FLOTEK INDUSTRIES INC/CN/
Form 10-Q
August 07, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2013
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 1-13270
FLOTEK INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	90-0023731 (I.R.S. Employer Identification No.)
10603 W. Sam Houston Parkway N. #300 Houston, TX (Address of principal executive offices)	77064 (Zip Code)

(713) 849-9911
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

As of July 29, 2013, there were 51,225,900 outstanding shares of Flotek Industries, Inc. common stock, $0.0001 par value.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements
FLOTEK INDUSTRIES, INC.
UNAUDITED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	June 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$5,503	$2,700
Restricted cash	—	150
Accounts receivable, net of allowance for doubtful accounts of $783 and $714 at June 30, 2013 and December 31, 2012, respectively	58,264	42,259
Inventories, net	74,467	45,177
Deferred tax assets, net	1,602	1,274
Other current assets	3,123	4,654
Total current assets	142,959	96,214
Property and equipment, net	79,167	56,499
Goodwill	66,271	26,943
Deferred tax assets, net	14,999	16,045
Other intangible assets, net	79,714	24,166
TOTAL ASSETS	$383,110	$219,867
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$31,570	$22,373
Accrued liabilities	10,230	6,503
Income taxes payable	1,559	3,479
Interest payable	209	114
Convertible senior notes, net of discount	—	5,133
Current portion of long-term debt	45,770	4,329
Total current liabilities	89,338	41,931
Long-term debt, less current portion	42,991	22,455
Deferred tax liabilities, net	25,631	751
Total liabilities	157,960	65,137
Commitments and contingencies		
Stockholders' equity:		
Cumulative convertible preferred stock, $0.0001 par value, 100,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.0001 par value, 80,000,000 shares authorized; 57,753,557 shares issued and 51,220,325 shares outstanding at June 30, 2013; 53,123,978 shares issued and 49,601,495 shares outstanding at December 31, 2012	6	5
Additional paid-in capital	257,121	195,485
Accumulated other comprehensive income (loss)	(184)	(40)
Accumulated deficit	(20,814)	(37,019)
Treasury stock, at cost; 5,134,517 and 2,198,193 shares at June 30, 2013 and December 31, 2012, respectively	(10,979)	(3,701)
Total stockholders' equity	225,150	154,730
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$383,110	$219,867

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents

FLOTEK INDUSTRIES, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Revenue	$93,586	$78,303	$171,829	$157,498
Cost of revenue	(55,992)	(45,278)	(101,605)	(91,022)
Gross margin	37,594	33,025	70,224	66,476
Expenses:				
Selling, general and administrative	(21,081)	(15,776)	(39,098)	(30,689)
Depreciation and amortization	(2,003)	(1,038)	(3,193)	(1,996)
Research and development	(979)	(622)	(1,854)	(1,454)
Total expenses	(24,063)	(17,436)	(44,145)	(34,139)
Income from operations	13,531	15,589	26,079	32,337
Other income (expense):				
Loss on extinguishment of debt	—	(995)	—	(6,386)
Change in fair value of warrant liability	—	6,524	—	2,649
Interest expense	(531)	(2,164)	(965)	(4,415)
Other income (expense), net	170	(343)	58	(350)
Total other income (expense)	(361)	3,022	(907)	(8,502)
Income before income taxes	13,170	18,611	25,172	23,835
Income tax expense	(4,730)	(5,433)	(8,967)	(7,051)
Net income	$8,440	$13,178	$16,205	$16,784
Earnings per common share:				
Basic earnings per common share	$0.17	$0.27	$0.33	$0.35
Diluted earnings per common share	$0.16	$0.25	$0.31	$0.33
Weighted average common shares:				
Weighted average common shares used in computing basic earnings per common share	51,086	48,227	49,841	47,890
Weighted average common shares used in computing diluted earnings per common share	53,713	54,032	52,445	50,586

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents

FLOTEK INDUSTRIES, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Net income	$8,440	$13,178	$16,205	$16,784
Other comprehensive income (loss):				
Foreign currency translation adjustment	(137)	(41)	(157)	(28)
Unrealized gain on investments available for sale	13	—	13	—
Other comprehensive loss	$(124)	$(41)	$(144)	$(28)
Comprehensive income	$8,316	$13,137	$16,061	$16,756

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents

FLOTEK INDUSTRIES, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six months ended June 30, 2013	2012
Cash flows from operating activities:		
Net income	$16,205	$16,784
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in fair value of warrant liability	—	(2,649)
Depreciation and amortization	6,923	5,501
Amortization of deferred financing costs	12	530
Accretion of debt discount	55	2,031
Gain on sale of assets	(2,568)	(2,475)
Stock compensation expense	5,820	5,877
Deferred income tax provision	(422)	746
Excess tax benefit related to share-based awards	(432)	(518)
Non-cash loss on extinguishment of debt	—	4,270
Changes in current assets and liabilities:		
Restricted cash	150	—
Accounts receivable, net	(2,540)	2,175
Inventories	(5,970)	(3,089)
Other current assets	2,045	(2,321)
Accounts payable	(8,293)	(1,992)
Accrued liabilities	1,043	604
Income taxes payable	(638)	(2,397)
Interest payable	93	(1,004)
Net cash provided by operating activities	11,483	22,073
Cash flows from investing activities:		
Capital expenditures	(9,119)	(9,478)
Proceeds from sale of assets	3,026	2,618
Payments for acquisition, net of cash acquired	(53,396)	—
Purchase of patents and other intangible assets	—	(29)
Net cash used in investing activities	(59,489)	(6,889)
Cash flows from financing activities:		
Repayments of indebtedness	(7,649)	(51,535)
Proceeds of borrowings	26,190	—
Borrowings on revolving credit facility	153,571	—
Repayments on revolving credit facility	(116,014)	—
Debt issuance costs	(991)	—
Issuance costs of preferred stock and detachable warrants	(200)	—
Excess tax benefit related to share-based awards	432	518
Purchase of treasury stock	(4,859)	(490)
Proceeds from sale of common stock	352	—
Proceeds from exercise of stock options	128	131
Proceeds from the exercise of stock warrants	6	263
Net cash provided by (used in) financing activities	50,966	(51,113)
Effect of changes in exchange rates on cash and cash equivalents	(157)	(28)
Net increase (decrease) in cash and cash equivalents	2,803	(35,957)
Cash and cash equivalents at the beginning of period	2,700	46,682

