FLOTEK INDUSTRIES INC/CN/
Form 10-K
March 07, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

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.)**

2930 W. Sam Houston Parkway N. #300

Houston, TX	**77043**
(Address of principal executive offices)	**(Zip Code)**

(713) 849-9911

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $0.0001 par value	**New York Stock Exchange, Inc.**
5.25% Convertible Senior Notes Due 2028 and guarantees	**New York Stock Exchange, Inc.**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark:

if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 ¨

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 ¨

if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

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

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

The aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2011 (based on the closing market price on the NYSE Composite Tape on June 30, 2011) was approximately $420,574,000. At March 2, 2012, there were 49,306,770 outstanding shares of the registrant s common stock, $0.0001 par value.

DOCUMENTS INCORPORATED BY REFERENCE

The information required in Part III of the Annual Report on Form 10-K is incorporated by reference to the registrant s definitive proxy statement to be filed pursuant to Regulation 14A for the registrant s 2012 Annual Meeting of Stockholders.

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (the Annual Report), and in particular, Part I, Item 7 - 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. The forward-looking statements contained in this Annual Report are based on information available as of the date of this Annual 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 such as anticipate, believe,

estimate, continue, intend, expect, plan, forecast, project and similar expressions, or future-tense or conditional constructions such as should, could, etc. The Company cautions that these statements are merely predictions, 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 in this Annual Report and periodically in future 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.

PART I

Item 1. Business.

General

Flotek Industries, Inc. (Flotek or the Company) is a diversified global supplier of drilling and production related products and services. The Company s strategic focus, and that of all wholly owned subsidiaries (collectively referred to as the Company), includes oilfield specialty chemicals and logistics, down-hole drilling tools and downhole production tools used in the energy and mining industries. In December 2007, the Company s common stock began trading on the New York Stock Exchange (NYSE) under the stock ticker symbol FTK. Annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, (the Exchange Act) are posted to the Company s website, *www.flotekind.com*, as soon as practicable subsequent to electronically filing or furnishing to the SEC. Information contained in the Company s website is not to be considered as part of any regulatory filing. As used herein, Flotek, the Company, we, our and us refers to Flotek Industries, Inc. and/o Company s wholly owned subsidiaries. The use of these terms is not intended to connote any particular corporate status or relationship.

Historical Developments

The Company was originally incorporated in the Province of British Columbia on May 17, 1985. In October 2001, the Company moved the corporate domicile to Delaware and effected a 120 to 1 reverse stock split by way of a reverse merger with CESI Chemical, Inc. (CESI). Since then, the Company has grown through a series of acquisitions and organic growth.

Description of Operations

The Company has three strategic business segments: Chemicals and Logistics (Chemicals), Drilling Products (Drilling) and Artificial Lift. Each segment offers competitive products and services derived from patented technological advances that are reactive to industry demands in both domestic and international markets.

Financial information regarding operational segments and geographic concentration is provided within this Annual Report. See Part II, Item 8 Financial Statements and Supplementary Data, Note 17 Segment Information; in the Notes to Consolidated Financial Statements for additional information.

Chemicals and Logistics

The Chemicals business provides oil and natural gas field specialty chemicals for use in drilling, cementing, stimulation and production activities designed to maximize recovery within both new and mature fields. These specialty chemicals possess enhanced performance characteristics and are manufactured to withstand a broad range of down-hole pressures, temperatures and other well-specific conditions to be compliant with customer specifications. The Company has two operational laboratories: 1) a technical services laboratory and 2) a research and development laboratory. Each focuses on design improvements, development and viability testing of new chemical formulations, as well as continued enhancement of existing products. Chemicals branded complex nano-fluid (Cnf) are patented both domestically and internationally and are proven strategically cost-effective performance additives within both oil and natural gas markets. The Company s complex nano-fluid (Cnf) are environmentally friendly stable mixtures of oil, water and surface active agents which organize molecules into nanostructures. The combined advantage of solvents, surface active agent(s) and drilling structures result in improved well treatment results as compared to the independent use of solvents and surface active agent(s). Complex nano-fluid (Cnf) are composed of renewable, plant derived, cleaning ingredients and oils that are certified as biodegradable. Certain complex nano-fluid (Cnf) have been approved for use in the North Sea, which has some of the most stringent oil field environmental standards in the world. The Company s complex nano-fluid (Cnf) have resulted in improved operational and financial results in low permeability sand and shale reservoirs.

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The logistics business designs, operates and manages automated bulk material handling and loading facilities. The bulk facilities handle oilfield products, including sand and other materials for well-fracturing operations, dry cement and additives for oil and natural gas well cementing, and supply materials used in oilfield operations.

Drilling Products

The Company is a leading provider of down-hole drilling tools for use in oilfield, mining, water-well and industrial drilling activities. Further, the Company manufactures, sells, rents and inspects specialized equipment used in drilling, completion, production and work-over activities. Through internal growth initiatives, operational best practices and acquisitions, the Company has realized increased rental tool activity and has broadened the geographic market scope of operations. Established tool rental operations are strategically located throughout the United States (the US) and in an increasing number of international markets. Rental tools include stabilizers, drill collars, reamers, wipers, jars, shock subs, wireless survey, measurement while drilling (MWD) tools and mud-motors. Equipment sold primarily includes mining equipment, centralizers and drill bits. The Company remains focused on product marketing in the Southeast, Northeast, Mid-Continent and Rocky Mountain regions of the US, as well as on international sales expansion using third party agents and employees.

Artificial Lift

The Company provides pumping system components, electric submersible pumps (ESP s), gas separators, production valves and complementary services. Artificial Lift products satisfy the requirements of coal bed methane and traditional oil and natural gas production and assist natural gas, oil and other fluids movement from the producing horizon to the surface. Artificial Lift products employ proprietary technologies instrumental to improved well performance. Patented products within the Company s Petrovalve product line optimize pumping efficiency in horizontal well completions as well as in heavy oil wells and wells with high liquid to gas ratios. Petrovalve products placed horizontally increase flow per stroke and eliminate gas locking of traditional ball and seat valves that traditionally

require more maintenance. The patented gas separation technology is particularly effective in coal bed methane production, efficiently separating gas and water down-hole as well as ensuring solution gas is not lost in water production. Gas separated down-hole contributes to a reduction in the environmental impact of escaped gas at the surface. The majority of Artificial Lift products are manufactured in China, assembled domestically and distributed globally.

Seasonality

Overall, operations are not affected by seasonality. While certain working capital components build and recede throughout the year in conjunction with established selling cycles that can impact operations and financial position, the Company does not consider operations to be highly seasonal. The performance of certain services within each of the Company s segments, however, is susceptible to both weather and naturally occurring phenomena, including:

- severity and duration of winter temperatures in North America that impact natural gas storage levels and drilling activity;
- timing and duration of Canadian spring thaw and resulting restrictions that impacts activity levels; and
- timing and impact of hurricanes upon both coastal and offshore operations.

Artificial Lift results of operations are historically weakest in the second quarter of the calendar year due to Federal land drilling restrictions during identified breeding seasons of protected bird species.

