total       |
|--|--------------------|------------------------------------|-----------------------------|-------------|
| 2018   |                    |                                    |                             |             |
| Sales  | \$750,044          | \$291,697                          | \$174,456                   | \$1,216,197 |
| Operating income for reportable segments, excluding amortization | 80,718             | 33,943                             | 16,204                      | 130,865     |
| Identifiable assets at year end                                  | 402,944            | 188,765                            | 53,517                      | 645,226     |
| Capital expenditures   | 1,655              | 6,800                              | 296                         | 8,751       |
| Proceeds from sale of fixed assets                               | 3                  | 9                                  | —                           | 12          |
| Depreciation   | 3,974              | 4,064                              | 49                          | 8,087       |
| Amortization   | 9,272              | 6,237                              | 1,077                       | 16,586      |

|                  |          |         |         |          |
|------------------|----------|---------|---------|----------|
| Interest expense | \$11,178 | \$7,351 | \$2,408 | \$20,937 |
|------------------|----------|---------|---------|----------|

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| Years Ended December 31,   | Service<br>Centers | Innovative<br>Pumping<br>Solutions | Supply<br>Chain<br>Services | Total       |
|--|--------------------|------------------------------------|-----------------------------|-------------|
| 2017   |                    |                                    |                             |             |
| Sales  | \$641,275          | \$204,030                          | \$161,477                   | \$1,006,782 |
| Operating income for reportable segments, excluding amortization | 63,250             | 11,423                             | 15,451                      | 90,124      |
| Identifiable assets at year end                                  | 385,744            | 172,538                            | 59,942                      | 618,224     |
| Capital expenditures   | 1,076              | 1,488                              | 82                          | 2,646       |
| Depreciation   | 5,162              | 4,198                              | 103                         | 9,463       |
| Amortization   | 8,989              | 7,194                              | 1,083                       | 17,266      |
| Interest expense   | \$9,712            | \$5,352                            | \$1,990                     | \$17,054    |

| Years Ended December 31,   | Service<br>Centers | Innovative<br>Pumping<br>Solutions | Supply<br>Chain<br>Services | Total     |
|--|--------------------|------------------------------------|-----------------------------|-----------|
| 2016   |                    |                                    |                             |           |
| Sales  | \$621,007          | \$187,124                          | \$153,961                   | \$962,092 |
| Operating income for reportable segments, excluding amortization | 47,634             | 9,867                              | 15,449                      | 72,950    |
| Identifiable assets at year end                                  | 370,261            | 175,198                            | 44,796                      | 590,255   |
| Capital expenditures   | 447                | 3,827                              | 129                         | 4,403     |
| Proceeds from sale of fixed assets                               | 1,038              | 168                                | —                           | 1,206     |
| Depreciation   | 6,520              | 3,834                              | 126                         | 10,480    |
| Amortization   | 9,152              | 7,826                              | 1,083                       | 18,061    |
| Interest expense   | \$9,290            | \$4,422                            | \$1,852                     | \$15,564  |

|  | Years Ended December 31, |          |          |
|--|--------------------------|----------|----------|
|  | 2018                     | 2017     | 2016     |
| Operating income for reportable segments, excluding amortization | \$130,865                | \$90,124 | \$72,950 |
| Adjustments for:   |                          |          |          |
| Amortization of intangibles                                      | 16,586                   | 17,266   | 18,061   |
| Corporate and other expense, net                                 | 45,828                   | 39,368   | 35,557   |
| Total operating income   | 68,451                   | 33,490   | 19,332   |
| Interest expense   | 20,937                   | 17,054   | 15,564   |
| Other expenses (income), net                                     | (1,192 )                 | (456 )   | (5,906 ) |
| Income (loss) before income taxes                                | \$48,706                 | \$16,892 | \$9,674  |

The Company had capital expenditures at Corporate of \$0.6 million, \$0.2 million, and \$0.5 million for the years ended December 31, 2018, 2017, and 2016, respectively. The Company had identifiable assets at Corporate of \$54.7 million, \$19.4 million, and \$18.3 million as of December 31, 2018, 2017, and 2016, respectively. Corporate depreciation was \$1.5 million, \$1.8 million, and \$1.4 million for the years ended December 31, 2018, 2017, and 2016, respectively.