Cash and cash equivalents at the end of period	$5,503	$10,725

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents

FLOTEK INDUSTRIES, INC.
UNAUDITED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands)

	Common Stock		Treasury Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
	Shares Issued	Par Value	Shares	Cost				
Balance, December 31, 2012	53,124	$5	2,198	$(3,701)	$195,485	$(40)	$(37,019)	$154,730
Net income	—	—	—	—	—	—	16,205	16,205
Other comprehensive loss	—	—	—	—	—	(144)	—	(144)
Issuance costs of preferred stock and detachable warrants	—	—	—	—	(200)	—	—	(200)
Stock warrants exercised	5	—	—	—	6	—	—	6
Stock options exercised	333	—	—	—	2,546	—	—	2,546
Stock surrendered for exercise of stock options	—	—	165	(2,418)	—	—	—	(2,418)
Restricted stock granted	791	—	—	—	—	—	—	—
Restricted stock forfeited	—	—	38	—	—	—	—	—
Stock granted in incentive performance plan	217	—	—	—	—	—	—	—
Treasury stock purchased	—	—	316	(4,860)	—	—	—	(4,860)
Excess tax benefit related to share-based awards	—	—	—	—	432	—	—	432
Employee stock purchase plan	—	—	(22)	—	352	—	—	352
Stock compensation expense	—	—	—	—	5,789	—	—	5,789
Stock issued in Florida Chemical Company acquisition	3,284	1	—	—	52,711	—	—	52,712
Return of borrowed shares under share lending agreement	—	—	2,440	—	—	—	—	—
Balance, June 30, 2013	57,754	$6	5,135	$(10,979)	$257,121	$(184)	$(20,814)	$225,150

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of contents

FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Organization and Significant Accounting Policies

Organization and Nature of Operations

Flotek Industries, Inc. ("Flotek" or the "Company") is a technology-driven, global developer and supplier of drilling, completion and production technologies and related services. With its acquisition of Florida Chemical Company, Inc. on May 10, 2013 (see Note 3), the Company expanded its energy specialty chemical technologies and added non-energy chemical technologies as a new product line.

Flotek's strategic focus, and that of its diversified wholly-owned subsidiaries (collectively referred to as the "Company"), now includes energy related chemical technologies, drilling and artificial lift technologies, and non-energy chemical technologies. Within energy technologies, the Company provides oilfield specialty chemicals and logistics, down-hole drilling tools and down-hole production tools used in the energy and mining industries. Flotek's products and services enable customers to drill wells more efficiently, to realize increased production from both new and existing wells and to decrease future well operating costs. Major customers include leading oilfield service providers, pressure-pumping service companies, onshore and offshore drilling contractors, and major and independent oil and gas exploration and production companies. Within non-energy chemical technologies, the Company provides products for the flavor and fragrance industry and the industrial chemical industry. Major customers include beverage and food companies, fragrance companies, and companies providing household and industrial cleaning products.

The Company is headquartered in Houston, Texas, with operating locations in Florida, Louisiana, New Mexico, North Dakota, Oklahoma, Pennsylvania, Texas, Utah, Wyoming and The Netherlands. Flotek's products are marketed both domestically and internationally, with international presence and/or initiatives in over 20 countries.

Basis of Presentation

The accompanying Unaudited Consolidated Financial Statements and accompanying footnotes (collectively the "Financial Statements") reflect all adjustments, in the opinion of management, necessary for fair presentation of the financial condition and results of operations for the periods presented. All such adjustments are normal and recurring in nature. The Financial Statements, including selected notes, have been prepared in accordance with applicable rules and regulations of the Securities and Exchange Commission (the "SEC") regarding interim financial reporting and do not include all information and disclosures required by accounting principles generally accepted in the United States of America ("GAAP") for comprehensive financial statement reporting. These interim Financial Statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (the "Annual Report"). A copy of the Annual Report is available on the SEC's website, www.sec.gov, under the Company's ticker symbol ("FTK") or alternatively by visiting Flotek's website, www.flotekind.com. The results of operations for the six months ended June 30, 2013 are not necessarily indicative of the results to be expected for the year ending December 31, 2013.

Business Combinations

Acquisitions are accounted for by applying the acquisition method. Identifiable assets acquired and liabilities assumed are recorded at fair value at the acquisition date. Costs incurred to affect the acquisition are recognized as expenses as incurred.

Cash Management

In January 2013, the Company began using a controlled disbursement account for its main cash account. Under this system, outstanding checks can be in excess of the cash balances at the bank before the disbursement account is funded, creating a book overdraft. Book overdrafts on this account are presented as a current liability in accounts payable in the consolidated balance sheets.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and reported amounts of revenue and expenses. Actual results could differ from these estimates.

8

Table of contents

FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. The reclassifications did not impact net income.

Note 2 — Recent Accounting Pronouncements

Application of New Accounting Standards

Effective January 1, 2013, the Company adopted the accounting guidance in Accounting Standards Update ("ASU") No. 2012-02, “Testing Indefinite-Lived Intangible Assets for Impairment,” which permits a company to perform qualitative assessments regarding the likelihood that an indefinite-lived intangible asset is impaired and subsequently assess the need to perform a quantitative impairment test. Implementation of this standard did not have a material effect on the consolidated financial statements.

Effective January 1, 2013, the Company adopted the accounting guidance in ASU No. 2013-02, "Comprehensive Income: Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," which provides accounting guidance on the reporting of reclassifications out of accumulated other comprehensive income. The guidance requires an entity to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income if the amount is reclassified to net income in its entirety in the same reporting period. For other amounts not required to be reclassified in their entirety to net income in the same reporting period, a cross reference to other disclosures that provide additional detail about the reclassification amounts is required. Implementation of this standard did not have a material effect on the consolidated financial statements.

