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 September 30, 2014

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	90-0023731
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
10603 W. Sam Houston Parkway N., Suite 300 Houston, TX	77064
(Address of principal executive offices)	(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	x	Accelerated filer	¨
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 October 16, 2014, there were 53,938,945 outstanding shares of Flotek Industries, Inc. common stock, $0.0001 par value.

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PART I — FINANCIAL INFORMATION

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

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$5,257	$2,730
Restricted cash	801	—
Accounts receivable, net of allowance for doubtful accounts of $645 and $872 at September 30, 2014 and December 31, 2013, respectively	69,253	65,016
Inventories, net	81,439	63,132
Deferred tax assets, net	2,840	2,522
Other current assets	9,622	4,261
Total current assets	169,212	137,661
Property and equipment, net	83,270	79,114
Goodwill	71,131	66,271
Deferred tax assets, net	14,090	15,012
Other intangible assets, net	74,715	77,523
TOTAL ASSETS	$412,418	$375,581
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$32,656	$19,899
Accrued liabilities	13,468	12,778
Income taxes payable	1,018	3,361
Interest payable	76	111
Current portion of long-term debt	11,367	26,415
Total current liabilities	58,585	62,564
Long-term debt, less current portion	30,184	35,690
Deferred tax liabilities, net	26,048	27,575
Total liabilities	114,817	125,829
Commitments and contingencies		
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; 60,487,085 shares issued and 53,938,945 shares outstanding at September 30, 2014; 58,265,911 shares issued and 51,804,078 shares outstanding at December 31, 2013	6	6
Additional paid-in capital	283,571	266,122
Accumulated other comprehensive income (loss)	(397)	(359)
Retained earnings (accumulated deficit)	36,489	(841)
Treasury stock, at cost; 5,699,845 and 5,394,178 shares at September 30, 2014 and December 31, 2013, respectively	(22,419)	(15,176)

Flotek Industries, Inc. stockholders' equity	297,250	249,752
Noncontrolling interests	351	—
Total equity	297,601	249,752
TOTAL LIABILITIES AND EQUITY	$412,418	$375,581

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenue	$116,761	$98,388	$324,653	$270,217
Cost of revenue	70,683	60,886	192,585	162,491
Gross margin	46,078	37,502	132,068	107,726
Expenses:				
Selling, general and administrative	21,499	19,542	63,924	58,640
Depreciation and amortization	2,439	2,038	7,225	5,231
Research and development	1,293	835	3,599	2,689
Total expenses	25,231	22,415	74,748	66,560
Income from operations	20,847	15,087	57,320	41,166
Other income (expense):				
Interest expense	(424)	(530)	(1,259)	(1,495)
Other income (expense), net	(87)	59	(306)	117
Total other income (expense)	(511)	(471)	(1,565)	(1,378)
Income before income taxes	20,336	14,616	55,755	39,788
Income tax expense	(6,064)	(5,648)	(18,425)	(14,615)
Net income	$14,272	$8,968	$37,330	$25,173
Earnings per common share:				
Basic earnings per common share	$0.26	$0.17	$0.69	$0.50
Diluted earnings per common share	$0.26	$0.16	$0.67	$0.47
Weighted average common shares:				
Weighted average common shares used in computing basic earnings per common share	54,789	52,742	54,464	50,819
Weighted average common shares used in computing diluted earnings per common share	55,690	55,317	55,536	53,407

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net income	$14,272	$8,968	$37,330	$25,173
Other comprehensive income (loss):				
Foreign currency translation adjustment	(67)	(22)	(38)	(179)
Unrealized gain on investments available for sale	—	5	—	18
Comprehensive income	$14,205	$8,951	$37,292	$25,012

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Nine months ended September 30, 2014	2013
Cash flows from operating activities:		
Net income	$37,330	$25,173
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,276	10,948
Amortization of deferred financing costs	257	65
Accretion of debt discount	—	55
Gain on sale of assets	(2,552)	(3,452)
Stock compensation expense	7,429	8,697
Deferred income tax provision (benefit)	237	(315)
Excess tax benefit related to share-based awards	(3,425)	(835)
Changes in current assets and liabilities:		
Restricted cash	(450)	150
Accounts receivable, net	(3,896)	(6,521)
Inventories	(18,035)	(2,055)
Other current assets	(4,957)	259
Accounts payable	12,617	(17,341)
Accrued liabilities	1,019	4,931
Income taxes payable	1,082	1,585
Interest payable	(35)	16
Net cash provided by operating activities	39,897	21,360
Cash flows from investing activities:		
Capital expenditures	(13,494)	(9,985)
Proceeds from sale of assets	3,322	4,595
Payments for acquisitions, net of cash acquired	(5,704)	(53,396)
Purchase of patents and other intangible assets	(780)	—
Net cash used in investing activities	(16,656)	(58,786)
Cash flows from financing activities:		
Repayments of indebtedness	(8,506)	(9,777)
Proceeds of borrowings	—	26,190
Borrowings on revolving credit facility	305,750	231,696
Repayments on revolving credit facility	(317,798)	(204,319)
Debt issuance costs	(256)	(1,207)
Issuance costs of preferred stock and detachable warrants	—	(200)
Excess tax benefit related to share-based awards	3,425	835
Acquisition of treasury stock related to share-based awards	(6,060)	(5,325)
Proceeds from sale of common stock	763	567
Proceeds from exercise of stock options	461	491
Proceeds from exercise of stock warrants	1,545	323
Net cash (used in) provided by financing activities	(20,676)	39,274
Effect of changes in exchange rates on cash and cash equivalents	(38)	(179)
Net increase in cash and cash equivalents	2,527	1,669

Cash and cash equivalents at the beginning of period	2,730	2,700
Cash and cash equivalents at the end of period	$5,257	$4,369

See accompanying Notes to Unaudited Consolidated Financial Statements.

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

	Common Stock		Treasury Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Non-controlling Interests	Total Equity
	Shares Issued	Par Value	Shares	Cost					
Balance, December 31, 2013	58,266	$6	5,394	$(15,176)	$266,122	$ (359)	$ (841)	$ —	$249,752
Net income	—	—	—	—	—	—	37,330	—	37,330
Other comprehensive income	—	—	—	—	—	(38)	—	—	(38)
Common stock issued under employee stock purchase plan	—	—	(27)	—	763	—	—	—	763
Common stock issued in payment of accrued liability	27	—	—	—	600	—	—	—	600
Stock warrants exercised	1,277	—	—	—	1,545	—	—	—	1,545
Stock options exercised	302	—	—	—	1,644	—	—	—	1,644
Stock surrendered for exercise of stock options	—	—	46	(1,183)	—	—	—	—	(1,183)
Restricted stock granted	516	—	—	—	—	—	—	—	—
Restricted stock forfeited	—	—	55	—	—	—	—	—	—
Treasury stock acquired related to tax withholding for share-based awards	—	—	232	(6,060)	—	—	—	—	(6,060)
Excess tax benefit related to share-based awards	—	—	—	—	3,425	—	—	—	3,425
Stock compensation expense	—	—	—	—	7,429	—	—	—	7,429
Investment in Flotek Gulf, LLC and Flotek Gulf Research, LLC	—	—	—	—	—	—	—	351	351
Stock issued in EOGA acquisition	94	—	—	—	1,894	—	—	—	1,894
	5	—	—	—	149	—	—	—	149

Stock issued in SiteLark acquisition									
Balance, September 30, 2014	60,487	$6	5,700	$(22,419)	$283,571	$ (397)	$ 36,489	$ 351	$297,601

See accompanying Notes to Unaudited Consolidated Financial Statements.

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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 supplier of energy chemicals and consumer and industrial chemicals and is a global developer and supplier of drilling, completion and production technologies and related services.

Flotek's strategic focus, and that of its diversified wholly-owned subsidiaries (collectively referred to as the "Company"), includes energy-related chemical technologies, drilling technologies, production technologies (previously referred to as artificial lift technologies), and consumer and industrial chemical technologies. Within energy technologies, the Company provides oilfield specialty chemicals and logistics, down-hole drilling tools and production-related 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 consumer and industrial chemical technologies, the Company provides products for the flavor and fragrance industry and the industrial chemical industry. Major customers include food and beverage 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, Colorado, Pennsylvania, Texas, Utah, Wyoming, the Netherlands, and the Middle East. Flotek's products are marketed both domestically and internationally, with international presence and/or representation 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, 2013 (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 on Flotek's website, www.flotekind.com. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results to be expected for the year ending December 31, 2014.