## Geographical Information

Revenues are presented in geographic area based on location of the facility shipping products or providing services. Long-lived assets are based on physical locations and are comprised of the net book value of property.

The Company's revenues and property and equipment by geographical location are as follows (in millions):



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|                      | Years Ended<br>December 31, |         |       |
|----------------------|-----------------------------|---------|-------|
|                      | 2018                        | 2017    | 2016  |
| Revenues             |                             |         |       |
| United States        | \$1,110                     | \$903   | \$874 |
| Canada               | 106                         | 104     | 88    |
| Other <sup>(1)</sup> | \$—                         | \$—     | \$—   |
| Total                | \$1,216                     | \$1,007 | \$962 |

<sup>(1)</sup> Other includes Mexico and Dubai.

|                             | As of<br>December<br>31, |       |
|-----------------------------|--------------------------|-------|
|                             | 2018                     | 2017  |
| Property and Equipment, net |                          |       |
| United States               | \$ 41                    | \$ 43 |
| Canada                      | 10                       | 10    |
| Other <sup>(1)</sup>        | —                        | —     |
| Total                       | \$ 51                    | \$ 53 |

<sup>(1)</sup> Other includes Mexico and Dubai.

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## NOTE 20 - QUARTERLY FINANCIAL INFORMATION (unaudited)

Summarized quarterly financial information for the years ended December 31, 2018, 2017 and 2016 is as follows (in millions, except per share data):

|   | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|---|------------------|-------------------|------------------|-------------------|
| 2018  |                  |                   |                  |                   |
| Sales   | \$285.9          | \$311.2           | \$308.0          | \$311.0           |
| Gross profit  | 76.4             | 85.1              | 84.1             | 86.6              |
| Net income  | 4.5              | 11.6              | 8.4              | 11.1              |
| Net income attributable to DXP Enterprises, Inc.        | 4.6              | 11.6              | 8.4              | 11.1              |
| Earnings per share - basic                              | 0.26             | 0.66              | 0.48             | 0.63              |
| Earnings per share - diluted                            | \$0.25           | \$0.63            | \$0.46           | \$0.60            |
| 2017  |                  |                   |                  |                   |
| Sales   | \$238.5          | \$250.7           | \$251.9          | \$265.7           |
| Gross profit  | 64.5             | 68.9              | 67.0             | 71.2              |
| Net income  | 3.1              | 4.1               | 3.0              | 6.6               |
| Net income attributable to DXP Enterprises, Inc.        | 3.0              | 4.0               | 2.9              | 6.6               |
| Earnings per share - basic                              | 0.18             | 0.24              | 0.17             | 0.38              |
| Earnings per share - diluted                            | \$0.17           | \$0.23            | \$0.16           | \$0.37            |
| 2016  |                  |                   |                  |                   |
| Sales   | \$253.6          | \$256.2           | \$230.0          | \$222.3           |
| Gross profit  | 68.8             | 71.6              | 63.8             | 60.6              |
| Net income (loss)                                       | (5.2 )           | 5.1               | 0.1              | 7.1               |
| Net income (loss) attributable to DXP Enterprises, Inc. | (5.1 )           | 5.1               | 0.2              | 7.4               |
| Earnings (loss) per share - basic                       | (0.36 )          | 0.36              | 0.02             | 0.44              |
| Earnings (loss) per share - diluted                     | \$(0.36 )        | \$0.34            | \$0.02           | \$0.42            |

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

## NOTE 21 – RELATED PARTIES DISCLOSURES

The Board uses policies and procedures, to be applied by the Audit Committee of the Board, for review, approval or ratification of any transactions with related persons. Those policies and procedures will apply to any proposed transactions in which DXP is a participant, the amount involved exceeds \$120,000 and any director, executive officer or significant shareholder or any immediate family member of such a person has a direct or material indirect interest. Any related party transaction will be reviewed by the Audit Committee of the Board of Directors to determine, among other things, the benefits of any transaction to DXP, the availability of other sources of comparable products or services and whether the terms of the proposed transaction are comparable to those provided to unrelated third parties.

For the year ended December 31, 2018, the Company paid approximately \$1.4 million in lease expenses to entities controlled by the Company's Chief Executive Officer, David Little.