Note 3 — Acquisition of Florida Chemical Company, Inc.

On May 10, 2013, the Company acquired Florida Chemical Company, Inc. ("Florida Chemical"), the world's largest processor of citrus oils and a pioneer in solvent, chemical synthesis, and flavor and fragrance applications from citrus oils. Florida Chemical has been an innovator in creating high performance, bio-based products for a variety of industries, including applications in the oil and gas industry. The acquisition brings a portfolio of high performance renewable and sustainable chemistries that perform well in the oil and gas industry as well as non-energy related markets. This expands the Company's business into non-energy chemical technologies which provide products for the flavor and fragrance industry and the specialty chemical industry. These technologies are used by beverage and food companies, fragrance companies, and companies providing household and industrial cleaning products.

The Company acquired 100% of the outstanding shares of Florida Chemical's common stock. The purchase consideration transferred is as follows (in thousands):

Cash	$49,500
Common stock (3,284,180 shares)	52,711
Repayment of debt	4,227
Total purchase price	$106,438

FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

The allocation of purchase consideration was based upon the estimated fair value of the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition. The allocation was made to major categories of assets and liabilities based on management's best estimates, supported by independent third-party analyses. The excess of the purchase price over the estimated fair value of tangible and identifiable intangible assets acquired and liabilities assumed was allocated to goodwill. The allocation of purchase consideration is as follows (in thousands):

Cash	$331
Net working capital, net of cash	15,574
Property and equipment:	
Personal property	13,400
Real property	6,750
Other assets	205
Other intangible assets:	
Customer relationships	29,270
Trade names	12,670
Proprietary technology	14,080
Goodwill	39,328
Deferred tax impact of valuation adjustment	(25,170)
Total purchase price allocation	$106,438

The following unaudited pro forma financial information presents results of operations as if the acquisition had occurred as of January 1, 2012. This financial information does not purport to represent the results of operations which would actually have been obtained had the acquisition been completed as of January 1, 2012, or the results of operations that may be obtained in the future. Also, this financial information does no reflect the cost of any integration activities or benefits from the merger and synergies that may be derived from any integration activities, both of which may have a material effect on the consolidated results of operations in the periods following the completion of the merger.

Pro forma financial information is as follows (in thousands, except per share data):

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Revenue	$100,324	$100,943	$196,174	$204,209
Net income	9,099	13,482	18,072	16,986
Earnings per common share:				
Basic	$0.18	$0.28	$0.36	$0.35
Diluted	$0.17	$0.25	$0.34	$0.34

Pro forma adjustments include, but are not limited to, adjustments for amortization expense for acquired finite lived intangible assets, depreciation expense for the fair value of acquired property and equipment, interest expense for increased long-term debt and revolving credit facility borrowings required for the acquisition, and income tax expense on Florida Chemical income before income taxes. In addition, pro forma adjustments eliminate historical amortization, depreciation, and interest expense from the pro forma results of operations.

Table of contents
FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

The acquisition was financed through increased long term debt of $25.0 million, additional borrowings on the Company's revolving credit facility of $28.7 million and issuance of 3.3 million shares of the Company's common stock. An escrow fund totaling $10.0 million has been established to cover the indemnification obligations of Florida Chemical stockholders. Results of Florida Chemical's operations are included in the the Company's consolidated financial statements from the date of acquisition, May 10, 2013. The Company's consolidated statements of operations for both the three and six months ended June 30, 2013 include $14.5 million of revenue and $2.7 million of income from operations related to the operations of Florida Chemical.

The Company incurred $1.1 million of acquisition costs in connection with the transaction which have been expensed as incurred and included in selling, general and administrative expenses.

Note 4 — Supplemental Cash Flow Information

Supplemental cash flow information is as follows (in thousands):

	Six months ended June 30,	
	2013	2012
Supplemental non-cash investing and financing activities:		
Value of shares issued in acquisition of Florida Chemical	$52,711	$—
Fair value of warrant liability reclassified to additional paid-in capital	—	13,973
Equipment acquired through capital leases	691	873
Exercise of stock options by common stock surrender	2,418	—
Supplemental cash payment information:		
Interest paid	$780	$2,950
Income taxes paid	10,157	8,574

Note 5 — Revenue

The Company differentiates revenue and cost of revenue based on whether the source of revenue is attributable to products, rentals or services. Revenue and cost of revenue by source are as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Revenue:				
Products	$71,523	$56,425	$127,853	$113,681
Rentals	15,679	16,981	31,419	35,047
Services	6,384	4,897	12,557	8,770
	$93,586	$78,303	$171,829	$157,498
Cost of revenue:				
Products	$46,992	$34,136	$81,508	$68,620
Rentals	4,281	7,497	10,798	15,507
Services	2,832	1,831	5,569	3,391
Depreciation	1,887	1,814	3,730	3,504
	$55,992	$45,278	$101,605	$91,022

Table of contents
FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

Note 6 — Inventories
Inventories are as follows (in thousands):

	June 30, 2013	December 31, 2012
Raw materials	$34,224	$12,883
Work-in-process	2,158	342
Finished goods	41,479	34,704
Inventories	77,861	47,929
Less reserve for excess and obsolete inventory	(3,394)	(2,752)
Inventories, net	$74,467	$45,177

Note 7 — Property and Equipment
Property and equipment are as follows (in thousands):

	June 30, 2013	December 31, 2012
Land	$4,348	$1,442
Buildings and leasehold improvements	29,029	18,520
Machinery, equipment and rental tools	69,436	54,279
Equipment in progress	7,051	9,382
Furniture and fixtures	2,327	1,358
Transportation equipment	5,570	5,136
Computer equipment and software	6,555	6,743
Property and equipment	124,316	96,860
Less accumulated depreciation	(45,149)	(40,361)
Property and equipment, net	$79,167	$56,499

Depreciation expense, including expense recorded in cost of revenue, totaled $2.9 million and $2.3 million for the three months ended June 30, 2013 and 2012, respectively, and $5.4 million and $4.4 million for the six months ended June 30, 2013 and 2012, respectively.