Omani Entities

In November 2013, the Company signed shareholder agreements with Tasneea Oil and Gas Technologies, LLC ("Tasneea"), an Omani Limited Liability Company, to form Omani based Flotek Gulf, LLC ("Flotek Gulf") and Flotek Gulf Research, LLC ("Flotek Gulf Research"). Flotek will own 55% of the outstanding shares and Tasneea will own 45% of the outstanding shares of both Flotek Gulf and Flotek Gulf Research. During September 2014, Flotek and Tasneea transferred initial capital of $0.4 million to form Flotek Gulf and $0.4 million to form Flotek Gulf Research. At September 30, 2014, the total initial capital transfers of $0.8 million are reported as restricted cash.

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.

Reclassifications

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

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FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 2 — Recent Accounting Pronouncements

(a) Application of New Accounting Standards

Effective January 1, 2014, the Company adopted the accounting guidance in Accounting Standards Update ("ASU") No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," which provides guidance for reporting unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The guidance requires an unrecognized tax benefit to be presented as a decrease in a deferred tax asset where a net operating loss, a similar tax loss, or a tax credit carryforward exists and certain criteria are met. Implementation of this standard did not have a material effect on the consolidated financial statements.

(b) New Accounting Requirements and Disclosures

In June 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-12, "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." The ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. The ASU is effective for annual reporting periods beginning after December 15, 2015, with early adoption permitted. The Company is evaluating the potential impacts of the new standard on its existing stock-based compensation plans.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." The ASU will supersede most of the existing revenue recognition requirements in U.S. GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which the Company expects to be entitled in exchange for transferring goods or services to a customer. The new standard also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The pronouncement is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period and is to be applied retrospectively, with early application not permitted. The Company is currently evaluating the impact the pronouncement will have on the consolidated financial statements and related disclosures.

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements and Property, Plant, and Equipment - Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," which amends the definition of a discontinued operation by raising the threshold for a disposal to qualify as discontinued operations. The ASU will also require entities to provide additional disclosures about discontinued operations as well as disposal transactions that do not meet the discontinued operations criteria. The pronouncement is effective prospectively for all disposals (except disposals classified as held for sale before the adoption date) of components initially classified as held for sale in periods beginning on or after December 15, 2014. Early adoption is permitted. The Company is currently evaluating this guidance and does not expect that adoption will have a material effect on the consolidated financial statements.

Note 3 — Acquisitions

On January 1, 2014, the Company acquired 100% of the membership interests in Eclipse IOR Services, LLC ("EOGA"), a leading Enhanced Oil Recovery ("EOR") design and injection firm, for $6.4 million in cash consideration and 94,354 shares of the Company's Common Stock. EOGA’s enhanced oil recovery processes and its use of polymers to improve the performance of EOR projects has been combined with the Company’s existing EOR products and services.

On April 1, 2014, the Company acquired 100% of the membership interests in SiteLark, LLC ("SiteLark") for $0.4 million and 5,327 shares of the Company's common stock. SiteLark provides reservoir engineering and modeling services for a variety of hydrocarbon applications. Its services include proprietary software which assists engineers with reservoir simulation, reservoir engineering and waterflood optimization.

As discussed in more detail in the Company's 2013 Annual Report, the Company acquired Florida Chemical Company, Inc. ("Florida Chemical") on May 10, 2013 for a total purchase price of $106.4 million. Florida Chemical is

one of the world's largest processors 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. This 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 acquisition expands the Company's business into consumer and industrial chemical technologies which provide products for the flavor and fragrance industry and the specialty chemical industry. These technologies are used by food and beverage companies, fragrance companies, and companies providing household and industrial cleaning products.

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FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

During the three months ended September 30, 2014, the Company identified and recorded a final adjustment related to the acquisition of Florida Chemical. Current deferred tax assets were increased by $1.2 million with a corresponding decrease to goodwill within the consumer and industrial chemical technologies reporting unit. This final adjustment was not significant relative to the total consideration paid for Florida Chemical and, therefore, the final adjustment has not been retrospectively applied to the Company's balance sheet as of December 31, 2013. This adjustment, if recorded in 2013, would have had no impact on the 2013 consolidated statements of operations and cash flows.

Note 4 — Supplemental Cash Flow Information

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

	Nine months ended September 30,	
	2014	2013
Supplemental non-cash investing and financing activities:		
Value of common stock issued in acquisitions	$2,043	$52,711
Final Florida Chemical acquisition adjustment	1,162	—
Value of common stock issued in payment of accrued liability	600	—
Equipment acquired through capital leases	—	866
Exercise of stock options by common stock surrender	1,183	2,979
Supplemental cash payment information:		
Interest paid	$1,038	$1,410
Income taxes paid	18,393	13,343

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 September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenue:				
Products	$92,708	$76,376	$257,415	$204,229
Rentals	16,966	15,375	45,954	46,794
Services	7,087	6,637	21,284	19,194
	$116,761	$98,388	$324,653	$270,217
Cost of revenue:				
Products	$57,315	$50,367	$155,048	$131,875
Rentals	8,272	6,868	22,444	17,666
Services	3,074	1,610	9,042	7,179
Depreciation	2,022	2,041	6,051	5,771
	$70,683	$60,886	$192,585	$162,491

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FLOTEK INDUSTRIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

	September 30, 2014	December 31, 2013
Raw materials	$29,681	$13,953
Work-in-process	2,880	1,904
Finished goods	51,026	50,019
Inventories	83,587	65,876
Less reserve for excess and obsolete inventory	(2,148)	(2,744)
Inventories, net	$81,439	$63,132

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

	September 30, 2014	December 31, 2013
Land	$5,852	$5,088
Buildings and leasehold improvements	32,695	32,269
Machinery, equipment and rental tools	78,839	71,073
Equipment in progress	6,771	4,601
Furniture and fixtures	2,499	2,400
Transportation equipment	6,168	6,340
Computer equipment and software	7,513	7,617
Property and equipment	140,337	129,388
Less accumulated depreciation	(57,067)	(50,274)
Property and equipment, net	$83,270	$79,114

Depreciation expense, including expense recorded in cost of revenue, totaled $3.3 million and $3.0 million for the three months ended September 30, 2014 and 2013, respectively, and $9.7 million and $8.4 million for the nine months ended September 30, 2014 and 2013, respectively.
Note 8 — Goodwill and Other Intangible Assets
During the nine months ended September 30, 2014, the Company recognized $6.0 million of goodwill within the Energy Chemical Technologies reporting unit in connection with the acquisitions of EOGA and SiteLark. During the three months ended September 30, 2014, the Company recorded a final adjustment related to the acquisition of Florida Chemical (see Note 3). There were no impairments of goodwill recognized during the three and nine months ended September 30, 2014 and 2013.
Changes in the carrying value of goodwill for each reporting unit are as follows (in thousands):

	Energy Chemical Technologies	Consumer and Industrial Chemical Technologies	Teledrift®	Total
Balance at December 31, 2013	$30,296	$20,642	$15,333	$66,271
Final Florida Chemical acquisition adjustment	—	(1,162)	—	(1,162)
Addition upon acquisition of EOGA	5,455	—	—	5,455
Addition upon acquisition of SiteLark	567	—	—	567
Balance at September 30, 2014	$36,318	$19,480	$15,333	$71,131

Finite lived intangible assets acquired are amortized on a straight-line basis over two to 20 years. Amortization of finite lived intangible assets acquired totaled $1.2 million and $1.3 million for the three months ended September 30, 2014 and 2013, respectively, and $3.6 million and $2.7 million for the nine months ended September 30, 2014 and

2013, respectively.

Amortization of deferred financing costs was $0.1 million and $0.3 million for the three and nine months ended September 30, 2014, respectively. Amortization of deferred financing costs was not significant for the three and nine months ended September 30, 2013.

Note 9 — Long-Term Debt and Credit Facility

Long-term debt is as follows (in thousands):

	September 30, 2014	December 31, 2013
Long-term debt:		
Term loan	$37,327	$45,833
Borrowings under revolving credit facility	4,224	16,272
Total long-term debt	41,551	62,105
Less current portion of long-term debt	(11,367)	(26,415)
Long-term debt, less current portion	$30,184	$35,690

Credit Facility

On May 10, 2013, the Company and certain of its subsidiaries (the “Borrowers”) entered into an Amended and Restated Revolving Credit, Term Loan 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 December 31, 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 real and personal property, including accounts receivable, inventory, land, buildings, 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.

The Credit Facility includes a provision that 25% of EBITDA minus cash paid for taxes, dividends, debt payments and unfunded capital expenditures, not to exceed $3.0 million for any year, be paid within 60 days of the fiscal year end. For the year ended December 31, 2013, the excess cash flow exceeded $3.0 million. Consequently, the Company paid $3.0 million on its term loan balance to PNC Bank on March 3, 2014. This amount is classified as current debt at December 31, 2013.

Each of the Company’s domestic subsidiaries is fully obligated for Credit Facility indebtedness as a Borrower or as a guarantor.