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

None.

ITEM 9A. Controls and Procedures

Disclosure Controls and Procedures

DXP carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness as of December 31, 2018, of the design and operation of DXP's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15e and 15d-15e. Disclosure controls and procedures are the controls and other procedures of DXP that are designed to ensure that information required to be disclosed by DXP in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, (the "Exchange Act") is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the U.S. Securities and Exchange Commission (the "Commission"). Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by DXP in the reports that it files or submits under the Exchange Act, is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. As a result of this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of December 31, 2018, due to the material weaknesses described below in Management's Report on Internal Control Over Financial Reporting.

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

DXP Enterprises, Inc.'s management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). DXP Enterprises, Inc.'s internal control system was designed 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. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk. Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as set forth in Internal Control - Integrated Framework. In January 2018, we acquired substantially all of the assets of Application Specialties, Inc. This acquired business, which during 2018 comprised 3.9% of our revenues and as of December 31, 2018 comprised 1.2% of our total assets, is excluded from our report on internal control over financial reporting. Based on our evaluation under the COSO framework, our management has concluded that the Company's internal control over financial reporting was not effective as of December 31, 2018 due to material weaknesses in internal control over financial reporting as further discussed below.

Management's remediation efforts are also discussed below.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial

statements will not be prevented or detected on a timely basis.

As previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017, we had material weaknesses in our control environment and monitoring to support the financial reporting process. We specifically did not maintain effective management review controls over the monitoring and review of certain accounts; and management did not effectively design, document nor monitor (review, evaluate and assess) the key internal control activities that provide the accounting information contained in the Company's financial statements.

We committed to remediating the material weaknesses and, as such, implemented changes to our internal control over financial reporting. We implemented additional procedures to address the underlying causes of the material weaknesses prior to the filing

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of this Annual Report on Form 10-K, and continue to implement changes and improvements in our internal control over financial reporting to remediate the control deficiencies that caused the material weaknesses.

During the year, the following actions have been implemented:

• Engaged a third party consulting firm to lead our remediation efforts.

• Conducted a review of our organization structure, reporting relationships and adequacy of staffing levels and made specific staffing changes as a result of our review.

• Completed training for all appropriate personnel regarding the applicable accounting guidance and requirements.

• Training was conducted by both an outside expert and through internal training meetings and provided to accounting personnel, remote location personnel, and management positions.

• Strengthened our risk assessment, materiality and scoping, and fraud risk assessment.

• Significantly improved our COSO mapping of entity level controls.

• Developed or revised process maps for all key business processes.

• Identified and documented key controls and control gaps in a comprehensive consolidated risk control matrix

• Developed controls to address gaps and enhanced management review controls.

• Educated process owners as to the expectations for documentation to evidence key controls.

• The procedures described above have been implemented and controls have been successfully tested by our third party consultants.

Management is committed to a strong internal control environment. We believe with full implementation and testing of the design and operating effectiveness of the newly implemented and revised controls, the actions described above will successfully remediate the material weaknesses in our internal control over financial reporting. However, as of the date of this filing, we do not consider the weaknesses associated with our internal control over financial reporting remediated until the internal controls over these areas have been in operation for a sufficient period of time for our management to conclude that the material weakness has been remediated. Many of the new policies and changes made were completed in the fourth quarter of 2018. The Company will continue its efforts to implement and test the new controls in order to make this final determination in 2019.

## REMEDIATION OF PREVIOUSLY DISCLOSED MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

We previously identified a material weakness in internal control related to ineffective information technology general controls (ITGCs) in the areas of user access and program change-management over certain information technology (IT) systems that support the Company's financial reporting processes as of December 31, 2017. Our business process controls (automated and manual) that are dependent on the affected ITGCs were also deemed ineffective because they could have been adversely impacted. The material weakness did not result in any identified misstatements to the financial statements, and there were no changes to previously released financial results related to the material weakness. Management has been implementing and continues to implement measures designed to ensure that control deficiencies contributing to the material weakness are remediated, such that these controls are designed, implemented, and operating effectively. The remediation actions included:

• Engaged a third party consultant to lead our ITGC weakness remediation effort.

• Conducted training programs addressing ITGCs and policies, including educating control owners concerning the principles and requirements of each control, with a focus on those related to user access and change-management over IT systems impacting financial reporting.