Note 8 — Goodwill
Changes in the carrying value of goodwill for each reporting unit are as follows (in thousands):

	Chemical Technologies	Non-energy Chemical Technologies	Teledrift	Total
Balance at December 31, 2012	$11,610	$—	$15,333	$26,943
Add:				
Acquisition of Florida Chemical	18,686	20,642	—	39,328
Balance at June 30, 2013	$30,296	$20,642	$15,333	$66,271

Prior to the acquisition of Florida Chemical, the Company had four reporting units, Chemical Technologies, Drilling Tools, Teledrift, and Artificial Lift Technologies, of which only two, Chemical Technologies and Teledrift, had an existing goodwill balance. For segment reporting purposes, the Teledrift reporting unit is consolidated within the Drilling Technologies segment.

During May 2013, as a result of the Florida Chemical acquisition, the Company recognized $39.3 million of goodwill. During the fair value assessment process, the Company identified two separate reporting units, one which was consolidated within the Chemical Technologies segment and the other which was identified as the Non-energy Chemical Technologies reporting unit and segment. The Company recognized $18.7 million of additional goodwill within the Chemical Technologies reporting unit and $20.6 million of goodwill within the Non-energy Chemical Technologies reporting unit.

Table of Contents

Note 9 — Other Intangible Assets

Other intangible assets are as follows (in thousands):

	June 30, 2013		December 31, 2012	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Finite lived intangible assets:				
Patents and technology	$18,403	$1,957	$4,314	$1,654
Customer Lists	52,607	7,606	23,337	6,688
Non-compete agreements	402	402	402	402
Trademarks and brand names	7,191	1,725	6,151	1,513
Other	915	838	915	801
Total finite lived intangible assets acquired	79,518	12,528	35,119	11,058
Deferred financing costs	2,308	1,214	1,290	1,185
Total amortizable intangible assets	81,826	$13,742	36,409	$12,243
Indefinite lived intangible assets:				
Trademarks and brand names	11,630		—	
Total other intangibles assets	$93,456		$36,409	
Carrying value:				
Other intangible assets, net	$79,714		$24,166	

With the acquisition of Florida Chemical on May 10, 2013, the Company recorded increases in finite lived intangible assets of $14.1 million in patents and technology, $29.3 million in customer lists and $1.0 million in trademarks and brand names. In addition, the Company recorded $11.6 million in indefinite lived trademarks and brand names. These acquired intangible assets are recorded at fair value as of the date of acquisition.

The Company recorded an increase in deferred financing costs of $1.0 million during the six months ended June 30, 2013.

Finite lived intangible assets acquired are amortized on a straight-line basis over two to 20 years. Amortization of finite lived intangible assets totaled $1.0 million and $0.5 million for the three months ended June 30, 2013 and 2012, respectively, and $1.5 million and $1.1 million for the six months ended June 30, 2013 and 2012, respectively. Amortization of deferred financing costs was less than $0.1 million for the three and six months ended June 30, 2013. Amortization of deferred financing costs was $0.2 million and $0.5 million for the three months and six months ended June 30, 2012, respectively.

Note 10 — Convertible Notes, Long-Term Debt and Credit Facility

Convertible notes and long-term debt are as follows (in thousands):

	June 30, 2013	December 31, 2012
Convertible notes:		
Convertible senior unsecured notes (2008 Notes)	$—	$5,188
Less discount on notes	—	(55)
Convertible senior notes reported as current, net of discount	$—	$5,133
Long-term debt:		
Term loan	$49,405	$25,000
Borrowings under revolving credit facility	37,557	—
Capital lease obligations	1,799	1,784
Total long-term debt	88,761	26,784
Less current portion of long-term debt	(45,770)	(4,329)
Long-term debt, less current portion	$42,991	$22,455

Credit Facility

On September 23, 2011, the Company and certain of its subsidiaries (the “Borrowers”) entered into a Revolving Credit and Security Agreement (the “Credit Facility”) with PNC Bank, National Association (“PNC Bank”). The Company may borrow under the Credit Facility for working capital, permitted acquisitions, capital expenditures and other corporate purposes. Under terms of the Credit Facility, as amended on May 10, 2013, the Company (a) may borrow up to $75 million under a revolving credit facility and (b) has borrowed $50 million under a term loan.

The Credit Facility is secured by substantially all of the Company’s domestic personal property, including accounts receivable, inventory, equipment and other intangible assets. The Credit Facility contains customary representations, warranties, and both affirmative and negative covenants, including a financial covenant to maintain a consolidated earnings before interest, taxes, depreciation and amortization (“EBITDA”) to debt ratio of 1.10 to 1.00, a financial covenant to maintain a ratio of funded debt to adjusted EBITDA of not greater than 4.0 to 1.0, and an annual limit on capital expenditures of approximately $36 million. The Credit Facility restricts the payment of cash dividends on common stock. In the event of default, PNC Bank may accelerate the maturity date of any outstanding amounts borrowed under the Credit Facility.

Each of the Company’s domestic subsidiaries is fully obligated for Credit Facility indebtedness as a Borrower or as a guarantor pursuant to a guaranty dated September 23, 2011.

(a) Revolving Credit Facility

Under the revolving credit facility, the Company may borrow up to $75 million. This includes a sublimit of $10 million that may be used for letters of credit. The revolving credit facility is secured by substantially all the Company's domestic accounts receivable and inventory.

The interest rate on advances under the revolving credit facility varies based on the level of borrowing. Rates range (a) between PNC Bank's base lending rate plus 0.5% to 1.0% or (b) between the London Interbank Offered Rate (LIBOR) plus 1.5% to 2.0%. PNC Bank's base lending rate was 3.25% at June 30, 2013. The Company is required to pay a monthly facility fee of 0.25% on any unused amount under the commitment based on daily averages. At June 30, 2013, $37.6 million was outstanding under the revolving credit facility, with $12.6 million borrowed as base rate loans at an interest rate of 3.75% and $25.0 million borrowed as LIBOR loans at an interest rate of 1.70%.