(a) Revolving Credit Facility

Under the revolving credit facility, the Company may borrow up to $75 million through May 10, 2018. 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.

At September 30, 2014, eligible accounts receivable and inventory securing the revolving credit facility provided availability of $74.8 million under the revolving credit facility. Available borrowing capacity, net of outstanding borrowings, was $70.6 million at September 30, 2014.

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 September 30, 2014. 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 September 30, 2014, $4.2 million was outstanding under the revolving credit facility, with $0.2 million borrowed as base rate loans at an interest rate of 3.75% and $4.0 million borrowed as LIBOR loans at an interest rate of 1.66%.

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

(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 land, buildings, 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 September 30, 2014, $37.3 million was outstanding under the term loan, with $0.3 million borrowed as base rate loans at an interest rate of 4.50% and $37.0 million borrowed as LIBOR loans at an interest rate of 2.41%.

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 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.

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 of 1933, as amended. 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.

During 2011 and 2012, the Borrower returned 1,360,442 shares 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.

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Note 10 — 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 conversion 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 9). 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.

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 nine months ended September 30, 2013, 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 nine months ended September 30, 2013, 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 September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net income - Basic and Diluted	$14,272	$8,968	$37,330	$25,173
Weighted average common shares outstanding - Basic	54,789	52,742	54,464	50,819
Assumed conversions:				
Incremental common shares from warrants	—	1,365	162	1,404
Incremental common shares from stock options	867	1,134	901	1,143
Incremental common shares from restricted stock units	34	76	9	41
Weighted average common shares outstanding - Diluted	55,690	55,317	55,536	53,407
Basic earnings per common share	$0.26	$0.17	$0.69	$0.50
Diluted earnings per common share	$0.26	$0.16	$0.67	$0.47

Note 11 — 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.

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Fair Value of Other Financial Instruments

The carrying amounts of certain financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate fair value due to the short-term nature of these accounts. The Company had no cash equivalents at September 30, 2014 or December 31, 2013.

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

	September 30, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Term loan	$37,327	$37,327	$45,833	$45,833
Borrowings under revolving credit facility	4,224	4,224	16,272	16,272

The carrying value of the term loan and borrowings under the revolving credit facility approximate their fair value because the interest rates are variable.

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 nine months ended September 30, 2014 and 2013.

Liabilities Measured at Fair Value on a Recurring Basis

At September 30, 2014 and December 31, 2013, no liabilities were required to be measured at fair value on a recurring basis. There were no transfers in or out of either Level 1 or Level 2 fair value measurements during the nine months ended September 30, 2014 and 2013 and the year ended December 31, 2013. During the nine months ended September 30, 2014 and 2013 and the year ended December 31, 2013, there were no transfers in or out of the Level 3 hierarchy.

Note 12 — 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 September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Federal statutory tax rate	35.0 %	35.0 %	35.0 %	35.0 %
State income taxes, net of federal benefit	1.8	3.6	2.1	3.2
Return to accrual adjustments	(4.9)	1.1	(1.8)	0.4
Domestic production activities deduction	(1.9)	(2.3)	(2.4)	(2.4)
Other	(0.2)	1.2	0.1	0.5
Effective income tax rate	29.8 %	38.6 %	33.0 %	36.7 %

Fluctuations in effective tax rates were historically impacted by permanent tax differences with no associated income tax impact and existing deferred tax asset valuation allowances. The return to accrual adjustments for the three and nine months ended September 30, 2014 include the effect of a decrease in deferred tax liabilities related to a change in state tax apportionment.

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Deferred taxes are presented in the balance sheets as follows (in thousands):

	September 30, 2014	December 31, 2013
Current deferred tax assets	$2,840	$2,522
Non-current deferred tax assets	14,090	15,012
Non-current deferred tax liabilities	(26,048)	(27,575)
Net deferred tax assets (liabilities)	$(9,118)	$(10,041)

During the three months ended September 30, 2014, the Company recorded a final adjustment related to the acquisition of Florida Chemical that increased current deferred tax assets by $1.2 million (see Note 3).

Note 13 — 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”).

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.

In February 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. Currently, the Company has no issued or outstanding shares of preferred stock.

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 then qualified 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 were no longer fair value adjustments because the warrants continued 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.

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On February 7, 2014, warrants were exercised to purchase 1,277,250 shares of the Company's common stock at $1.21 per share. The Company received cash proceeds of $1.5 million in connection with the warrants exercised. Following the exercise, the Company no longer had any outstanding warrants from its sale of preferred stock and warrants in August 2009.

Note 14 — 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. The operations of the Company are categorized into four reportable segments: Energy Chemical Technologies, Consumer and Industrial Chemical Technologies, Drilling Technologies and Production Technologies.

- Energy Chemical Technologies designs, develops, manufactures, packages and markets specialty chemicals used in oil and natural gas well drilling, cementing, completion, stimulation and production. In addition, the Company's chemistries are used in specialized enhanced and improved oil recovery markets. 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.
- Consumer and Industrial Chemical Technologies designs, develops and manufactures products that are sold to companies in the flavor and fragrance industries and the 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 down-hole drilling equipment used in energy, mining, water well and industrial drilling activities.
- Production Technologies assembles and markets production-related equipment, including the Petrovalve product line of rod pump components, electric submersible pumps, gas separators, valves and services that support natural gas and oil 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 taxes, 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 September 30,	Energy Chemical Technologies	Consumer and Industrial Chemical Technologies	Drilling Technologies	Production Technologies	Corporate and Other	Total
2014						
Net revenue from external customers	$ 68,181	$ 13,713	$ 29,920	$ 4,947	$—	$116,761
Gross margin	28,424	3,310	11,928	2,416	—	46,078
Income (loss) from operations	19,903	1,758	5,557	1,583	(7,954)	20,847
Depreciation and amortization	1,103	547	2,433	81	298	4,462
Total assets	144,738	89,574	142,774	18,252	17,080	412,418
Capital expenditures	2,580	7	818	141	703	4,249
2013						
Net revenue from external customers	$ 51,670	$ 15,292	$ 27,569	$ 3,857	$—	$98,388
Gross margin	21,849	3,588	10,821	1,244	—	37,502
Income (loss) from operations	16,247	2,301	4,309	769	(8,539)	15,087
Depreciation and amortization	932	382	2,438	60	213	4,025

Total assets	121,876	97,129	136,832	16,542	8,600	380,979
Capital expenditures	161	165	1,596	225	328	2,475

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As of and for the nine months ended September 30,	Energy Chemical Technologies	Consumer and Industrial Chemical Technologies	Drilling Technologies	Production Technologies	Corporate and Other	Total
2014						
Net revenue from external customers	$ 193,148	$ 39,351	$ 82,061	$ 10,093	$—	$324,653
Gross margin	85,074	10,237	32,477	4,280	—	132,068
Income (loss) from operations	60,690	5,064	13,073	1,925	(23,432)	57,320
Depreciation and amortization	3,264	1,529	7,363	244	876	13,276
Total assets	144,738	89,574	142,774	18,252	17,080	412,418
Capital expenditures	5,383	37	6,139	252	1,683	13,494
2013						
Net revenue from external customers	$ 144,029	$ 27,967	$ 86,268	$ 11,953	$—	$270,217
Gross margin	61,548	7,281	34,622	4,275	—	107,726
Income (loss) from operations	45,300	4,648	15,510	2,712	(27,004)	41,166
Depreciation and amortization	2,201	634	7,215	181	717	10,948
Total assets	121,876	97,129	136,832	16,542	8,600	380,979
Capital expenditures	3,077	165	4,066	1,669	1,008	9,985

Geographic Information

Revenue by country is based on the location where services are provided and products are used. No individual country other than the United States ("U.S.") accounted for more than 10% of revenue. Revenue by geographic location is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
U.S.	$92,643	$84,640	$271,663	$234,151
Other countries	24,118	13,748	52,990	36,066
Total	$116,761	$98,388	$324,653	$270,217

Long-lived assets held in countries other than the U.S. are not considered material to the consolidated financial statements.

Major Customers

One customer accounted for 12.7% and 15.5% of consolidated revenue for the three months ended September 30, 2014 and 2013, respectively, and 17.0% and 16.6% of consolidated revenue for the nine months ended September 30, 2014 and 2013, respectively. Over 93% of the revenue from this customer was for sales in the Energy Chemical Technologies segment.

Note 15 — Commitments and Contingencies

Litigation

The Company is subject to routine litigation and other claims that arise in the normal course of business. Management is not aware of any pending or threatened lawsuits or proceedings that are expected to have a material effect on the Company's financial position, results of operations or liquidity.