• Evaluated and remediated IT control design for key areas such as Change Management and Logical Access.

• Documented and developed IT Policies and Procedures to support the IT General Control environment.

• Developed control documentation underlying ITGCs to promote knowledge transfer upon personnel and function changes.

• Developed enhanced risk assessment procedures and controls related to changes in IT systems.

The procedures described above have been implemented and controls have been successfully tested by our third party consultants.

With full implementation and testing of the design and operating effectiveness of the newly implemented and revised controls completed, the actions described above successfully remediated the material weakness in our internal control over financial reporting associated with ITGCs and were effective as of December 31, 2018.

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Changes in Internal Control over Financial Reporting

Except for the acquisition of the Application Specialties, Inc. noted above under “Management’s Report on Internal Control Over Financial Reporting”, and the enhancements described above for our financial reporting process and ITGCs there are no changes in our internal control over financial reporting that occurred during the year ended December 31, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The independent registered public accounting firm, Moss Adams LLP, has audited the effectiveness of internal control over financial reporting and expressed an adverse report on the operating effectiveness of the Company's internal control over financial reporting as of December 31, 2018. Such reports are included in Item 8 of this Annual Report on Form 10-K.

|                     |               |
|---------------------|---------------|
| /s/ David R. Little | /s/ Kent Yee  |
| David R. Little     | Kent Yee      |
|                     | Senior Vice   |
|                     | President and |
| President and Chief | Chief         |
| Executive Officer   | Financial     |
| (Principal          | Officer       |
| Executive Officer)  | (Principal    |
|                     | Financial     |
|                     | Officer)      |

ITEM 9B. Other Information

None.

PART III

ITEM 10. Directors, Executive Officers and Corporate Governance

The information required by this item will be included in our definitive Proxy statement for the 2019 Annual Meeting of Shareholders that we will file with the SEC within 120 days of the end of the fiscal year to which this Report relates (the “Proxy Statement”) and is hereby incorporated by reference thereto.

ITEM 11. Executive Compensation

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

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

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

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

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

ITEM 14. Principal Accounting Fees and Services.

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

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PART IV

ITEM 15. Exhibits, Financial Statement Schedules.

(a) Documents included in this Report:

1. Financial Statements – See Part II, Item 8 of this Report.
2. Financial Statement Schedules - All other schedules have been omitted since the required information is not applicable or significant or is included in the Consolidated Financial Statements or notes thereto.
3. Exhibits:

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

| Exhibit No. | Description   |
|-------------|---|
| 3.1         | <u>Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with the Commission on August 20, 1998).</u>  |
| 3.2         | <u>Bylaws, as amended on July 27, 2011.</u>   |
| 4.1         | <u>Form of Common Stock certificate (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 (Reg. No. 333-61953), filed with the Commission on August 20, 1998).</u>  |
| 4.2         | <u>See Exhibit 3.1 for provisions of the Company's Restated Articles of Incorporation, as amended, defining the rights of security holders.</u>   |
| 4.3         | <u>See Exhibit 3.2 for provisions of the Company's Bylaws defining the rights of security holders.</u>  |
| 4.4         | <u>Form of Senior Debt Indenture of DXP Enterprises, Inc. (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-3 (Reg. No. 333-166582), filed with the Commission on May 6, 2010).</u>   |
| 4.5         | <u>Form of Subordinated Debt Indenture of DXP Enterprises, Inc. (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-3 (Reg. No. 333-166582), filed with the SEC on May 6, 2010).</u>  |
| 10.1        | <u>Employment Agreement dated effective as of January 1, 2004, between DXP Enterprises, Inc. and David R. Little (incorporated by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K (File No. 000-21513:04663259) for the fiscal year ended December 31, 2003, filed with the Commission on March 11, 2004).</u> |



- 10.2 Amendment Number One to Employment Agreement dated effective as of January 1, 2004, between DXP Enterprises, Inc. and David R. Little (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-21513:06979954), filed with the Commission on July 26, 2006).
- 10.3 Amendment Number Two to Employment Agreement dated effective January 1, 2004 between DXP Enterprises, Inc. and David R. Little (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-21513:09846339) filed with the Commission on May 22, 2009).
- 10.4 Amendment Two to David Little Equity Incentive Program effective May 1, 2013 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 000-21513:11823072) filed with the Commission on May 3, 2013).
- 10.5 DXP Enterprises, Inc. 2016 Omnibus Incentive Plan (incorporated by reference to Exhibit 10.6 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2016 (File No. 000-21513:161832364) filed with the Commission on August 15, 2016).