Product Demand and Marketing

Demand for the Company s products and services is reactive to levels of natural gas storage and production, conventional and nonconventional oil and natural gas well drilling and corresponding work-over activity, both domestically and internationally. Products are marketed directly to customers through contractual agency arrangements and sales employees. Established customer relationships provide repeat sales opportunities within all segments. Marketing is currently concentrated within the US. Internationally, the Company primarily markets products and services through use of third party agents in Canada, Mexico, Central America, South America, the Middle East, and Asia.

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Customers

The Company s customers include major integrated oil and natural gas companies, independent oil and natural gas companies, pressure pumping service companies and state-owned oil companies. One of the Company s customers and its affiliates, accounted for 13%, 12% and 17% of the Company s consolidated revenue for the years ended December 31, 2011, 2010 and 2009, respectively. The Company s top three customers accounted for 28%, 18% and 22% of consolidated revenue for the years ended December 31, 2011, 2010 and 2009, respectively.

Research and Development

The Company is engaged in research and development activities focused on the improvement of existing products and services, the design of specialized customer need products and the development of new products, processes and services. For the years ended December 31, 2011, 2010, and 2009 the Company incurred $2.3 million, $1.4 million and $2.1 million respectively of research and development expenses. In 2011, research and development expense approximated 1% of consolidated revenue. The Company expects to maintain 2012 research and development investment at levels consistent with 2011 expenditures.

Backlog

Due to the nature of the Company s contractual customer relationships and operational management, the Company has historically not had significant backlog order activity.

Intellectual Property

The Company s policy is to ensure patent protection, both within and outside of the US, for all products and methods deemed to have commercial significance and to qualify for patent protection. The decision to pursue patent protection is dependent upon whether patent protection can be obtained, cost-effectiveness and alignment with operational and commercial interests. The Company believes patents and trademarks, combined with trade secrets, proprietary designs, manufacturing and operational expertise are appropriate to protect intellectual property and ensure continued strategic business operations. The Company currently has patents

pending on production valve design, casing centralizer design, ProSeries tool design and trade secrets. Existing patents expire at various dates during 2022 and 2023.

Competition

The ability to compete in the oilfield services industry is dependent upon the Company s ability to differentiate products and services, provide superior quality and service, and maintain a competitive cost structure. Activity levels in all segments are impacted by current and expected commodity prices, vertical and horizontal drilling rig count, other oil and natural gas drilling activity, production levels and customer drilling and production designated capital spending. Domestic and international regions in which Flotek operates are highly competitive. The competitive environment continues to intensify due to mergers among oil and gas companies and the reduction in the number of available customers. The 2011 global energy environment and global economy was exposed to volatile energy prices, domestic and global natural disasters, continued financial instability of European countries, and political turmoil and unrest throughout the Middle East petroleum producing countries. The unpredictability of the energy industry and commodity price fluctuations created both increased risk and opportunity for the Company s services, and that of competitors. Certain oil and natural gas service companies competing with Flotek are larger and have access to more resources. These competitors could be better situated to withstand industry downturns, compete on the basis of price, and acquire and develop new equipment and technologies; all of which could affect the Company s revenue and profitability. Oil and natural gas service companies also compete for customers and strategic business opportunities. Thus, competition could have a detrimental impact upon the Company s business. The Company expects that competition for contracts and margins will continue to be intense in the foreseeable future but considers that improvements in existing and developmental products and services will enable the Company to realize incremental gains in market share in 2012.

Raw Materials

Materials and components used in the Company s servicing and manufacturing operations, as well as

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those purchased for sale, are generally available on the open market from multiple sources. Collection and transportation of raw materials to Company facilities however could be adversely affected by extreme weather conditions. Additionally, certain raw materials used by the Chemicals segments are available from limited sources. Disruptions to suppliers could materially impact sales. The prices paid for raw materials are contingent on energy, steel and other commodity price fluctuations, tariffs, duties on imported materials, foreign currency exchange rates, business cycle position and global demand. During 2011, the price of raw materials increased over 2010 levels and additional increases are anticipated in 2012. Higher prices combined with lower availability of chemicals, steel and other raw materials could adversely impact future sales and contract fulfillments. The Company is diligent in identification of alternate suppliers and contingency planning efforts in the event of supply shortages and in proactive with efforts to realize purchase price efficiencies through competitive bidding practices.

Drilling and Artificial Lift segments purchase raw materials and steel on the open market from numerous suppliers. When able, the Company uses multiple suppliers, both domestically and internationally, for all raw materials purchases.

Drilling maintains a three to six month supply of mud-motor inventory parts sourced from China as well as an equivalent amount of parts necessary to meet forecast demand within Artificial Lift operations. The Company s inventory approximates the lead time required to secure parts to avoid disruption of service to customers.

Government Regulations

The Company is subject to federal, state and local environmental, occupational safety and health laws and regulations within the US and other countries in which the Company does business. The Company strives to ensure full compliance with all regulatory requirements and is unaware of any material instances of noncompliance. In the US, compliance laws and regulations include, among others:

- the Comprehensive Environmental Response, Compensation and Liability Act;
- the Resource Conservation and Recovery Act;
- the Federal Water Pollution Control Act; and
- the Toxic Substances Control Act.

In addition to US federal laws and regulations, the Company does business in other countries with extensive environmental, legal, and regulatory requirements by which the Company must abide. Laws and regulations strictly govern the manufacture, storage, handling, transportation, use and sale of chemical products. The Company evaluates the environmental impact of all Company actions and attempts to quantify the price of contaminated property in order to identify and avoid potential liability, as well as maintain compliance with regulatory requirements. Several of Chemicals products are considered hazardous or flammable. In the event of a leak or spill in association with Company operations, the Company is exposed to risk of material cost, net of insurance proceeds, to remediate any contamination. The Company is occasionally involved in environmental litigation and claims, including remediation of properties owned or operated. No environmental litigation or claims are being litigated as of the date of this Annual Report filing. The Company does not expect costs related to known or unknown mediation requirements to have a material adverse effect on the Company s consolidated financial position or results of operations.

Employees

At December 31, 2011, the Company had approximately 379 employees, exclusive of existing worldwide agency relationships. None of the company s employees are covered by a collective bargaining agreement and labor relations are generally positive. Certain international location changes in staffing or work arrangements are contingent upon local work councils or other regulatory approval.

Available Information

The Company s website is accessible at *https://www.flotekind.com*. Annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are available (see Investor Relations section of the Company s website), as soon as reasonably practicable subsequent to the Company electronically filing or otherwise

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providing reports to the SEC. Corporate governance materials, guidelines, charter and code of conduct are also available on the website. A copy of corporate governance materials is available upon written request to the Company.

All material filed with the SEC s Public Reference Room at 100 F Street NE, Washington, DC 20549 is available to be read or copied. Information regarding the Public Reference Room can be obtained by contacting the SEC at 1-800-SEC-0330. Further, the SEC maintains the *http://www.sec.gov* website, which contains reports and other registrant information filed electronically with the SEC.