At June 30, 2013, eligible accounts receivable and inventory securing the revolving credit facility provided availability of approximately $62.0 million under the revolving credit facility.

Borrowing under the revolving credit agreement is classified as current debt as a result of the required lockbox arrangement and subjective acceleration clauses.

(b) Term Loan

The Company increased borrowing to $50 million under the term loan on May 10, 2013. Monthly principal payments of $0.6 million are required. The unpaid balance of the term loan is due May 10, 2018. Prepayments are permitted, and may be required in certain circumstances. Amounts repaid under the term loan may not be reborrowed. The term loan is secured by substantially all of the Company's domestic equipment and other intangible assets.

The interest rate on the term loan varies based on the level of borrowing under the revolving credit facility. Rates range (a) between PNC Bank's base lending rate plus 1.25% to 1.75% or (b) between LIBOR plus 2.25% to 2.75%. At June 30, 2013, $49.4 million was outstanding under the term loan, with $1.4 million borrowed as base rate loans at an interest rate of 4.50% and $48.0 million borrowed as LIBOR loans at an interest rate of 2.45%.

Convertible Notes

The Company’s convertible notes have consisted of Convertible Senior Unsecured Notes (“2008 Notes”) and Convertible Senior Secured Notes (“2010 Notes”). On February 15, 2013, the Company repurchased the remaining $5.2 million of outstanding 2008 Notes. Following this repurchase, the Company no longer has any outstanding convertible senior notes.

In February 2008, the Company issued the 2008 Notes at par, in an aggregate principal amount of $115 million. The 2008 Notes had an interest rate of 5.25% and a scheduled maturity on February 15, 2028. The Company accounted for both the liability and equity components of the 2008 Notes using the Company’s nonconvertible debt borrowing rate of

11.5%. The Company used a five-year expected term for accretion of the associated debt discount which represented the period from inception until contractual call/put options contained in the 2008 Notes became exercisable on February 15, 2013. The Company assumed an effective tax

Table of contents

rate of 38%. At the date of issuance, the discount on the 2008 Notes was $27.8 million, with an associated deferred tax liability of $10.6 million.

In March 2010 the Company exchanged $40 million of 2008 Notes for aggregate consideration of $36 million of 2010 Notes and $2 million worth of shares of the Company's common stock. The transaction was accounted for as an exchange of debt. Accordingly, no gain or loss was recognized and the difference between the debt exchanged and the net carrying value of the debt was recorded as a reduction of previously recognized debt discount. The remaining debt discount continued to be accreted over the same period, at an assumed rate of 9.9%, using the effective interest method. The Company capitalized commitment fees related to the Exchange Agreement that were amortized using the effective interest method over the period the convertible debt was expected to remain outstanding.

The 2010 Notes carried the same maturity date, interest rate, conversion rights, conversion rate, redemption rights and guarantees as the 2008 Notes. The only difference in terms was that the 2010 Notes were secured by a second priority lien on substantially all of the Company's assets, while the 2008 Notes remained unsecured.

The convertible notes had a scheduled maturity on February 15, 2028. On or after February 15, 2013, the Company could redeem, for cash, all or a portion of the convertible notes at a price equal to 100% of the outstanding principal amount, plus any associated accrued and unpaid interest. Holders of the convertible notes could require the Company to purchase all, or a portion, of the holder's outstanding notes on each of February 15, 2013, February 15, 2018, and February 15, 2023. The convertible notes were convertible into shares of the Company's common stock at the option of the note holders, subject to certain contractual conditions. The conversion rate was 43.9560 shares per $1,000 principal note amount (equal to a conversion price of approximately $22.75 per share).

In May 2011, note holders exchanged $4.5 million of the 2008 Notes for 559,007 shares of the Company's common stock. Upon exchange, the Company recognized a loss on the extinguishment of debt of $1.1 million representing the difference between the reacquisition price of the debt over its net carrying amount including write-off of proportionate unaccreted discount and unamortized deferred financing costs.

On January 5, 2012, the Company repurchased all $36 million of the outstanding 2010 Notes for cash equal to 104.95% of the original principal amount of the notes, plus accrued and unpaid interest. As a result of this transaction, the Company recognized a loss on extinguishment of debt of $5.4 million, consisting of a cash premium of $1.8 million and the write-off of unaccreted discount and unamortized deferred financing costs. Upon repurchase, the 2010 Notes were canceled and the second priority liens on the Company's assets were released.

On June 25, 2012, the Company repurchased $15 million of outstanding 2008 Notes for cash equal to 102% of the original principal amount, plus accrued and unpaid interest. As a result of this transaction, the Company recognized a loss on extinguishment of debt of $1 million, consisting of the cash premium of $0.3 million and the write-off of unaccreted discount and unamortized deferred financing costs.

On December 31, 2012, the Company repurchased $50.3 million of outstanding 2008 Notes for cash equal to the original principal amount and a total premium of $0.3 million, plus accrued and unpaid interest. As a result of this transaction, the Company recognized a loss on extinguishment of debt of $0.9 million, consisting of the cash premium and the write-off of unaccreted discount and unamortized debt financing costs.

On February 15, 2013, the Company repurchased the remaining $5.2 million of outstanding 2008 Notes for cash equal to the original principal amount, plus accrued and unpaid interest. These 2008 Notes were either tendered by the holder pursuant to the Company's tender offer or were redeemed by the Company pursuant to provisions of the indenture for the 2008 Notes. Following this repurchase, the Company no longer has any outstanding convertible senior notes.

Guarantees of the Convertible Notes

The convertible notes were guaranteed by substantially all of the Company's wholly owned subsidiaries. Flotek Industries, Inc., the parent company, is a holding company with no independent assets or operations. The guarantees provided by the Company's subsidiaries were full and unconditional, and joint and several. Any subsidiaries of the Company that were not guarantors were deemed to be "minor" subsidiaries in accordance with SEC Regulation S-X, Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered."

The agreements governing the Company's long-term indebtedness did not contain any significant restrictions on the ability of the Company, or any guarantor, to obtain funds from subsidiaries by dividend or loan.