Representation Agreements

In February 2011, the Company entered into two separate representation agreements with Basin Supply Corporation ("Basin Supply"), a multinational, energy industry-focused supply chain management company, to market certain of the Company's specialty chemicals and down-hole drilling products and services within various international markets, including the Middle East, Africa, Latin America and the former Soviet Union. Both agreements are effective through

December 31, 2015. Under each agreement, Basin Supply is eligible to receive warrants to purchase Flotek common stock (at an exercise price of 125% of the price of Flotek's common stock on the grant date) upon exceeding contractually defined annual base and “stretch” sales targets. The number of warrants that could be issued under the terms of each of the agreements is 100,000 during 2014.

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Concentrations and Credit Risk

The majority of the Company’s revenue is derived from the oil and gas industry. Customers include major oilfield services companies, major integrated oil and natural gas companies, independent oil and natural gas companies, pressure pumping service companies and state-owned national oil companies. This concentration of customers in one industry increases credit and business risks.

The Company is subject to concentrations of credit risk within trade accounts receivable as the Company does not generally require collateral as support for trade receivables. In addition, the majority of the Company’s cash is maintained at one major financial institution and balances often exceed insurable amounts.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Quarterly Report on Form 10-Q (the "Quarterly Report"), and in particular, Part I, Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations," contains "forward-looking statements" within the meaning of the safe harbor provisions, 15 U.S.C. § 78u-5, of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Forward-looking statements are not historical facts, but instead represent the Company's current assumptions and beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside the Company's control. Such statements include estimates, projections, and statements related to Flotek Industries, Inc.'s ("Flotek" or the "Company") business plan, objectives, expected operating results and assumptions upon which those statements are based. The forward-looking statements contained in this Quarterly Report are based on information available as of the date of this Quarterly Report.

The forward-looking statements relate to future industry trends and economic conditions, forecast performance or results of current and future initiatives and the outcome of contingencies and other uncertainties that may have a significant impact on the Company's business, future operating results and liquidity. These forward-looking statements generally are identified by words including, but not limited to, "anticipate," "believe," "estimate," "continue," "intend," "expec "plan," "forecast," "project" and similar expressions, or future-tense or conditional constructions such as "will," "may," "shoul "could," etc. The Company cautions that these statements are merely predictions, and are not to be considered guarantees of future performance. Forward-looking statements are based upon current expectations and assumptions that are subject to risks and uncertainties that can cause actual results to differ materially from those projected, anticipated or implied.

A detailed discussion of potential risks and uncertainties that could cause actual results and events to differ materially from forward-looking statements is included in Part I, Item 1A - "Risk Factors" of the Annual Report on Form 10-K for the year ended December 31, 2013 (the "Annual Report") and periodically in subsequent reports filed with the Securities and Exchange Commission (the "SEC"). The Company has no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or future events, except as required by law.

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the unaudited consolidated financial statements and the related notes thereto, as well as the Annual Report. Phrases such as "Company," "we," "our" and "us" refer to Flotek Industries, Inc. and its subsidiaries.

Executive Summary

Flotek is a global diversified, technology-driven company that develops and supplies oilfield products, services and equipment to the oil, gas and mining industries, and high value compounds to companies that make cleaning products, cosmetics, food and beverages, and other products that are sold in the consumer and industrial markets.

The Company's oilfield businesses include specialty chemicals and logistics, down-hole drilling tools and production-related tools. Flotek's technologies enable customers to drill wells more efficiently, increase well production and decrease well operating costs. The Company also provides automated bulk material handling, loading facilities and blending capabilities. The Company sources citrus oil domestically and internationally and is one of the largest processors of citrus oil in the world. Products produced from processed citrus oil include (1) high value compounds used as additives by companies in the flavors and fragrances markets and (2) environmentally friendly chemicals for use in numerous industries around the world, specifically the oil and gas ("O&G") industry.

Flotek operates in over 20 domestic and international markets, including the Gulf Coast, Southwest, West Coast, Rocky Mountains, Northeastern and Mid-Continental regions of the United States (the "U.S."), Canada, Mexico, Central America, South America, Europe, Africa, Middle East, Australia and Asia-Pacific. Customers include major integrated O&G companies, oilfield services companies, independent O&G companies, pressure-pumping service companies, national and state-owned oil companies, and international supply chain management companies. The Company's Consumer and Industrial Chemical Technologies ("CICT") segment also serves customers who purchase non-energy-related citrus oil and related products, including household and commercial cleaning product companies, fragrance and cosmetic companies, and food manufacturing companies.

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The operations of the Company are categorized into four reportable segments: Energy Chemical Technologies, Consumer and Industrial Chemical Technologies, Drilling Technologies and Production Technologies (previously referred to as Artificial Lift Technologies).

- Energy Chemical Technologies designs, develops, manufactures, packages and markets specialty chemicals used in O&G well drilling, cementing, completion, stimulation and production. In addition, the Company's chemistries are used in specialized enhanced and improved oil recovery markets ("EOR" or "IOR"). 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.

- Consumer and Industrial Chemical Technologies designs, develops and manufactures products that are sold to companies in the flavor and fragrance industries and the 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 down-hole drilling equipment used in energy, mining, water well and industrial drilling activities.

- Production Technologies assembles and markets production-related equipment, including the Petrovalve product line of rod pump components, electric submersible pumps, gas separators, valves and services that support natural gas and oil production activities.

Market Conditions

The Company's success is sensitive to a number of factors, which include, but are not limited to, drilling activity, customer demand for its advanced technology products, market prices for raw materials and governmental actions.

Drilling activity levels are influenced by a number of factors, including the number of rigs in operation, the geographical areas of rig activity, and drill rig efficiency (rig days required per well). Additional factors that influence the level of drilling activity include:

- Historical, current, and anticipated future O&G prices,
- Federal, State and local governmental actions that may encourage or discourage drilling activity,
- Customers' strategies relative to capital funds allocations,
- Weather conditions, and
- Technological changes to drilling methods and economics.

Historical North American drilling activity is reflected in "TABLE A" on the following page.

Customers' demand for advanced technology products and services provided by the Company are dependent on their recognition of the value of:

- Chemistries that improve the economics of their O&G operations,
- Drilling products that improve drilling operations and efficiencies, and
- Chemistries that are economically viable, socially responsible and ecologically sound.

Market prices for citrus oils can be influenced by:

- Historical, current, and anticipated future production levels of the global citrus (primarily orange) crop,
- Weather related risks, and
- Health and condition of citrus trees (e.g., disease and pests).

Governmental actions may restrict the future use of hazardous chemicals, including but not limited to, the following industrial applications:

- O&G drilling and completion operations,

- O&G production operations, and
- Non-O&G industrial solvents.

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TABLE A

	Three months ended September 30,			Nine months ended September 30,		
	2014	2013	% Change	2014	2013	% Change
North American Average Active Drilling Rigs						
U.S.	1,903	1,770	7.5 %	1,845	1,763	4.7 %
Canada	386	350	10.3 %	370	349	6.0 %
Total Average North American Drilling Rigs	2,289	2,120	8.0 %	2,215	2,112	4.9 %
U.S. Average Active Drilling Rigs by Type						
Vertical	372	436	(14.7)%	385	443	(13.1)%
Horizontal	1,314	1,073	22.5 %	1,246	1,096	13.7 %
Directional	217	261	(16.9)%	214	224	(4.5)%
Total Average U.S. Drilling Rigs by Type	1,903	1,770	7.5 %	1,845	1,763	4.7 %
Oil vs. Natural Gas Average North American Drilling Rigs						
Oil	1,797	1,609	11.7 %	1,731	1,610	7.5 %
Natural Gas	492	511	(3.7)%	484	502	(3.6)%
Total North America	2,289	2,120	8.0 %	2,215	2,112	4.9 %
U.S. Average Wells Drilled per Quarter per Rig	5.19	5.31	(2.3)%	5.22	5.20	0.4 %

Source: Rig and well counts are per Baker Hughes, Inc. (www.bakerhughes.com). Rig counts are the averages of the weekly rig count activity. Average wells drilled per quarter per rig is the number of wells drilled in the reporting period divided by the average weekly rig count. Current quarter well count data from Baker Hughes, Inc. is preliminary and is subject to revision.

During the three and nine months ended September 30, 2014, total North American active drilling rig count saw an increase when compared to the comparable periods of 2013, primarily in oil drilling rigs. Average North American oil drilling rig activity increased by 11.7% and 7.5% for the three and nine months ended September 30, 2014, respectively, when compared to the same periods of 2013. North American natural gas drilling rig count decreased by 3.7% and 3.6% for the three and nine months ended September 30, 2014, respectively, compared to the same periods of 2013.

Overall U.S. rig activity increased 7.5% and 4.7% for the three and nine months ended September 30, 2014 compared to the same periods in 2013, and the number of wells drilled per rig per quarter held relatively constant for the nine months ended September 30, 2014 at 5.22 compared to 5.20 for the same period in 2013. For the three and nine months ended September 30, 2014, U.S. drilling rigs by type continued to show a shift toward horizontal wells and away from vertical and directional wells.