The 2010 Annual Chief Executive Officer Certification required by the NYSE was submitted on June 13, 2011. The certification was not qualified in any respect. Additionally, the Company has filed with this Annual Report all principal executive officer and financial officer certifications as required under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002.

Information with respect to the Company s executive officers and directors is incorporated herein by reference to information to be included in the proxy statement for the Company s 2012 Annual Meeting of Stockholders.

The Company has disclosed and will continue to disclose any changes or amendments to the Company s code of ethics as well as waivers to the code of ethics applicable to executive management by posting such changes or waivers on the Company s website.

Item 1A. Risk Factors.

The Company s business, financial condition, results of operations and cash flows are subject to various risks and uncertainties, including those described below. These risks and uncertainties could cause actual results to vary materially from current or forecast results. The risks below are not all-inclusive of risks that could impact the Company. Additional risks not currently known to the Company or that the Company presently considers immaterial could impact the Company s business operations.

This Annual Report contains forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. Forward-looking statements discuss Company prospects, expected revenue, expenses and profits, strategic operational initiatives and other activity. Forward-looking statements also contain suppositions regarding future oil and natural gas industry conditions within both domestic and international market economies. The Company s results could differ materially from those anticipated in the forward-looking statements as a result of a variety of factors, including risks described below

and elsewhere. See Forward-Looking Statements at the beginning of this Annual Report.

Risks Related to the Company s Business

The Company had profitable operations during 2011 but may not be able to sustain profitable operations in 2012.

The Company s net income from 2011 operations totaled $26.5 million, while the Company experienced net losses in both 2010 and 2009. There is no assurance that the Company s 2012 Plan of Operations will be executed successfully or, that the Company will maintain profitability in 2012.

The Company s business is dependent upon domestic and international oil and natural gas industry spending. Spending could be adversely affected by industry conditions or by new or increased governmental regulations beyond the Company s control.

The Company is dependent upon customers willingness to make operating and capital expenditures for exploration, development and production of oil and natural gas in both the North

American market and abroad. Customers expectations of future oil and natural gas market prices could curtail spending thereby reducing demand for the Company s products and services. Industry conditions in the US are influenced by numerous factors over which the Company has no control, including the supply of and demand for oil and natural gas, domestic and international economic conditions, political instability in oil and natural gas producing countries and merger and divestiture activity among oil and natural gas producers. The volatility of oil and natural gas prices and the consequential effect on exploration and production activity could adversely impact the Company s customers level of activity. One indicator of drilling and production spending is fluctuation in rig count which the company actively monitors to gauge market conditions and forecast product and service demand. A reduction in drilling activity could cause a decline in the demand for, or negatively affect the price of, the Company s products and services. Domestic demand for oil and natural gas could also be uniquely affected by public attitude regarding drilling in environmentally sensitive areas, vehicle emissions and other environmental standards, alternative fuels, taxation of oil and gas, perception of excess profits of oil and gas companies, and anticipated changes in governmental regulation and policy.

Demand for a significant number of Company products and service is dependent on the level of expenditures within the oil and natural gas industry. If current global economic conditions and the availability of credit worsen or oil and natural gas prices weaken for an extended period of time, reductions in levels of customers expenditures could have a significant adverse effect on revenue, margins and overall operating results.

The current global credit and economic environment has tempered worldwide demand for energy. Crude oil and natural gas prices have continued to be volatile. A substantial or extended decline in oil or natural gas prices could affect customers spending for products and services. Demand for a significant number of the Company s products and services is dependent upon the level of expenditures within the oil and gas industry for exploration, development and production of crude oil and natural gas reserves. Expenditures are

sensitive to oil and natural gas prices, as well as the industry s outlook regarding future oil and natural gas prices. Increased competition continued to exert downward pressure on prices charged for company products and services in 2011. Limited price increases were available to the Company in 2011. Volatile economic conditions could weaken customer exploration and production expenditures, causing reduced demand for Company products and services and a significant adverse effect on the Company s operating results. It is difficult to predict the pace of any industry growth, whether the economy will worsen, and to what extent this could affect the Company.

Reduced cash flow and capital availability could adversely impact the financial condition of the Company s customers, which could result in customer project modifications, delays or cancellations, general business disruptions, and delay in, or nonpayment of, amounts that are owed to the Company. This could cause a negative impact on the Company s results of operations and cash flows.

If certain of the Company s suppliers were to experience significant cash flow constraints or become insolvent as a result of such conditions, a reduction or interruption in supplies or a significant increase in the price of supplies could occur, and adversely impact the Company s results of operations and cash flows.

The price for oil and natural gas is subject to a variety of factors, including:

- demand for energy reactive to worldwide population growth, economic development and general economic and business conditions;
- ability of the Organization of Petroleum Exporting Countries (OPEC) to set and maintain production levels;
- production of oil and gas by non-OPEC countries;
- availability and quantity of natural gas storage;
- import volume and pricing of Liquefied Natural Gas;

pipeline capacity to critical markets;

political and economic uncertainty and socio-political unrest;

- cost of exploration, production and transport of oil and natural gas;

- technological advances impacting energy consumption; and

- weather conditions.

The Company s revolving credit facility may not be renewed or current interest rates could increase, limiting the Company s flexibility and preventing the Company from taking certain actions, which could adversely affect execution of business strategies.

At December 31, 2011, the Company had a $35 million revolving credit facility commitment that remains undrawn. Any borrowings are at a variable rate of prime plus 1% (4.25% at December 31, 2011). The current credit facility remains in effect until December 15, 2012. There can be no assurance that the revolving credit facility will be extended or renewed or that the interest rates will not significantly fluctuate.

Holders of the Company s 5.25% convertible senior notes may exercise their option to require the Company purchase the holder s outstanding notes for cash, which could result in cash constraints or require the Company to secure additional cash financing through a debt or equity offering.

The Company is attendant to the possibility that holders of $70.5 million of the Company s 5.25% convertible senior notes due February 15, 2028 could exercise their option to require the Company to purchase all or a portion of outstanding notes for cash on February 15, 2013. The Company could be required to deplete cash reserves used to execute business strategies, secure additional cash through a new debt or equity offerings, modify debt terms with current holders, or execute a combination of these possibilities.

The Company s implementation of a new enterprise resource planning (ERP) system may adversely affect the Company s business and results of operations or the effectiveness of internal control over financial reporting.

During the second quarter of 2011, the Company began implementing a new generation of work processes and information systems. ERP implementations are complex and time-consuming

projects that involve substantial expenditures on system software and implementation activities that take a year or longer to implement. ERP implementations also require transformation of business and financial processes in order to reap the benefits of the ERP System. If the Company does not effectively implement the ERP System as planned or if the system does not operate as intended, it could adversely affect the financial reporting systems, the Company s ability to produce financial reports, and/or the effectiveness of internal control over financial reporting.

If the Company does not manage the potential difficulties associated with expansion successfully, the Company s operating results could be adversely affected.