Table of contents

FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

Share Lending Agreement

Concurrent with the offering of the 2008 Notes, the Company entered into a share lending agreement (the “Share Lending Agreement”) with Bear, Stearns International Limited which was subsequently acquired and became an indirect, wholly owned subsidiary of JPMorgan Chase & Company (the “Borrower”). In accordance with the Share Lending Agreement, the Company loaned 3.8 million shares of its common stock (the “Borrowed Shares”) to the Borrower for a period commencing February 11, 2008 and ending on the earlier of February 15, 2028 or the date the 2008 Notes were paid. The Borrower was permitted to use the Borrowed Shares only for the purpose of directly or indirectly facilitating the sale of the 2008 Notes and for the establishment of hedge positions by holders of the 2008 Notes. The Company did not require collateral to mitigate any inherent or associated risk of the Share Lending Agreement.

The Company did not receive any proceeds for the Borrowed Shares, but did receive a nominal loan fee of $0.0001 for each share loaned. The Borrower retained all proceeds from sales of Borrowed Shares pursuant to the Share Lending Agreement. Upon conversion or replacement of the 2008 Notes, the number of Borrowed Shares proportionate to the converted or repaid notes were to be returned to the Company. The Borrowed Shares were issued and outstanding for corporate law purposes. Accordingly, holders of Borrowed Shares possessed all of the rights of a holder of the Company’s outstanding shares, including the right to vote the shares on all matters submitted to a vote of stockholders and the right to receive any dividends or other distributions declared or paid on outstanding shares of common stock. Under the Share Lending Agreement, the Borrower agreed to pay to the Company, within one business day after a payment date, an amount equal to any cash dividends that the Company paid on the Borrowed Shares, and to pay or deliver to the Company, upon termination of the loan of Borrowed Shares, any other distribution, in liquidation or otherwise, that the Company made on the Borrowed Shares.

To the extent the Borrowed Shares loaned under the Share Lending Agreement were not sold or returned to the Company, the Borrower agreed to not vote any borrowed shares of which the Borrower was the owner of record. The Borrower also agreed, under the Share Lending Agreement, to not transfer or dispose of any borrowed shares unless such transfer or disposition was pursuant to a registration statement that was effective under the Securities Act. Investors that purchased shares from the Borrower, and all subsequent transferees of such purchasers, were entitled to the same voting rights, with respect to owned shares, as any other holder of common stock.

The Company valued the share lending arrangement at $0.5 million at the date of issuance. The corresponding fair value was recognized as a debt issuance cost and was amortized to interest expense through the earliest put date of the related debt, February 15, 2013.

During June 2012 and November 2011, the Borrower returned 659,340 shares and 701,102 shares, respectively, of the Company’s borrowed common stock. On January 22, 2013, the remaining 2,439,558 shares of the Company's common stock held by J.P. Morgan Markets Limited were returned to the Company. No consideration was paid by the Company for the return of the Borrowed Shares. The Share Lending Agreement has been terminated.

Shares that had been loaned under the Share Lending Agreement were not considered outstanding for the purpose of computing and reporting earnings per share.

Capital Lease Obligations

The Company leases equipment and vehicles under capital leases. At June 30, 2013, the Company had $1.8 million of capital lease obligations.

Note 11 — Earnings Per Share

Basic earnings per common share is calculated by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per common share is calculated by dividing net income, adjusted for the effect of assumed conversions of convertible notes, by the weighted average number of common shares outstanding combined with dilutive common share equivalents outstanding, if the effect is dilutive.

In connection with the sale of the 2008 Notes, the Company entered into a Share Lending Agreement for 3.8 million shares of the Company’s common stock (see Note 10). Contractual undertakings of the Borrower had the effect of substantially eliminating the economic dilution that otherwise would result from the issuance of the Borrowed Shares, and all shares outstanding under the Share Lending Agreement were contractually obligated to be returned to the Company. As a result, shares loaned under the Share Lending Agreement were not considered outstanding for the purpose of computing and reporting earnings per share. The Share Lending Agreement was terminated on January 22, 2013 upon the return of all Borrowed Shares to the Company.

Table of contents
FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

On February 15, 2013, the Company repurchased the remaining $5.2 million of outstanding 2008 Notes for cash. Following this repurchase, the Company no longer has any outstanding convertible senior notes. For the six months ended June 30, 2013 and 2012, the Company's convertible notes were excluded from the calculation of diluted earnings per common share, as inclusion was anti-dilutive. In addition, for the three and six months ended June 30, 2013 and 2012, approximately 0.1 million stock options with an exercise price in excess of the average market price of the Company's common stock were excluded from the calculation of diluted earnings per common share.
Basic and diluted earnings per common share are as follows (in thousands, except per share data):

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Net income - Basic	$8,440	$13,178	$16,205	$16,784
Impact of assumed conversions:				
Interest on convertible notes	—	570	—	—
Net income - Diluted	$8,440	$13,748	$16,205	$16,784
Weighted average common shares outstanding - Basic	51,086	48,227	49,841	47,890
Assumed conversions:				
Incremental common shares from warrants	1,429	1,657	1,421	1,678
Incremental common shares from stock options	1,174	983	1,167	977
Incremental common shares from restricted stock units	24	73	16	41
Incremental common shares from convertible senior notes	—	3,092	—	—
Weighted average common shares outstanding - Diluted	53,713	54,032	52,445	50,586
Basic earnings per common share	$0.17	$0.27	$0.33	$0.35
Diluted earnings per common share	$0.16	$0.25	$0.31	$0.33

Note 12 — Fair Value Measurements

Fair value is defined as the amount that would be received for selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company categorizes financial assets and liabilities into the three levels of the fair value hierarchy. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value and bases categorization within the hierarchy on the lowest level of input that is available and significant to the fair value measurement.

- Level 1 — Quoted prices in active markets for identical assets or liabilities;
- Level 2 — Observable inputs other than Level 1, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and
- Level 3 — Significant unobservable inputs that are supported by little or no market activity or that are based on the reporting entity's assumptions about the inputs.