Company Outlook

Future economic conditions are expected to remain consistent with recent market conditions. Increases in drilling rig operating efficiencies noted above are resulting in pricing pressure on rig-based operations. To some extent, those pressures impact drilling suppliers such as Flotek, especially in our Drilling Technologies segment. Our tools are being leased for a smaller amount of time per well drilled, which is partially offset by the expansion in the number of wells being drilled per quarter per rig.

The Company is expanding its Energy Chemical Technologies and Drilling Technologies businesses by expanding its production capacity, developing innovative new products and pursuing and developing new market opportunities. The Company continues to reposition the Production Technologies segment to focus on niche technologies in the oil and natural gas markets. As a result of this repositioning, the Company plans to increase capital allocated to this segment. Capital expenditures, exclusive of acquisitions, totaled $13.5 million and $10.0 million for the nine months ended September 30, 2014 and 2013, respectively. The Company continues to pursue selected strategic acquisitions and

relationships, both domestically and internationally, when opportunities arise.

• In November 2013, the Company signed a shareholder agreement with Tasneea Oil and Gas Technologies, LLC ("Tasneea") an Omani Limited Liability Company, to form Omani based Flotek Gulf, LLC ("Flotek Gulf") and Flotek Gulf Research, LLC ("Flotek Gulf Research"). During the three months ended September 30, 2014, Flotek and Tasneea transferred initial capital into Flotek Gulf and Flotek Gulf Research. Flotek Gulf and Flotek Gulf Research will develop and market specialty chemistries for the oil and gas industry throughout the Middle East and North Africa. In the coming year, Flotek Gulf expects to construct a manufacturing facility designed to produce Flotek's patented and proprietary products for distribution throughout the region.

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- Effective January 1, 2014, the Company acquired Eclipse IOR Services, LLC (“EOGA”), a leading enhanced oil recovery (EOR) design and injection firm. EOGA’s expertise in enhanced oil recovery processes and the use of polymers to improve the performance of EOR projects has been combined with the Company’s existing EOR products and services. The combined product and service offerings are well positioned to serve the growing market for EOR products and services.
- On April 1, 2014, the Company acquired 100% of the membership interests in SiteLark, LLC (“SiteLark”) for $0.4 million and 5,327 shares of the Company's common stock. SiteLark provides reservoir engineering and modeling services for a variety of hydrocarbon applications. Its services include proprietary software which assists engineers with reservoir simulation, reservoir engineering and waterflood optimization.
- In May 2014, the Company launched its patent pending FracMax™ software technology. The FracMax™ application is an innovative software technology that allows the Company to quantitatively demonstrate the benefits associated with the use of the Company’s patented and proprietary Complex nano-Fluid® chemistries. The FracMax™ application has been integrated into the Company’s sales and marketing process leading to new sales opportunities. In October 2014, the Company announced the formation of FracMax Analytics, LLC, a wholly owned subsidiary that will use the FracMax™ software platform to provide customized data analysis to oil and gas operators, investors and other companies.

The Company believes governmental reaction to constituents’ environmental concerns regarding the hydraulic fracturing process and the use of hazardous chemicals in O&G operations could work to its advantage. These environmental concerns favor the Company's chemistries as economical replacements for more hazardous chemicals currently in use in many drilling and producing operations. Several states and countries have grass-roots, citizen movements that are aimed specifically at “greening” the hydraulic fracturing process, and management believes it is likely these environmental concerns/reactions will broaden to other states in the quarters to come.

The outlook for the Company’s consumer and industrial chemistries will be driven by availability and demand for citrus oils and other bio-based raw materials. Current inventory and crop expectations for 2014 and into 2015 are sufficient to meet the Company’s needs to supply its flavor and fragrance business as well as the industrial markets. However, market price volatility will likely result in revenue and margin fluctuations from quarter to quarter.

The Company works to maintain a portfolio of products which are adaptable to meet our customers’ demands for customized products for the various drilling and producing environments in which they operate. The Company's commitment to research and innovation permits the Company to remain responsive to increased demand and continued growth. The Company remains committed to continued development of its product technologies to better serve its customers' needs. The Company believes that it is well-positioned to respond to increased demand for the Company's suite of hydrocarbon stimulation and completion products, particularly the Company's patented Complex nano-Fluid™ chemistries. In addition, the Company anticipates continued strong demand for its Teledrift® Pro-series tool product lines and its recently introduced Stemulator® tool.

Changes to global geo-political and economic events could have an impact, either positive or negative, on the Company’s business. In the event of significant adverse changes to the demand for O&G production, the market conditions affecting the Company could change quickly and materially. Should such adverse changes to market conditions occur, management believes the Company has adequate liquidity to withstand the impact of such changes. In addition, management believes the Company is well-positioned to take advantage of significant increases in demand for its products should market conditions improve in the near term.

The Company expects that competition for contracts and margins will remain intense in the future but believes that product innovation, service improvements and quantitative data from its FracMax™ technology will enable the Company to realize market share gains during the remainder of 2014 and into 2015.

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Consolidated Results of Operations (in thousands):

	Three months ended September 30,				Nine months ended September 30,			
	2014		2013		2014		2013	
Revenue	$116,761		$98,388		$324,653		$270,217	
Cost of revenue	70,683		60,886		192,585		162,491	
Gross margin	46,078		37,502		132,068		107,726	
Gross margin %	39.5	%	38.1	%	40.7	%	39.9	%
Selling, general and administrative costs	21,499		19,542		63,924		58,640	
Selling, general and administrative costs %	18.4	%	19.9	%	19.7	%	21.7	%
Depreciation and amortization	2,439		2,038		7,225		5,231	
Research and development	1,293		835		3,599		2,689	
Income from operations	20,847		15,087		57,320		41,166	
Income from operations %	17.9	%	15.3	%	17.7	%	15.2	%
Interest and other expense, net	(511	)	(471	)	(1,565	)	(1,378	)
Income before income taxes	20,336		14,616		55,755		39,788	
Income tax expense	(6,064	)	(5,648	)	(18,425	)	(14,615	)
Net income	$14,272		$8,968		$37,330		$25,173	
Net income %	12.2	%	9.1	%	11.5	%	9.3	%

Consolidated Results of Operations: Three and Nine Months Ended September 30, 2014 Compared to the Three and Nine Months Ended September 30, 2013

Consolidated revenue for the three and nine months ended September 30, 2014 increased $18.4 million, or 18.7%, and $54.4 million, or 20.1%, respectively, relative to the comparable periods of 2013. The increase in revenue for the three months ended September 30, 2014 compared to the same period of 2013 was primarily due to increased sales of stimulation chemical additives in our Energy Chemical Technologies segment, increased actuated tool and Teledrift® tool rentals in our Drilling Technologies segment, and increased international valve and valve equipment sales in our Production Technologies segment. The increase in revenue for the nine months ended September 30, 2014 compared to the same period of 2013 was primarily due to increased sales of stimulation chemical additives in our Energy Chemical Technologies segment, the acquisition of Florida Chemical in the second quarter of 2013, and incremental revenue from the 2014 acquisitions of EOGA and SiteLark. These increases were partially offset by revenue declines in the Drilling Technologies and Production Technologies segments.

Consolidated gross margin for the three and nine months ended September 30, 2014 increased $8.6 million, or 22.9%, and $24.3 million, or 22.6%, respectively, relative to the comparable periods of 2013. The increase in gross margin was primarily due to the increase in revenue. Gross margin as a percentage of revenue increased to 39.5% for the three months ended September 30, 2014 from 38.1% in the same period of 2013, primarily due to increased international sales in our Production Technologies segment. Gross margin as a percentage of revenue increased to 40.7% for the nine months ended September 30, 2014 from 39.9% in the same period of 2013, primarily attributable to supply chain benefits from the Florida Chemical acquisition, partially offset by the change in portfolio mix resulting from the inclusion of Florida Chemical in the consolidated results for the nine months ended September 30, 2014.