The Company has grown over the last several years through internal growth, strategic alliances, and to a lesser extent, strategic business/asset acquisitions. The Company believes future success will depend, in part, on the Company s ability to adapt to market opportunities and changes and to successfully integrate the operations of any businesses acquired. The following factors could result in strategic business difficulties:

- lack of experienced management personnel;
- increased administrative burdens;
- lack of customer retention;
- technological obsolescence; and
- infrastructure, technological, communication and logistical problems associated with large, expansive operations.

If the Company fails to manage potential difficulties successfully, including increased costs associated with growth, the Company s operating results could be adversely affected.

The Company s ability to grow and compete could be adversely affected if adequate capital is not available.

The ability of the Company to grow and compete is reliant on the availability of adequate capital. Access to capital is dependent, in large part, on the Company s cash flows from operations and the availability of equity and debt financing. The Company cannot guarantee cash flows from operations will be sufficient, or that the Company will continue to be able to obtain equity or debt

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financing on acceptable terms, or at all, in order to realize growth strategies. As a result, the Company may not be able to finance strategic growth plans, to take advantage of business opportunities or to respond to competitive pressures.

The Company s future success and profitability may be adversely affected if the Company or the Company s suppliers fail to develop and/or introduce new and innovative products and services.

The oil and natural gas drilling industry is characterized by technological advancements that have historically resulted in, and will likely continue to result in, substantial improvements in the scope and quality of oilfield chemicals, drilling and artificial lift products and services function and performance. Consequently, the Company s future success is dependent, in part, upon the Company s and the Company s suppliers continued ability to timely develop innovative products and services. Increasingly sophisticated customer needs and the ability to timely anticipate and respond to technological and operational advances in the oil and natural gas drilling industry is critical. If the Company or the Company s suppliers fail to successfully develop and introduce innovative products and services that appeal to customers, or if new market entrants or competitors develop superior products and services, the Company s revenue and profitability could suffer.

The Company may pursue strategic acquisitions, which could have an adverse impact on the Company s business.

The Company remains committed to growth through strategic acquisitions and alliances with complementary businesses. The Company s historical and potential acquisitions involve risks that could adversely affect the Company s business climate and results of operations. Negotiations of potential acquisitions or integration of newly acquired businesses could divert management s attention from other business concerns as well as be cost prohibitive and time consuming. Acquisitions could also expose the Company to unforeseen liabilities or risks associated with new markets or businesses. Unforeseen operational difficulties related to acquisitions could result in diminished financial performance or require a disproportionate

amount of the Company s management s attention and resources. Additional acquisitions could result in the commitment of capital resources without the realization of anticipated returns.

Unforeseen developments in contingencies such as litigation could adversely affect the Company s financial condition.

The Company is, and from time to time may become, a party to legal proceedings incidental to the Company s business involving alleged injuries arising from the use of Company products, exposure to hazardous substances, patent infringement, employment matters and commercial disputes. The defense of these lawsuits may require significant expenses, divert management s attention, and may require the Company to pay damages that could adversely affect the Company s financial condition. In addition, any insurance or indemnification rights that the Company may have may be insufficient or unavailable to protect against potential loss exposures.

The Company s current insurance policies may not adequately protect the Company s business from all potential risks.

The Company s operations are subject to risks inherent in the oil and natural gas industry, such as, but not limited to, accidents, blowouts, explosions, fires, severe weather, oil and chemical spills and other hazards. These conditions can result in personal injury or loss of life, damage to property, equipment and environment, as well as suspension of customer s oil and gas operations. Litigation arising from any catastrophic occurrence where the Company s equipment, products or services are being used could result in the Company being named as a defendant in lawsuits asserting large claims. The Company maintains insurance coverage believed adequate and customary to the oil and natural gas industry to mitigate liabilities associated with these potential hazards. The Company does not have insurance against all foreseeable risks, either because insurance is not available or is cost prohibitive. Further, the Company may not have the financial wherewithal to maintain adequate insurance coverage in the future. Consequently, losses and liabilities arising from uninsured or underinsured events could have a material adverse effect on the Company s business, financial condition and results of operations.

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The Company is subject to complex foreign, federal, state and local environmental, health and safety laws and regulations, which expose the Company to liabilities that could have a material adverse effect on the Company s business, financial condition and results of operations.

The Company s operations are subject to foreign, federal, state and local laws and regulations related to, among other things, the protection of natural resources, injury, health and safety considerations, waste management and transportation of waste and other hazardous materials. The Chemicals segment exposes the company to risks of environmental liability that could result in fines, penalties, remediation, property damage and personal injury liability. In order to remain compliant with laws and regulations, the Company maintains permits, authorizations and certificates as required from regulatory authorities. Sanctions for noncompliance with such laws and regulations could include assessment of administrative, civil and criminal penalties, revocation of permits and issuance of corrective action orders.

The Company could incur substantial costs to ensure compliance with existing and future laws and regulations. Laws protecting the environment have generally become more stringent and are expected to continue during 2012 and into the foreseeable future. Failure to comply with applicable laws and regulations could result in material expense associated with future environmental compliance and remediation expense. The Company s costs of compliance could also increase if existing laws and regulations are amended or reinterpreted. Such amendments or reinterpretations of existing laws or regulations or the adoption of new laws or regulations could curtail exploratory or developmental drilling for and production of oil and natural gas which, in turn, could limit demand for the Company s products and services. Some environmental laws and regulations could also impose joint and strict liability meaning that in certain situations the Company could be exposed to increased liabilities as a result of the Company s conduct that was lawful at the time it occurred or conduct of, or conditions caused by, prior operators or other third parties. Remediation expense and other damages arising as a result of such laws and regulations could be substantial and have a material adverse effect on the Company s financial condition and results of operations.

Material levels of the Company s revenue are derived from customers engaged in hydraulic fracturing services, a process that creates fractures extending from the well bore through the rock formation to enable natural gas or oil to flow more easily through the rock pores to a production well. Bills pending in the US House and Senate have asserted that chemicals used in the fracturing process adversely affect drinking water supplies. The proposed legislation could require the reporting and public disclosure of current proprietary fracturing chemical formulas. Legislation, if adopted, could establish additional levels of federal regulation that could result in operational delays and increased operating costs. Some states have adopted regulations which require operators to publicly disclose certain non-proprietary information. The adoption of any future federal or state laws or local requirements or the implementation of regulations imposing reporting obligations on, or otherwise limiting, the hydraulic fracturing process could increase the difficulty of oil and natural gas well production activity and could have an adverse effect on the Company s 2012 forecast results of operations, liquidity and financial condition.

Regulation of greenhouse gases and/or climate change could have a negative impact on the Company s business.

Certain scientific studies have suggested that emissions of certain gases, commonly referred to as greenhouse gases , which include carbon dioxide and methane, may be contributory to the warming effect of the Earth s atmosphere and other climatic changes. In response to such studies, the issue of climate change and the effect of greenhouse gas emissions, in particular emissions from fossil fuels, is attracting increasing worldwide attention. Legislative and regulatory measures to address greenhouse gas emissions have not yet been finalized as of the date of this Annual Report but remain impactive across international, national, regional and state levels.