Liabilities Measured at Fair Value on a Recurring Basis

The Company had no liabilities required to be measured at fair value on a recurring basis at June 30, 2013 and December 31, 2012. There were no transfers in or out of either Level 1 or Level 2 fair value measurements during the six months ended June 30, 2013 and the year ended December 31, 2012. During the six months ended June 30, 2013 and the year ended December 31, 2012, there were no transfers in or out of the Level 3 hierarchy.

Table of contents

FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

Changes in Level 3 liabilities are as follows (in thousands):

	Six months ended June 30, 2013	Year ended December 31, 2012
Balance, beginning of period	$—	$16,622
Fair value adjustments, net	—	(2,649)
Reclassification to additional paid-in capital	—	(13,973)
Net transfers in/(out)	—	—
Balance, end of period	$—	$—

On June 14, 2012, provisions in the Company's Exercisable and Contingent Warrant Certificates were amended to eliminate anti-dilution price adjustment provisions and remove cash settlement provisions of a change of control event. Upon amendment, the warrants met the requirements for classification as equity. All fluctuations in the fair value of the warrant liability prior to June 2012 were recognized as non-cash income or expense items within the statement of operations. The fair value accounting methodology for the warrant liability is no longer required following the contractual amendment.

Fair Value of Other Financial Instruments

The carrying value and estimated fair value of the Company's marketable securities, convertible notes and long-term debt are as follows (in thousands):

	June 30, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Marketable securities	$199	$199	$—	$—
2008 Notes (1)	—	—	5,133	5,163
Term loan	49,405	49,405	25,000	25,000
Capital lease obligations	1,799	1,729	1,784	1,736

(1)The carrying value of the 2008 Notes represents the discounted debt component only, while the fair value of the Notes is based on the market value of the respective notes, including convertible equity features.

The estimated fair value of the 2008 Notes is based upon quoted market prices. The carrying value of the term loan approximates its fair value because the interest rate is variable. The fair value of capital lease obligations is based on recent lease rates adjusted for a risk premium.

Assets Measured at Fair Value on a Nonrecurring Basis

The Company's non-financial assets, including property and equipment, goodwill and other intangible assets are measured at fair value on a non-recurring basis and are subject to fair value adjustment in certain circumstances. No impairment of any of these assets was recognized during the six months ended June 30, 2013 and 2012.

Table of Contents

Note 13 — Income Taxes

The Company's corporate organizational structure requires the filing of two separate consolidated U.S. Federal income tax returns. Taxable income of one group cannot be offset by tax attributes, including net operating losses, of the other group.

A reconciliation of the effective tax rate to the U.S. federal statutory tax rate is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Federal statutory tax rate	35.0 %	35.0 %	35.0 %	35.0 %
State income taxes, net of federal benefit	3.3	3.4	2.9	2.7
Change in valuation allowance	(0.3)	0.5	(0.2)	(4.2)
Warrant liability fair value adjustment	—	(6.5)	—	(1.7)
Domestic production activities deduction	(2.4)	(2.5)	(2.4)	(2.3)
Other	0.3	(0.7)	0.3	0.1
Effective income tax rate	35.9 %	29.2 %	35.6 %	29.6 %

Fluctuations in effective tax rates were historically impacted by non-cash changes in the fair value of the Company's warrant liability, permanent tax differences with no associated income tax impact, and existing deferred tax asset valuation allowances.

The change in the net deferred tax asset (liability) relates primarily to an increase in deferred tax liabilities from the acquisition of Florida Chemical. Deferred taxes are presented in the balance sheets as follows (in thousands):

	June 30, 2013	December 31, 2012
Current deferred tax assets	$1,602	$1,274
Non-current deferred tax assets	14,999	16,045
Non-current deferred tax liabilities	(25,631)	(751)
Net deferred tax assets (liabilities)	$(9,030)	$16,568

As part of its acquisition assessment, the Company recognized a deferred tax asset related to Florida Chemical's allowance for doubtful accounts and inventory obsolescence reserve expected to be realized in the future. In addition, the Company recorded a deferred tax liability for the difference between the assigned fair values of the tangible and intangible assets acquired and the tax bases of those assets.

Note 14 — Convertible Preferred Stock and Stock Warrants

In August 2009, the Company sold 16,000 units (the "Units"), consisting of preferred stock and warrants for $1,000 per Unit. Each Unit consisted of one share of Series A cumulative convertible preferred stock ("Convertible Preferred Stock"), detachable warrants to purchase up to 155 shares of the Company's common stock at an exercise price of $2.31 per share ("Exercisable Warrants") and detachable contingent warrants to purchase up to 500 shares of the Company's common stock at an exercise price of $2.45 per share ("Contingent Warrants").

The gross proceeds from issuance of the Units were allocated, at the date of the transaction, based upon the preferred stock and warrants relative fair values. The Company obtained third-party valuations to assist in quantifying the relative fair value of the Unit's debt and equity components. The fair value of the warrants was determined with the Black-Scholes option-pricing model assuming a five-year term, a volatility rate of 54%, a risk-free rate of return of 2.7%, and an assumed dividend rate of zero. The fair value of the preferred stock component was determined based upon a valuation of the beneficial conversion right and the host contract. The fair value of the beneficial conversion right was estimated based upon a Monte Carlo simulation of the Company's possible future stock price to assess the likelihood of conversion. Due to a lack of comparable transactions by companies with similar credit ratings, the value of the host contract was determined by applying a risk-adjusted rate of return to the annual dividend. At the date of the transaction, the Company recorded approximately 68% of the proceeds or $10.8 million (net of the discount recognized upon the allocation of proceeds to the detachable warrants) as preferred stock in stockholders' equity. The fair value of the detachable warrants was assessed at $5.2 million and recorded as a warrant liability. The Company determined that the

conversion option embedded within the preferred stock had intrinsic value beneficial to the holders of the preferred stock. The intrinsic value was determined to be $5.2 million and was recorded as a beneficial conversion discount with an offset to additional paid-in capital at the date of the transaction. The preferred stock conversion period was estimated to be thirty-six months based upon an evaluation of the conversion options.