Selling, general and administrative (“SG&A”) expenses are not directly attributable to products sold or services provided. SG&A costs as a percentage of revenue declined from 19.9% to 18.4% for the three months ended September 30, 2014 and from 21.7% to 19.7% for the nine months ended September 30, 2014 as compared to the same periods of 2013, as revenues grew faster than SG&A costs. SG&A costs increased $2.0 million, or 10.0%, for the three months ended September 30, 2014 as compared to the same period of 2013, primarily due to costs for additional headcount to support the Company's growth and costs attributable to the companies we acquired. SG&A costs increased $5.3 million, or 9.0%, for the nine months ended September 30, 2014, compared to the same period of

2013 primarily due to SG&A costs for the acquired companies discussed above.
Depreciation and amortization expense for the three and nine months ended September 30, 2014 increased by $0.4 million, or 19.7%, and $2.0 million, or 38.1%, respectively, relative to the comparable periods of 2013. The increase for the nine months

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ended September 30, 2014 was primarily attributable to the depreciation and amortization of assets recognized as part of the acquisition of Florida Chemical in the second quarter of 2013 and the acquisition of EOGA in the first quarter of 2014.
Research and Development ("R&D") expense increased $0.5 million, or 54.9%, and $0.9 million, or 33.8%, for the three and nine months ended September 30, 2014, respectively, as compared to the same periods in 2013. The increase in R&D is primarily attributable to new product development and Flotek's commitment to remaining responsive to customer needs, increased demand and continued growth of our existing product lines.
Interest and other expense remained relatively flat for the three and nine months ended September 30, 2014 as compared to the same periods of 2013.
The Company recorded income tax provisions of $6.1 million and $18.4 million, yielding effective tax rates of 29.8% and 33.0% for the three and nine months ended September 30, 2014, respectively, compared to income tax provisions of $5.6 million and $14.6 million reflecting effective tax rates of 38.6% and 36.7% for the comparable periods in 2013.
Results by Segment
Energy Chemical Technologies (dollars in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenue	$68,181	$51,670	$193,148	$144,029
Gross margin	28,424	21,849	85,074	61,548
Gross margin %	41.7 %	42.3 %	44.0 %	42.7 %
Income from operations	19,903	16,247	60,690	45,300
Income from operations %	29.2 %	31.4 %	31.4 %	31.5 %

Energy Chemical Technologies Results of Operations: Three and Nine Months Ended September 30, 2014 Compared to the Three and Nine Months Ended September 30, 2013
Energy Chemical Technologies revenue for the three months ended September 30, 2014 increased $16.5 million, or 32.0%, relative to the comparable period of 2013. Excluding the incremental revenue impact of the EOGA and SiteLark acquisitions of $1.5 million, revenue increased $15.0 million, or 29.1%, for the three months ended September 30, 2014 compared to the same period of 2013. Increased sales of stimulation chemical additives accounted for the majority of the revenue increase. Revenue for the nine months ended September 30, 2014 increased $49.1 million, or 34.1%, relative to the comparable period of 2013. Excluding the incremental revenue impact of the Florida Chemical, EOGA and SiteLark acquisitions of $9.4 million, revenue increased $39.7 million, or 28.6%, compared to the same period of 2013, primarily due to the increased sales of stimulation chemical additives mentioned above.
Energy Chemical Technologies gross margin increased $6.6 million, or 30.1%, and $23.5 million, or 38.2%, for the three and nine months ended September 30, 2014, respectively, compared to the same periods of 2013 primarily due to the increase in product sales revenue. Gross margin as a percentage of revenue decreased to 41.7% for the three months ended September 30, 2014 from 42.3% in the same period of 2013, primarily due to a new incentive pricing structure, increased logistics costs and inventory adjustments during 2014, partially offset by improved margins for xylene replacement products, expanded markets for CnF® and productivity improvements in the manufacturing process. Gross margin as a percentage of revenue increased to 44.0% for the nine months ended September 30, 2014 from 42.7% in the same period of 2013, primarily due to the supply chain benefits of the Florida Chemical acquisition.
Income from operations for the Energy Chemical Technologies segment increased $3.7 million, or 22.5%, for the three months ended September 30, 2014, and increased $15.4 million, or 34.0%, for the nine months ended September 30, 2014 relative to the comparable periods of 2013. The increase in income from operations for both periods is primarily attributable to an increase in gross margin, partially offset by increased headcount, travel and associated costs related to the pursuit of growth opportunities.

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Consumer and Industrial Chemical Technologies (dollars in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenue	$13,713	$15,292	$39,351	$27,967
Gross margin	3,310	3,588	10,237	7,281
Gross margin %	24.1 %	23.5 %	26.0 %	26.0 %
Income from operations	1,758	2,301	5,064	4,648
Income from operations %	12.8 %	15.0 %	12.9 %	16.6 %

CICT Results of Operations: Three and Nine Months Ended September 30, 2014 Compared to the Three and Nine Months Ended September 30, 2013

CICT revenue for the three months ended September 30, 2014 decreased $1.6 million, or 10.3%, compared to the same period in 2013, primarily due to decreased terpene sales between the two periods. Revenue for the nine months ended September 30, 2014 increased $11.4 million, or 40.7%, from the comparable period of 2013, as the segment was created in the second quarter of 2013 upon the acquisition of Florida Chemical.

CICT gross margin for the three months ended September 30, 2014 decreased $0.3 million, or 7.7%, from the comparable period of 2013, primarily due to the lower terpene sales mentioned above. Gross margin for the nine months ended September 30, 2014 increased $3.0 million, or 40.6%, from the comparable period of 2013, primarily due to the segment being created in the second quarter of 2013 upon the acquisition of Florida Chemical. Gross margin as a percentage of revenue increased to 24.1% for the three months ended September 30, 2014 from 23.5% in the same period of 2013, primarily due to increased sales of higher margin flavor and fragrance products. Gross margin as a percentage of revenue remained flat at 26.0% for the nine months ended September 30, 2014 as compared to the same period of 2013.

Income from operations for the CICT segment decreased $0.5 million, or 23.6%, for the three months ended September 30, 2014 compared to the same period of 2013, primarily due to the revenue and gross margin factors described above. Income from operations increased $0.4 million, or 9.0%, for the nine months ended September 30, 2014 compared to the same period of 2013, primarily due to the increased revenue between the two periods.

Drilling Technologies (dollars in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenue	$29,920	$27,569	$82,061	$86,268
Gross margin	11,928	10,821	32,477	34,622
Gross margin %	39.9 %	39.3 %	39.6 %	40.1 %
Income from operations	5,557	4,309	13,073	15,510
Income from operations %	18.6 %	15.6 %	15.9 %	18.0 %

Drilling Technologies Results of Operations: Three and Nine Months Ended September 30, 2014 Compared to the Three and Nine Months Ended September 30, 2013

Drilling Technologies revenue for the three months ended September 30, 2014 increased $2.4 million, or 8.5%, relative to the same period in 2013, primarily due to an increase in actuated tool rentals, Teledrift® tool rentals, and increases in float equipment product sales. Revenue for the nine months ended September 30, 2014 decreased $4.2 million, or 4.9%, relative to the same period in 2013, primarily due to a decrease in Teledrift® domestic rental revenue, decreased international drill pipe sales, and decreased non-actuated tool rentals.

- Rental revenue for the three months ended September 30, 2014 increased $1.7 million, or 10.9%, compared to the same period of 2013. This increase can be attributed to an 45.2% increase in actuated tool rental revenue in the Bakken and a 22.9% increase in international Teledrift® tool rentals. Rental revenue for the nine months ended

September 30, 2014 decreased by $0.9 million, or 1.9%, compared to the same period of 2013. This decline is due to a 5.1% decrease in Teledrift® domestic tool rental revenue attributed to competitive pricing pressure and decreasing vertical rig counts,

partially offset by an increase of 11.8% in actuated tool and Stemulator® tool rentals for the nine months ended September 30, 2014 as compared to the same period of 2013.

- Product sales revenue for the three months ended September 30, 2014 compared to the same period of 2013 increased by $0.9 million, or 9.9%, due to increased float and centralizer equipment sales. Product revenue for the nine months ended September 30, 2014 decreased by $2.8 million, or 9.8%, relative to the same period in 2013, primarily due to decreased international drill pipe sales for the mining industry and decreased domestic motor sales.

- Service revenue for the three and nine months ended September 30, 2014 decreased $0.2 million, or 4.7%, and $0.5 million, or 4.6%, respectively, relative to comparable periods of 2013. The decrease in service revenue was primarily related to decreased rig service jobs and inspections.

Drilling Technologies gross margin for the three months ended September 30, 2014 increased $1.1 million, or 10.2%, from the comparable period of 2013, primarily due to the revenue factors mentioned above and a 5.4% decrease in direct costs, due to lower employee-related compensation costs. Drilling Technologies gross margin for the nine months ended September 30, 2014 decreased $2.1 million, or 6.2%, due to the reduction in revenue and increased Teledrift® repair expenses. Gross margin as a percentage of revenue remained relatively flat for the three and nine months ended September 30, 2014.

Drilling Technologies income from operations for the three months ended September 30, 2014 increased by $1.2 million, or 29.0%, as compared to the same period of 2013. Income from operations as a percentage of revenue increased to 18.6% for the three months ended September 30, 2014, up from 15.6% for the same period of 2013. These increases are primarily due to reductions in direct costs, increased rental activity, and increased product sales. Drilling Technologies income from operations for the nine months ended September 30, 2014 decreased by $2.4 million, or 15.7%, over the same period of 2013. Income from operations as a percentage of revenue decreased to 15.9% for the nine months ended September 30, 2014, down from 18.0% for the same period of 2013. These decreases are primarily due to the decreased revenue explained above and increased Teledrift® repair expenses.