Existing or future laws, regulations, treaties or international agreements related to greenhouse gases and climate change, including energy conservation or alternative energy incentives, could have a negative impact on the Company s operations if regulations resulted in a reduction in worldwide demand for oil and natural gas or global economic activity. Other results could be increased compliance costs and additional operating restrictions, each of which would have a negative impact on the Company s operations. Lastly, the Company s operations could be negatively impacted by related physical changes or changes in weather patterns.

Changes in regulatory compliance obligations of critical suppliers may adversely impact our operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, (Dodd-Frank Act), signed into law on July 21, 2010, includes Section 1502, which requires the Securities and Exchange Commission to adopt additional disclosure requirements related to certain minerals sourced from the Democratic Republic of Congo and surrounding countries, or conflict minerals, for which such conflict minerals are necessary to the functionality of a product manufactured, or contracted to be manufactured, by an SEC reporting company. The metals covered by the proposed rules, promulgated on December 15, 2010, include tin, tantalum, tungsten and gold. We and our suppliers may use these materials in the production processes. If the rules are adopted as proposed, in order to be able to accurately report our compliance with Section 1502, we will have to perform supply chain due diligence, third-party verification and possibly private sector audits on the sources of these metals all the way down to the mine of origin. Global supply chains are complicated, with multiple layers and suppliers between the mine and the final product. Accordingly, we could incur significant cost related to the compliance process. While the impact of Section 1502 on our business is uncertain at this time, we could potentially have difficulty in procuring needed materials from conflict-free sources and in satisfying the associated disclosure requirements when finalized by the SEC.

If the Company is unable to adequately protect intellectual property rights or is found to infringe upon the intellectual property rights of others, the Company s business is likely to be adversely affected.

The Company relies on a combination of patents, trademarks, non-disclosure agreements and other security measures to establish and protect the

Company s intellectual property rights. Although the Company believes that existing measures are reasonably adequate to protect intellectual property rights, there is no assurance that the measures taken will prevent misappropriation of proprietary information or dissuade others from independent development of similar products or services. Moreover, there is no assurance that the Company will be able to prevent competitors from copying, reverse engineering or otherwise obtaining and/or using the Company s technology and proprietary rights for products. As of the date of this Annual Report, the Company has not sought foreign protection corresponding to existing intellectual property rights. Consequently, the Company may not be able to enforce intellectual property rights outside of the US. Furthermore, the laws of certain countries in which the Company s products and services are manufactured or marketed may not protect the Company s proprietary rights to the same extent as the laws of the US. Finally, parties may challenge, invalidate or circumvent the Company s patents, trademarks, copyrights and trade secrets. In each case, the Company s ability to compete could be significantly impaired.

A portion of the Company s products are without patent protection. The issuance of a patent does not guarantee validity or enforceability, accordingly, Company patents may not be valid or enforceable against third parties. The issuance of a patent does not guarantee that the Company has the right to use the patented invention. Third parties may have blocking patents that could be used to prevent the Company from marketing the Company s own patented products and utilizing the patented technology.

The Company is exposed to allegations of patent and other intellectual property infringement. Furthermore, the Company could become involved in costly litigation or proceedings regarding patents or other intellectual property rights. If any such claims are asserted against the Company, the Company could seek to obtain a license under the third party s intellectual property rights in order to mitigate exposure. In the event the Company cannot obtain a license, affected parties could file lawsuits against the Company seeking damages (including treble damages) or an injunction against the sale of the Company s products. These could result in the Company having to discontinue the sale of certain products, increase the cost of selling products, or

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result in damage to the Company s reputation. The award of damages, including material royalty payments, or the entry of an injunction order against the manufacture and sale of any of the Company s products, could have a material adverse effect on the Company s results of operations and ability to compete.

The Company and the Company s customers are subject to risks associated with doing business outside of the US including political risk, foreign exchange risk and other uncertainties.

Revenue from the sale of products to customers outside the US exceeded 14% of the Company s 2011 annual revenue. The Company and its customers are subject to risks inherent in doing business outside of the US, including:

- governmental instability;
- war and other international conflicts;
- civil and labor disturbances;
- requirements of local ownership;
- partial or total expropriation or nationalization;
- currency devaluation; and
- foreign laws and policies, each of which can limit the movement of assets or funds or result in the deprivation of contractual rights or appropriation of property without fair compensation.

Collections and recovery of rental tools from international customers and agents could also prove difficult due to inherent uncertainties in foreign law and judicial procedures. The Company could experience significant difficulty with collections or recovery due to the political or judicial climate in foreign countries where Company operations occur or in which the Company s products are used.

The Company s international operations must be compliant with the Foreign Corrupt Practices Act (the FCPA) and other applicable US laws. The Company could become liable under these laws for actions taken by employees or agents. Compliance with international laws and regulations could become more complex and expensive thereby creating increased risk as the Company s international business portfolio grows. Further, the US periodically enacts laws and imposes regulations prohibiting or restricting trade with certain nations. The US government could also change these laws or enact new laws that could restrict or prohibit the Company from doing business in identified foreign countries.

Although most of the Company s international revenue is derived from transactions denominated in US dollars, the Company has conducted, and most likely will continue to conduct, some business in currencies other than the US dollar. The Company currently does not hedge against foreign currency fluctuations. Accordingly, the Company s profitability could be affected by fluctuations in foreign exchange rates.

The Company has no control over and can provide no assurances that future laws and regulations will not materially impact the Company s ability to conduct international business.

The loss of key customers could have a material adverse effect on the Company s results of operations and could result in a decline in the Company s revenue.

The Company has critical customer relationships which are dependent upon production and development activity related to a handful of customers. Revenue derived from key customers as a percentage of consolidated revenue for the years ended December 31, 2011, 2010 and 2009, totaled 28%, 18% and 22%, respectively. Chemicals customer relationships are historically governed by purchase orders or other short-term contractual obligations as opposed to long-term contracts. The loss of one or more key customers could have a material adverse effect on the Company s results of operations and could result in a decline in the Company s revenue.

Loss of key suppliers, the inability to secure raw materials on a timely basis, or the Company s inability to pass commodity price increases on to customers could have a material adverse effect on the Company s ability to service customer s needs and could result in a loss of customers.

Materials used in servicing and manufacturing operations as well as those purchased for sale are generally available on the open market from multiple sources. Acquisition costs and transportation of raw materials to Chemical s facilities have historically been impacted by extreme weather conditions. Certain raw materials used by Chemicals are available only from limited sources; accordingly, any disruptions to critical suppliers operations could adversely impact the Company s operations. Prices paid for raw

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materials could be affected by energy, steel and other commodity prices; tariffs and duties on imported materials; foreign currency exchange rates; phases of the general business cycle and global demand.

The Drilling and Artificial Lift segments purchase critical raw materials on the open market and, where able, from multiple suppliers, both domestically and internationally.