Preferred Stock

Each share of Convertible Preferred Stock was convertible at any time, at the holder's option, into 434.782 shares of the Company's common stock. The conversion rate represented an equivalent conversion price of approximately $2.30 per share of common stock.

Each share of Convertible Preferred Stock had a liquidation preference of $1,000. Dividends accrued at a rate of 15% of the liquidation preference per year and accumulated, if not paid quarterly. Subsequent to February 11, 2010, the Company had the ability to convert the preferred shares into common shares if the closing price of the common stock met certain price criteria. In the event any Convertible Preferred Stock was converted, the Company was obligated to pay an amount, in cash or common stock, equal to eight quarterly dividend payments less any dividends previously paid.

On January 6, 2011, the Company paid all accumulated and unpaid dividends on the outstanding shares of Convertible Preferred Stock in shares of the Company's common stock. The payment, at an annual rate of 15% of the liquidation preference, covered the period from issuance, August 12, 2009, through December 31, 2010. Dividends per share were paid in shares of commons stock valued at $4.81, based upon the prior ten business day volume-weighted average price per share. Fractional shares were paid in cash.

On February 4, 2011, the Company exercised its contractual right to mandatorily convert all outstanding shares of Convertible Preferred Stock into shares of common stock at the prevailing conversion rate of 434.782 shares of common stock for each share of preferred stock. The Company issued 4,871,719 shares of common stock for preferred share conversions during 2011, including those mandatorily converted. Holders of preferred shares subject to mandatory conversion were entitled to eight quarterly dividend payments. On February 4, 2011, dividends per share of $91.67 were paid in shares of common stock valued at $6.63, based upon the prior ten business day volume-weighted average price per share. Fractional shares were paid in cash.

Stock Warrants

Exercisable Warrants were exercisable upon issuance and expire August 12, 2014, if not exercised. Contingent Warrants became exercisable on November 9, 2009, and expire November 9, 2014, if not exercised. Prior to June 14, 2012, the warrants contained anti-dilution price protection in the event the Company issued shares of common stock or securities exercisable for, or convertible into, common stock at a price per share less than the warrants' exercise price. In accordance with these contractual anti-dilution price adjustment provisions, the warrants were re-priced as a result of a payment of a portion of the initial and deferred commitment fees related to the Company's term loan with common stock on March 31, 2010 and September 30, 2010.

Due to the anti-dilution price adjustment provisions established at the issuance date, the warrants were deemed to be a liability and were recorded at fair value at the date of issuance. The warrant liability was adjusted to fair value at the end of each reporting period through the statement of operations during the period the anti-dilution price adjustment provisions were in effect. On June 14, 2012, contractual provisions within the Company's Exercisable and Contingent Warrant agreements were modified to eliminate the anti-dilution price adjustment provisions of the warrants and remove the cash settlement provisions in the event of a change of control. The amended warrants now qualify to be classified as equity. Accordingly, the Company revalued the warrants as of June 14, 2012, the date of contractual amendment. The change in fair value of the warrant liability compared to the fair value on December 31, 2011, $2.6 million, was recognized in income during 2012. The revalued warrant liability of $14.0 million was reclassified to additional-paid-in-capital on June 14, 2012. There will no longer be fair value adjustments as long as the warrants continue to meet the criteria for equity classification.

The Company used the Black-Scholes option-pricing model to estimate the fair value of the warrant liability for each reporting period. On June 14, 2012, the date the warrants were amended, inputs into the fair value calculation included the actual remaining term of the warrants, a volatility rate of 58.1%, a risk-free rate of return of 0.36%, and an assumed dividend rate of zero.

At June 30, 2013, Exercisable and Contingent Warrants to purchase up to 1,539,250 shares of common stock at $1.21 per share remain outstanding.

Table of contents
FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED

Note 15 — Business Segment, Geographic and Major Customer Information
Segment Information
Operating segments are defined as components of an enterprise for which separate financial information is available that is regularly evaluated by chief operating decision-makers in deciding how to allocate resources and assess performance. With its acquisition of Florida Chemical Company, Inc. on May 10, 2013 (see Note 3), the Company added operations in a new segment, Non-energy Chemical Technologies. The operations of the Company are now categorized into four reportable segments: Chemical Technologies, Non-energy Chemical Technologies, Drilling Technologies and Artificial Lift Technologies.

- Chemical Technologies designs, develops, manufactures, packages and markets specialty chemicals, some of which hold patent protection, used in oil and gas well cementing, stimulation, acidizing, drilling and production. Activities in this segment also include construction and management of automated material handling facilities and management of loading facilities and blending operations for oilfield services companies.

- Non-energy Chemical Technologies designs, develops and manufactures products that are sold to companies in the flavor and fragrance industry and specialty chemical industry. These technologies are used by beverage and food companies, fragrance companies, and companies providing household and industrial cleaning products.

- Drilling Technologies rents, sells, inspects, manufactures and markets downhole drilling equipment used in energy, mining, water well and industrial drilling activities.
- Artificial Lift Technologies assembles and markets artificial lift equipment, including the Petrovalve product line of rod pump components, electric submersible pumps, gas separators, valves and services that support natural gas, oil and coal bed methane production activities.

The Company evaluates performance based upon a variety of criteria. The primary financial measure is segment operating income. Various functions, including certain sales and marketing activities and general and administrative activities, are provided centrally by the corporate office. Costs associated with corporate office functions, other corporate income and expense items, and income tax provisions (benefits), are not allocated to reportable segments.
Summarized financial information of the reportable segments is as follows (in thousands):

As of and for the three months ended June 30,	Chemical Technologies	Non-energy Chemical Technologies	Drilling Technologies	Artificial Lift Technologies	Corporate and Other	Total
2013						
Net revenue from external customers	$ 47,709	$ 12,675	$ 29,785	$ 3,417	$—	$93,586
Gross margin	20,586	3,693	12,455	860	—	37,594
Income (loss) from operations	14,729	2,347	5,782	330	(9,657)	13,531
Depreciation and amortization	809	252	2,415			