Production Technologies (dollars in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenue	$4,947	$3,857	$10,093	$11,953
Gross margin	2,416	1,244	4,280	4,275
Gross margin %	48.8 %	32.3 %	42.4 %	35.8 %
Income from operations	1,583	769	1,925	2,712
Income from operations %	32.0 %	19.9 %	19.1 %	22.7 %

Production Technologies Results of Operations: Three and Nine Months Ended September 30, 2014 Compared to the Three and Nine Months Ended September 30, 2013

Revenue for the Production Technologies segment for the three months ended September 30, 2014 increased by $1.1 million, or 28.3%, from the same period in 2013 due to increased sales of international valves, valve equipment, and domestic hydraulic lifting units. For the nine months ended September 30, 2014, revenue decreased by $1.9 million, or 15.6%, relative to the same period in 2013 as sales of pumps and pump equipment declined.

Production Technologies gross margin increased by $1.2 million, or 94.2%, for the three months ended September 30, 2014 as compared to the same period in 2013, and gross margin as a percentage of revenue increased to 48.8% for the three months ended September 30, 2014 from 32.3% for the same period in 2013. These increases are due to product mix from increased international Petrovalve sales and decreased domestic rod pump component sales. Gross margin was flat for the nine months ended September 30, 2014, but gross margin as a percentage of revenue increased to 42.4%, compared to 35.8% for the same period in 2013, primarily due to the higher margins associated with the

international valve sales and improving margins on pump equipment.

Income from operations increased by $0.8 million, or 105.9%, for the three months ended September 30, 2014 compared to the same period in 2013, due to product mix. Income from operations decreased by $0.8 million, or 29.0%, for the nine months ended September 30, 2014 compared to the same period in 2013, primarily due to decreases in sales and increases in SG&A costs attributable to employee-related expenses as the segment continues to refocus and reposition for growth in the market.

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Off-Balance Sheet Arrangements

There have been no transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as “structured finance” or “special purpose entities” (“SPEs”), established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 30, 2014, the Company was not involved in any unconsolidated SPEs.

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 would be material to investors.

Critical Accounting Policies and Estimates

The Company’s Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Preparation of these statements requires management to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and accompanying footnotes. Part II, Item 8, Financial Statements and Supplementary Data, Note 2 of "Notes to Unaudited Consolidated Financial Statements" and Part II, Item 7, Management’s Discussion and Analysis of Financial Conditions and Results of Operations, “Critical Accounting Policies and Estimates” of the Company’s Annual Report, and the “Notes to Unaudited Consolidated Financial Statements” of this Quarterly Report describe the significant accounting policies and critical accounting estimates used to prepare the consolidated financial statements. Critical accounting policies and estimates are defined as those that are both most important to the portrayal of the Company’s financial condition and results of operations and require management’s most subjective judgments. The Company regularly reviews and challenges judgments, assumptions and estimates related to critical accounting policies. The Company’s estimates and assumptions are based on historical experience and expected changes in the business environment; however, actual results may materially differ from the estimates.

As part of the acquisition process the Company reaffirmed policies and estimates surrounding business combination in accordance with GAAP, specifically, utilizing the guidance of Accounting Standards Codification ("ASC") Topic 805, formerly Statement of Financial Accounting Standards ("SFAS") No. 141R, as amended by FSP SAFAS No. 141(R)-1 which became effective on January 1, 2009. ASC Topic 805 requires an acquiring entity in a transaction to recognize all of the identifiable assets acquired and liabilities assumed at fair value at the acquisition date at their estimated fair values on the acquisition date, to recognize and measure pre-acquisition contingencies, including contingent consideration, at fair value (if possible), to remeasure liabilities related to contingent consideration at fair value in each subsequent reporting period and to expense all acquisition relates costs. Though the Company has implemented business combination accounting guidance, there have been no significant changes in the Company’s critical accounting estimates during the nine months ended September 30, 2014.

Application of New Accounting Standards

Effective January 1, 2014, the Company adopted the accounting guidance in Accounting Standards Update ("ASU") No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," which provides guidance for reporting unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The guidance requires an unrecognized tax benefit to be presented as a decrease in a deferred tax asset where a net operating loss, a similar tax loss, or a tax credit carryforward exists and certain criteria are met. Implementation of this standard did not have a material effect on the consolidated financial statements.

New Accounting Requirements and Disclosures

In June 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-12, "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." The ASU requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. The ASU is effective for annual reporting periods beginning after December 15, 2015, with early adoption permitted. The Company is evaluating the potential impacts

of the new standard on its existing stock-based compensation plans.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." The ASU will supersede most of the existing revenue recognition requirements in U.S. GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which the Company expects to be entitled in exchange for transferring goods or services to a customer. The new standard also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The

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pronouncement is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period and is to be applied retrospectively, with early application not permitted. The Company is currently evaluating the impact the pronouncement will have on the consolidated financial statements and related disclosures.

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements and Property, Plant, and Equipment - Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," which amends the definition of a discontinued operation by raising the threshold for a disposal to qualify as discontinued operations. The ASU will also require entities to provide additional disclosures about discontinued operations as well as disposal transactions that do not meet the discontinued operations criteria. The pronouncement is effective prospectively for all disposals (except disposals classified as held for sale before the adoption date) of components initially classified as held for sale in periods beginning on or after December 15, 2014. Early adoption is permitted. The Company is currently evaluating this guidance and does not expect that adoption will have a material effect on the consolidated financial statements.

Capital Resources and Liquidity

Overview

Ongoing capital requirements arise from the Company’s need to service debt, acquire and maintain equipment, and fund working capital requirements. During the first nine months of 2014, the Company funded capital requirements primarily with operating cash flows.

The Company's primary source of debt financing is its Revolving Credit Facility with PNC Bank. This credit facility contains provisions for revolving debt of up to $75.0 million, based on a borrowing base supported by accounts receivable and inventory, and a term loan of $50.0 million. As of September 30, 2014, the Company had $4.2 million in outstanding borrowings under the revolving debt portion of the credit facility and $37.3 million outstanding under the term loan. At September 30, 2014, the Company was in compliance with all debt covenants. Significant terms of the Company’s credit facility are discussed in Part I, Item 1 — "Financial Statements" in Note 9 of "Notes to Unaudited Consolidated Financial Statements" in this Quarterly Report.

Cash and cash equivalents totaled $5.3 million at September 30, 2014. During the first nine months of 2014, the Company generated $39.9 million of cash inflows from operations, net of $12.7 million expended in working capital. The Company used $16.7 million of net cash in investing activities, including $13.5 million for capital expenditures and $5.7 million, net of cash acquired, for the purchase of EOGA and SiteLark, partially offset by proceeds of $3.3 million from the sale of assets. Net cash used in financing activities totaled $20.7 million. The Company repaid net draws and term loans on the amended Credit Facility of $12.0 million and $8.5 million, respectively. Additionally, the Company paid $6.1 million in purchases of treasury stock for tax withholding purposes related to vesting of restricted stock awards.

Cash Flows

Consolidated cash flows by type of activity are noted below (in thousands):

	Nine months ended September 30,	
	2014	2013
Net cash provided by operating activities	$39,897	$21,360
Net cash used in investing activities	(16,656)	(58,786)
Net cash provided by financing activities	(20,676)	39,274
Effect of changes in exchange rates on cash and cash equivalents	(38)	(179)
Net increase (decrease) in cash and cash equivalents	$2,527	$1,669

Operating Activities

Net cash provided by operating activities was $39.9 million and $21.4 million during the nine months ended September 30, 2014 and 2013, respectively. Consolidated net income for the nine months ended September 30, 2014 totaled $37.3 million, compared to consolidated net income of $25.2 million for the nine months ended September 30, 2013.

During the nine months ended September 30, 2014, net non-cash contributions to net income totaled $15.2 million. Contributory non-cash items consisted of $13.5 million for depreciation and amortization, $7.4 million for stock-based compensation expense and $0.2 million for net decreases in deferred income taxes. Non-cash reductions to net income included $2.6 million for net gains on asset disposals, $3.4 million for recognized incremental tax benefits related to the Company's share based awards.