The Company maintains a three to six month supply of critical mud-motor inventory parts that the Company sources from China. This inventory stock position approximates the lead time required to secure these parts in order to avoid disruption of service to the Company s customers. The Company s inability to secure reasonably priced critical inventory parts in a timely manner would adversely affect the Company s ability to provide service to potential customers. The Company sources the vast majority of motor parts from a national supplier. As part of the 2012 business plan, the Company is actively managing and developing relationships with back-up parts and service suppliers. If unsuccessful in identifying and engaging back-up suppliers, the Company could be exposed to a disruption of key suppliers that could result in a loss of revenue and margins related to key customers. Additionally, if the customers were to seek or develop alternatives for the products or services the Company offers, the Company could suffer a decline in revenue and loss of key customers.

The Company currently does not hedge commodity prices. The Company forecast may be unable to pass along price increases to its customers, which could result in a decline in revenue or operating profits.

The Company s inability to develop new products or differentiate existing products could have a material adverse effect on the ability to be responsive to customer s needs and could result in a loss of customers.

The Company s ability to compete within the oilfield services business is dependent upon the ability to differentiate products and services, provide superior quality and service, and maintain a competitive cost structure. Activity levels in the

Company s operations are driven by current and forecast commodity prices, drilling rig count, oil and natural gas production levels, and customer capital spending for drilling and production. The regions in which the Company operates are highly competitive. The Company is also smaller than many other oil and natural gas service companies and has fewer resources as compared to these competitors. The larger competitors are better positioned to withstand industry downturns, compete on the basis of price and acquire new equipment and technologies, all of which could affect the Company s revenue and profitability. The Company competes for both customers and acquisition opportunities. Competition could adversely affect on the Company s operating profit. The Company believes that competition for products and services will continue to be intense in the foreseeable future.

If the Company loses the services of key members of management, the Company may not be able to manage operations and implement growth strategies.

The Company depends on the continued service of the President, the Executive Vice President, Finance, the Executive Vice President, Operations, Executive Vice President, Business Development, and the Chief Accounting Officer, who possess significant expertise and knowledge of the Company s business and industry. Further, the President serves as Chairman of the Board of Directors. The Company has entered into employment agreements with each of these key members, however, at December 31, 2011 the Company did not carry key man life insurance all of these executives. Any loss or interruption of the services of key members of the Company s management could significantly reduce the Company s ability to manage operations effectively and implement strategic business initiatives. The Company can provide no assurance that appropriate replacements for key positions could be found should the need arise.

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Failure to maintain effective disclosure controls and procedures and internal controls over financial reporting could have an adverse effect on the Company s operations and the trading price of the Company s common stock.

Effective internal controls are necessary for the Company to provide reliable financial reports, effectively prevent fraud and operate successfully as a public company. If the Company cannot provide reliable financial reports or effectively prevent fraud, the Company s reputation and operating results could be harmed. If the Company is unable to maintain effective disclosure controls and procedures and internal controls over financial reporting, the Company may not be able to provide reliable financial reports or prevent fraud, which, in turn could affect the operating results or cause the Company to fail to meet its reporting obligations. Ineffective internal controls could also cause investors to lose confidence in reported financial information, which could negatively effect the trading price of the Company s common stock, limit the ability to access capital markets in the future and require the incurrence of additional costs to improve internal control systems and procedures.

The Company s management evaluated the effectiveness of the design and operation of the Company s disclosure controls and procedures as of December 31, 2011, and concluded that the Company s disclosure controls and procedures are effective. Management also evaluated the effectiveness of the Company s internal control over financial reporting as of December 31, 2011, and concluded that it is effective. The Company s independent registered public accounting firm audited the Company s internal control over financial reporting as of December 31, 2011, and concluded that the Company maintained effective internal control over financial reporting.

At December 31, 2010 and at the end of each of the first three quarters of 2011, management evaluated the effectiveness of the design and operation of the Company s disclosure controls and procedures and concluded that a previously identified material weakness in internal control related to the timely and effective preparation of account reconciliations in connection with the monthly close process still existed. On-going remediation efforts have resolved the identified material weakness as of December 31, 2011.

Risks Related to the Company s Industry

Uncertainty regarding the irregular recovery from the recent recession could still have an adverse effect on exploration and production activity and result in lower demand for the Company s products and services.

Continued worldwide financial and credit crisis uncertainty can reduce the availability of liquidity and credit markets to fund the continuation and expansion of industrial business operations worldwide. The shortage of liquidity and credit combined with pressure on worldwide equity markets could continue to impact the worldwide economic climate. Unrest in the Middle East may also impact demand for the Company s products and services both domestically and internationally.

Demand for the Company s products and services is dependent on oil and natural gas industry activity and expenditure levels that are directly affected by trends in oil and natural gas prices. Demand for the Company s products and services is particularly sensitive to levels of exploration, development, and production activity of, and the corresponding capital spending by, oil and natural gas companies, including national oil companies. One indication of drilling and production activity and spending is rig count, which the Company monitors to gauge market conditions. Any prolonged reduction in oil and natural gas prices or drop in rig count could depress current levels of exploration, development, and production activity. Perceptions of longer-term lower oil and natural gas prices by oil and natural gas companies could similarly reduce or defer major expenditures given the long-term nature of many large-scale development projects. Lower levels of activity could result in a corresponding decline in the demand for the Company s oil and natural gas well products and services, which could have a material adverse effect on the Company s revenue and profitability.

Continuation of the global credit crisis could have an adverse impact on the Company s customers and on the Company s dealings with lenders, insurers and financial institutions.

Events in global credit markets over the past several years have significantly impacted the availability of credit and associated financing costs for many of the Company s customers. A significant portion of

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the Company s customers finance drilling and production programs through third-party lenders. Lack of available credit or increased costs of borrowing could cause customers to reduce spending on drilling programs, thereby reducing demand and potentially resulting in lower prices for the Company s products and services. Also, the credit and economic environment could significantly impact the financial condition of some customers over a prolonged period, leading to business disruptions and restricted ability to pay for the Company s products and services. The Company s forward-looking statements assume that the Company s lenders, insurers and other financial institutions will be able to fulfill their obligations under various credit agreements, insurance policies and contracts. If any of the Company s significant lenders, insurers and others are unable to perform under such agreements, and if the Company was unable to find suitable replacements at a reasonable cost, the Company s results of operations, liquidity and cash flows could be adversely impacted.

A prolonged period of depressed oil and natural gas prices could result in reduced demand for the Company s products and services and adversely affect the Company s business, financial condition and results of operations.

The markets for oil and natural gas have historically been extremely volatile. Such volatility in oil and natural gas prices, or the perception by the Company s customers of unpredictability in oil and natural gas prices, could adversely affect spending within targeted industries. The Company anticipates that current markets will continue to be volatile in the future. The demand for the Company s products and services is, in large part, driven by current and anticipated oil and natural gas prices and the related general levels of production spending and drilling activity. In particular, volatile fluctuation in oil prices and continued depressed natural gas prices could cause a decline in exploration and drilling activities. This, in turn, could result in lower demand for the Company s products and services and could result in lower prices for the Company s products and services. A prolonged decline in oil or natural gas prices could adversely affect the Company s business, financial condition and results of operations.

New and existing competitors within the Company s industry could have an adverse effect on results of operations.