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10.6 Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.7 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2016 (File No. 000-21513:161832364) filed with the Commission on August 15, 2016).

10.7 Term Loan and Security Agreement Dated as of August 29, 2017 by and among DXP Enterprises, Inc., Borrower and the Other Persons Party hereto from time to time, as Guarantors, and Goldman Sachs Bank USA, as Administrative Agent and Certain Financial Institutions, as Lenders (incorporated by reference to Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2017 (File No. 000-21513:171191516) filed with the Commission on November 9, 2017).

10.8 Loan and Security Agreement Dated as of August 29, 2017 by and among DXP Enterprises, Inc., Pump-PMI, LLC, PMI Operating Company, LTD., PMI Investment, LLC, Integrated Flow Solutions, LLC, DXP Holdings, Inc., Best Holding, LLC, Best Equipment Service & Sales Company, LLC, B27 Holdings Corp., B27, LLC, B27 Resources, Inc. and Pumpworks 610, LLC as US Borrowers, DXP Canada Enterprises, LTD., Industrial Paramedic Services, LTD., HSE Integrated LTD., and National Process Equipment Inc., as Canadian Borrowers and the Other Persons Party hereto from time to time, as Guarantors, and Bank of America, N.A., as agent and Certain Financial Institutions as Lenders, Bank of America, N.A. as Sole Lead Arranger and Sole Bookrunner and BMO Capital Markets Corp., as Documentation Agent (incorporated by reference to Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2017 (File No. 000-21513:171191516) filed with the Commission on November 9, 2017).

10.9 First Amendment to Loan Agreement as of June 25, 2018 (incorporated by reference to Exhibit 10.1 to Registrant's Quarterly Report on Form 10Q for the quarterly period ended June 30, 2018 (File No. 000-21513) filed with the Commission on August 8, 2018).

16.1 Letter of Hein & Associates LLP to the SEC dated November 17, 2017 (incorporated by reference to Exhibit 16.1 to Registrant's current report on Form 8-K (File No. 000-21513:171210595) filed with the Commission on November 17, 2017).

\*21.1 Subsidiaries of the Company.

\*23.1 Consent of Moss Adams LLP, Independent Registered Public Accounting Firm.

\*23.2 Consent of Hein and Associates LLP, Independent Registered Public Accounting Firm.

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

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

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

\*32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended.

101 Interactive Data Files

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

+ Indicates a management contract or compensation plan or arrangement.

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

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ITEM 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DXP ENTERPRISES, INC. (Registrant)

By: /s/DAVID R. LITTLE

David R. Little  
Chairman of the Board,  
President and Chief Executive Officer

Dated: March 8, 2019

Each person whose signature appears below appoints David R. Little, as his or her true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, with full power and authority to said attorney-in-fact and agent to do and perform each and every act whatsoever that is necessary, appropriate or advisable in connection with any or all of the above-described matters and to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent or his substitute, may lawfully do or cause to be done by virtue thereof.

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

| NAME                                  | TITLE   | DATE          |
|---------------------------------------|---|---------------|
| /s/David R. Little<br>David R. Little | Chairman of the Board, President<br>Chief Executive Officer and Director<br>(Principal Executive Officer)   | March 8, 2019 |
| /s/Kent Yee<br>Kent Yee               | Senior Vice President/Finance and<br>Chief Financial Officer and Secretary<br>(Principal Financial Officer) | March 8, 2019 |
| /s/Gene Padgett<br>Gene Padgett       | Senior Vice President/Finance,<br>Chief Accounting Officer<br>(Principal Accounting Officer)                | March 8, 2019 |
| /s/Cletus Davis<br>Cletus Davis       | Director  | March 8, 2019 |

/s/Timothy P. Halter Director  
Timothy P. Halter

March 8, 2019

/s/David Patton Director  
David Patton

March 8, 2019