During the nine months ended September 30, 2013, net non-cash contributions to net income totaled $15.2 million, primarily consisting of $8.7 million for stock compensation expense and $11.0 million for depreciation and amortization, partially offset by $3.5 million for net gain on sale of assets, $0.3 million for deferred income taxes, and $0.8 million recognized incremental tax benefits related to the Company’s share based awards.
During the nine months ended September 30, 2014, net working capital was reduced by $12.7 million. Working capital was used to increase inventory by $18.0 million, increase other current assets by $5.0 million, and increase accounts receivable by $3.9 million. The reductions to working capital were partially offset by increased accounts payable of $12.6 million, increased income taxes payable of $1.1 million, and increased accrued liabilities by $1.0 million.
During the nine months ended September 30, 2013, net working capital was reduced by $19.0 million. Working capital was primarily used to decrease accounts payable by $17.3 million, increase inventories by $2.1 million, increase accounts receivable by $6.5 million, partially offset by a decrease in other current assets of $0.3 million, increase income taxes payable of $1.6 million, and an increase in accrued liabilities of $4.9 million.
Investing Activities
Net cash used in investing activities was $16.7 million for the nine months ended September 30, 2014. Cash used by investing activities in 2014 were for capital expenditures of $13.5 million and net cash payments for the acquisitions of EOGA, SiteLark, and various patents of $6.5 million, partially offset by $3.3 million for proceeds received from the sale of fixed assets.
Net cash used in investing activities was $58.8 million for the nine months ended September 30, 2013. Cash used by investing activities in 2013 were for the acquisition of Florida Chemical in the second quarter of 2013 for $53.4 million and capital expenditures of $10.0 million, partially offset by $4.6 million for proceeds received from the sale of fixed assets.
Financing Activities
Net cash used by financing activities was $20.7 million for the nine months ended September 30, 2014. Cash used by financing activities was primarily due to $20.6 million for repayments of debt, net of borrowings, $6.1 million for purchases of treasury stock for tax withholding purposes related to vesting of restricted stock awards, and debt issuance costs of $0.3 million. Cash used by financing activities was partially offset by proceeds from the exercise of stock warrants of $1.5 million, proceeds from the excess tax benefit related to stock-based compensation of $3.4 million, proceeds from the sale of common stock of $0.8 million and proceeds from the exercise of stock options of $0.5 million.
During the nine months ended September 30, 2013, financing activities provided net cash of $39.3 million. Financing activities included proceeds from borrowings, net of repayments of debt, of $43.8 million, proceeds from the excess tax benefit related to stock-based compensation of $0.8 million, proceeds from the sale of common stock of $0.6 million, and proceeds from the exercise of stock options of $0.5 million. Cash provided by financing activities was partially offset by purchases of treasury stock of $5.3 million and debt issuance costs of $1.2 million.
Although the Company has no immediate intention to access the capital markets, the Company intends to file a "universal" shelf registration with the Securities and Exchange Commission in the future. This shelf registration statement will register the issuance and sale from time to time of various securities by the Company, including but not limited to senior notes, subordinated notes, preferred stock, common stock, and warrants. Once this shelf registration statement is filed with the Securities and Exchange Commission and becomes effective, the Company will have the financial flexibility to access the capital markets quickly and efficiently from time to time as the need may arise.
Contractual Obligations
Cash flows from operations are dependent on a variety of factors, including fluctuations in operating results, accounts receivable collections, inventory management, and the timing of payments for goods and services. Correspondingly, the impact of contractual obligations on the Company’s liquidity and capital resources in future periods is analyzed in conjunction with such factors.

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Material contractual obligations consist of repayment of amounts borrowed on the Company's Credit Facility with PNC Bank and payment of operating lease obligations. Contractual obligations at September 30, 2014 are as follows (in thousands):

	Payments Due by Period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Term loan	$37,327	$7,143	$14,286	$15,898	$—
Interest expense on term loan (1)	3,887	1,330	2,101	456	—
Borrowings under revolving credit facility (2)	4,224	4,224	—	—	—
Operating lease obligations	25,247	2,123	4,962	3,843	14,319
Total	$70,685	$14,820	$21,349	$20,197	$14,319

(1) Interest expense amounts assume interest rates on this variable rate obligation remain unchanged from September 30, 2014 rates. The weighted-average interest rate is 2.43% at September 30, 2014.
(2) The borrowing is classified as current debt. The weighted-average interest rate is 1.77% at September 30, 2014.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to market risk from changes in interest rates and, to a limited extent, commodity prices and foreign currency exchange rates. There have been no material changes to the quantitative or qualitative disclosures about market risk set forth in Part II, Item 7A of the Company’s Annual Report.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in reports filed or submitted 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 SEC's rules and forms. The Company's disclosure controls and procedures are also designed to ensure such information is accumulated and communicated to management, including the principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance that control objectives are attained. The Company's disclosure controls and procedures are designed to provide such reasonable assurance.

The Company's management, with the participation of the principal executive and principal financial officers, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2014, as required by Rule 13a-15(e) of the Exchange Act. Based upon that evaluation, the principal executive and principal financial officers have concluded that the Company’s disclosure controls and procedures were effective as of September 30, 2014.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's system of internal control over financial reporting during the three months ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to routine litigation and other claims that arise in the normal course of business. Management is not aware of any pending or threatened lawsuits or proceedings that are expected to have a material effect on the Company’s financial position, results of operations or liquidity.

Item 1A. Risk Factors

There have been no material changes to the risk factors set forth in Part I, Item 1A of the Company’s Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

Repurchases of the Company's equity securities during the three months ended September 30, 2014 are as follows:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs (2)
July 1, 2014 to July 31, 2014	1,777	$33.44	—	$25,000,000
August 1, 2014 to August 31, 2014	7,051	$27.91	—	$25,000,000
September 1, 2014 to September 30, 2014	326	$27.20	—	$25,000,000
Total	9,154	$—	—	

(1) The Company purchased shares of its common stock (a) to satisfy tax withholding requirements and payment remittance obligations related to period vesting of restricted shares and exercise of non-qualified stock options, and (b) to satisfy payments required for common stock upon the exercise of stock options.

(2) In November 2012, the Company's Board of Directors authorized the repurchase of up to $25 million of the Company's common stock. Repurchases may be made in open market or privately negotiated transactions. Through September 30, 2014, the Company has not repurchased any of its common stock and $25 million may yet be used to purchase shares.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Number		Description of Exhibit
3.1		Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Form 10-Q for the quarter ended September 30, 2007).
3.2		Certificate of Designations for Series A Cumulative Convertible Preferred Stock dated August 11, 2009 (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed on August 17, 2009).
3.3		Certificate of Amendment to the Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Form 10-Q for the quarter ended September 30, 2009).
3.4		Bylaws (incorporated by reference to Appendix F to the Company's Definitive Proxy Statement filed on September 27, 2001).
4.1		Form of Certificate of Common Stock (incorporated by reference to Appendix E to the Company's Definitive Proxy Statement filed on September 27, 2001).
4.2		Form of Certificate of Series A Cumulative Convertible Preferred Stock (incorporated by reference to Exhibit A to the Certificate of Designations for Series A Cumulative Convertible Preferred Stock filed as Exhibit 3.1 to the Company's Form 8-K filed on August 17, 2009).
4.3		Form of Warrant to Purchase Common Stock of the Company, dated August 31, 2000 (incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form SB-2 (File No. 333-129308) filed on October 28, 2005).
4.4		Form of Exercisable Warrant, dated August 11, 2009 (incorporated by reference to Exhibit 4.1 to the Company's Form 8-K filed on August 17, 2009).
4.5		Form of Contingent Warrant, dated August 11, 2009 (incorporated by reference to Exhibit 4.2 to the Company's Form 8-K filed on August 17, 2009).
4.6		Amendment to Warrant to Purchase Common Stock, dated as of June 14, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on June 18, 2012).
4.7		Amendment to Amended and Restated Warrant to Purchase Common Stock, dated as of February 5, 2014 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on February 11, 2014).
31.1	*	Rule 13a-14(a) Certification of Principal Executive Officer.
31.2	*	Rule 13a-14(a) Certification of Principal Financial Officer.
32.1	*	Section 1350 Certification of Principal Executive Officer.
32.2	*	Section 1350 Certification of Principal Financial Officer.
101.INS	**	XBRL Instance Document.
101.SCH	**	XBRL Schema Document.
101.CAL	**	XBRL Calculation Linkbase Document.
101.LAB	**	XBRL Label Linkbase Document.
101.PRE	**	XBRL Presentation Linkbase Document.
101.DEF	**	XBRL Definition Linkbase Document.

*	Filed herewith.
**	Furnished with this Form 10-Q, not filed.

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SIGNATURES

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

FLOTEK INDUSTRIES, INC.

By: /s/ JOHN W. CHISHOLM
John W. Chisholm
President, Chief Executive Officer and
Chairman of the Board

Date: October 22, 2014

FLOTEK INDUSTRIES, INC.

By: /s/ H. RICHARD WALTON
H. Richard Walton
Executive Vice President and
Chief Financial Officer

Date: October 22, 2014