The oil and natural gas industry is highly competitive and fragmented. The Company s principal competitors include numerous small companies capable of competing effectively in the Company s markets on a local basis, as well as a number of large companies that possess substantially greater financial and other resources than does the Company. Larger competitors may be able to devote greater resources to developing, promoting and selling products and services. The Company may also face increased competition due to the entry of new competitors including current suppliers that decide to sell their products and services directly to the Company s customers. As a result of this competition, the Company could experience lower sales or greater operating costs, which could have an adverse effect on the Company s margins and results of operations.

The Company s industry has a high rate of employee turnover. Difficulty attracting or retaining personnel or agents could adversely affect the Company s business.

The Company operates in an industry that has historically been highly competitive in securing qualified personnel with the required technical skills and experience. The Company s services require skilled personnel able to perform physically demanding work. Due to industry volatility and the demanding nature of the work, workers could choose to pursue employment opportunities that offer a more desirable work environment at wages competitive with the Company s. As a result, the Company may not be able to find qualified labor, which could limit the Company s growth ability. In addition, the cost of attracting and retaining qualified personnel has increased over the past several years due to competitive pressures. The Company expects labor costs will continue to increase in the foreseeable future. In order to attract and retain qualified personnel, the Company may be required to offer increased wages and benefits. If the Company is unable to increase the prices of products and services to compensate for increases in compensation, or is unable to attract and retain qualified personnel, operating results could be adversely affected.

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Severe weather could have a material adverse impact on the Company s business.

The Company s business could be materially and adversely affected by severe weather conditions. Hurricanes, tropical storms, blizzards, cold weather and other severe weather conditions could result in curtailment of services, damage to equipment and facilities, interruption in transportation of products and materials and loss of productivity. If the Company s customers are unable to operate or are required to reduce operations due to severe weather conditions, and as a result curtail purchases of the Company s products and services, the Company s business could be materially adversely affected.

A terrorist attack or armed conflict could harm the Company s business.

Terrorist activities, anti-terrorist efforts and other armed conflicts involving the US could adversely affect the US and global economies and could prevent the Company from meeting financial and other obligations. The Company could experience loss of business, delays or defaults in payments from payors, or disruptions of fuel supplies and markets if pipelines, production facilities, processing plants or refineries are direct targets or indirect casualties of an act of terror or war. Such activities could reduce the overall demand for oil and natural gas which, in turn, could also reduce the demand for the Company s products and services. The Company has implemented certain security measures in response to the threat of terrorist activities. Terrorist activities and the threat of potential terrorist activities and any resulting economic downturn could adversely affect the Company s results of operations, impair the ability to raise capital or otherwise adversely impact the Company s ability to realize certain business strategies.

Risks Related to the Company s Securities

The market price of the Company s common stock has been and may continue to be volatile.

The market price of the Company s common stock has historically been subject to significant fluctuations. The following factors, among others, could cause the price of the Company s common stock to fluctuate significantly:

- variations in the Company s quarterly results of operations;
- changes in market valuations of companies in the Company s industry;
- fluctuations in stock market prices and volume;
- fluctuations in oil and natural gas prices;
- issuances of common stock or other securities in the future;
- additions or departures of key personnel; and
- announcements by the Company or the Company s competitors of new business, acquisitions or joint ventures.

The stock market has experienced unusual price and volume fluctuations in recent years that have significantly affected the price of common stock of many companies within the oil and natural gas industry. Further changes can occur without regard to specific operating performance. The price of the Company s common stock could continue to fluctuate based upon factors that have little to do with the Company s operational performance, and these fluctuations could materially reduce the Company s stock price. Class action lawsuits have historically been brought against companies following periods of common stock market price volatility. The Company could be named in a legal case of this type, which could be expensive and divert management s attention and company resources, as well as have a material adverse effect on the Company s business, financial condition and results of operations.

An active market for the Company s common stock may not continue to exist or may not continue to exist at current trading levels.

Trading volume for the Company s common stock has historically been low when compared to companies with larger market capitalizations. The Company cannot presume that an active trading market for the Company s common stock will continue or be sustained. Sales of significant amounts of shares of the Company s common stock in the public market could lower the market price of the Company s stock.

The Company has no plans to pay dividends on the Company s common stock, and, therefore, investors will have to look to stock appreciation for return on investments.

The Company does not anticipate paying any cash dividends on the Company s common stock in the foreseeable future. The Company currently intends

to retain all future earnings to fund the development and growth of the Company s business and to meet current debt obligations. Any payment of future dividends will be at the discretion of the Company s board of directors and will depend on, among other things, the Company s earnings, financial condition, capital requirements, level of indebtedness, statutory and contractual restrictions applying to the payment of dividends and other considerations deemed relevant by the board of directors. Additionally, should the Company seek future financing or refinancing of indebtedness, covenants could restrict the payment of dividends without the prior written consent of lenders. Investors must rely on sales of common stock held after price appreciation, which may never occur, in order to realize a return on their investment.

Certain anti-takeover provisions of the Company s charter documents and applicable Delaware law could discourage or prevent others from acquiring the Company, which may adversely affect the market price of the Company s common stock.

The Company s certificate of incorporation and bylaws contain provisions that:

- permit the Company to issue, without stockholder approval, up to 100,000 shares of preferred stock, in one or more series and, with respect to each series, to fix the designation, powers, preferences and rights of the shares of the series;
- prohibit stockholders from calling special meetings;
- limit the ability of stockholders to act by written consent;
- prohibit cumulative voting; and
- require advance notice for stockholder proposals and nominations for election to the board of directors to be acted upon at meetings of stockholders.

In addition, Section 203 of the Delaware General Corporation Law limits business combinations with owners of more than 15% of the Company s stock without the approval of the board of directors. Aforementioned provisions and other similar provisions make it more difficult for a third party to acquire the Company exclusive of negotiation. The Company s board of directors could choose not to negotiate with an acquirer deemed not beneficial to or synergistic with the Company s strategic outlook. If an acquirer were discouraged from

offering to acquire the Company or prevented from successfully completing a hostile acquisition by referenced anti-takeover measures, stockholders could lose the opportunity to sell owned shares at a favorable price.

Future issuance of additional shares of common stock could cause dilution of ownership interests and adversely affect the Company s stock price.

The Company may, in the future, issue previously authorized and unissued shares of common stock, which would result in the dilution of current stockholders ownership interests. The Company is currently authorized to issue 80,000,000 shares of common stock, of which 51,957,652 were issued as of December 31, 2011. Additional shares are subject to future issuance through the exercise of options granted under various equity compensation plans or through the exercise of options still available for future equity grants. The potential issuance of additional shares of common stock, whether directly or pursuant to any conversion right associated with the convertible senior notes or other convertible securities of the Company, or through exercise of outstanding warrants may create downward pressure on the trading price of the Company s common stock. The Company may also issue additional shares of common stock or other securities that are convertible into or exercisable for common stock in order to raise capital or effectuate other business purposes. Future sales of substantial amounts of common stock, or the perception that sales could occur, could have a material adverse effect on the price of the Company s common stock.

All outstanding warrants are exercisable as of December 31, 2011.

The Company may issue additional shares of preferred stock or debt securities with greater rights than the Company s common stock.

Subject to the rules of the NYSE, the Company s certificate of incorporation authorizes the board of directors to issue one or more additional series of preferred stock and to set the terms of the issuance without seeking approval from holders of common stock. Currently, there are 100,000 preferred shares authorized, with no shares outstanding at March 7, 2012. Any preferred stock that is issued may rank senior to common stock in terms of dividends,

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priority and liquidation premiums, and may have greater voting rights than holders of common stock.

The Company s ability to use net operating loss carryforwards and tax attribute carryforwards to offset future taxable income may be limited as a result of transactions involving the Company s common stock.

Under section 382 of the Internal Revenue Code of 1986, as amended, a corporation that undergoes an ownership change is subject to limitations on the Company s ability to utilize pre-change net operating losses (NOLs), and certain other tax attributes to offset future taxable income. In general, an ownership change occurs if the aggregate stock ownership of certain stockholders increases by more than 50 percentage points over such stockholders lowest percentage ownership during the testing period (generally three years). An ownership change could limit the Company s ability to utilize existing NOLs and tax attribute carryforwards for taxable years including or following an identified ownership change. Transactions involving the Company s common stock, even those outside the Company s control, such as purchases or sales by investors, within the testing period, could result in an ownership change . Limitations imposed on the ability to use NOLs and tax credits to offset future taxable income could require the Company to pay US federal income taxes in excess of that which would otherwise be required if such limitations were not in effect. net operating losses and tax attributes could expire unused, in each instance reducing or eliminating the benefit of the NOLs and tax attributes. Similar rules and limitations may apply for state income tax purposes.

Disclaimer of Obligation to Update

Except as required by applicable law or regulation, the Company assumes no obligation (and specifically disclaims any such obligation) to update these risk factors or any other forward-looking statement contained in this Annual Report to reflect actual results, changes in assumptions or other factors affecting such forward-looking statements.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

As of February 7, 2012, the Company operated 31 manufacturing and warehouse facilities in nine U.S. states. The Company owns 11 of these facilities with the remainder being leased with initial lease terms that expire at various years through 2032. In addition, our corporate office is a leased facility located in Houston, Texas. The following table sets forth facility locations:

Segment	Owned/Leased	Location
Chemicals	Leased	Raceland, Louisiana
	Owned	Marlow, Oklahoma
	Owned	Carthage, Texas
	Owned	Wheeler, Texas
	Leased	Raceland, Louisiana
	Leased	Wilburton, Oklahoma
	Leased	The Woodlands, Texas
Drilling	Owned	Chickasha, Oklahoma
	Owned	Oklahoma City, Oklahoma
	Owned	Houston, Texas
	Owned	Midland, Texas
	Owned	Robstown, Texas
	Owned	Vernal, Utah
	Owned	Evanston, Wyoming
	Leased	Bossier City, Louisiana
	Leased	New Iberia, Louisiana
	Leased	Shreveport, Louisiana
	Leased	Farmington, New Mexico
	Leased	Corpus Christi, Texas
	Leased	Granbury, Texas
	Leased	Grand Prairie, Texas

	Leased	Houston, Texas
	Leased	Midland, Texas
	Leased	Odessa, Texas
	Leased	Pittsburg, Pennsylvania
	Leased	Wysox, Pennsylvania
	Leased	Casper, Wyoming
Artificial Lift	Owned	Gillette, Wyoming
	Leased	Farmington, New Mexico
	Leased	Gillette, Wyoming

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The Company considers owned and leased facilities to be in good condition and suitable for the conduct of business.

Item 3. Legal Proceedings.
The Company is subject to routine on-going litigation and claims that arise in the normal course

of business. Management is not aware of any pending or threatened lawsuits or proceedings which would have a material effect on the Company s financial position, results of operations or liquidity.

Item 4. Mine Safety Disclosures.
Not applicable.

PART II

Item 5. Market for Registrant s Common Equity,

Related Stockholder Matters and Issuer

Purchases of Equity Securities.

The Company s common stock began trading on the NYSE on December 27, 2007 under the stock ticker symbol FTK. As of the close of business on March 2, 2012, there were 49,306,770 shares of common stock outstanding held by approximately 16,500 holders of record. The last reported sale price of the common stock on the NYSE on March 2, 2012 was $11.13. The Company has never declared or paid cash dividends on common stock. While the

Company regularly assesses the dividend policy, the Company has no current plans to declare dividends on common stock, and intends to continue to use earnings and other cash in the maintenance and expansion of the business. Further, the Company s Revolving Credit and Security Agreement contains provisions that limit its ability to pay cash dividends on its common stock.

The following table sets forth, on a per share basis for the periods indicated, the high and low closing sales prices of common stock as reported by the NYSE. These prices do not include retail mark-ups, mark-downs or commissions.

	2011		2010	
Fiscal quarter ended:	High	Low	High	Low
March 31,	$8.57	$5.12	$1.90	$1.20
June 30,	$9.58	$7.55	$2.24	$1.16
September 30,	$10.55	$4.40	$1.73	$1.01
December 31,	$10.41	$4.16	$5.75	$1.40

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Stock Performance Graph

The performance graph below illustrates a five year comparison of cumulative total returns based on an initial investment of $100 in the Company s common stock, as compared with the Russell 2000 Index and the Philadelphia Oil Services Index for the period 2006 through 2011. The performance graph assumes $100 invested on December 31, 2006 in each of the Company s common stock, the Russell 2000 Index and the Philadelphia Oil Service Index, and that all dividends were reinvested.

The succeeding graph should not be deemed to be filed as part of this Annual Report, does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other filing of the Company under the Securities Act of 1933, as amended, or the Exchange Act, as amended, except to the extent the Company specifically incorporates the graph by reference.

	December 31,					
	2006	2007	2008	2009	2010	2011
Flotek Industries, Inc.	$100	$257	$18	$10	$39	$71
Russell 2000 Index	$100	$98	$65	$83	$105	$101
Philadelphia Oil Service Index (OSX)	$100	$152	$61	$100	$126	$113

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Securities Authorized for Issuance Under Equity Compensation Plans

The following table summarizes equity compensation plan information regarding equity securities authorized for issuance under individual stock option compensation agreements:

Plan category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in the Column(a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	2,529,690	$5.32	2,596,802
Equity compensation plans not approved by security holders			
Total	2,529,690	$5.32	2,596,802

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Item 6. Selected Financial Data.

The following table sets forth certain selected historical financial data and should be read in conjunction with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and Part II, Item 8. Financial Statements and Supplementary Data, which are included elsewhere within this Annual Report. The selected operating and financial position data as of and for each of the five years presented have been derived from audited consolidated Company financial statements, some of which appear elsewhere in this Annual Report. During the annual periods 2007 and 2008, the Company affected a number of business combinations and other transactions that materially impacted the comparability of the information set forth below.

The Company has incurred significant non-recurring charges from 2007 through 2011. During 2010, the Company recorded fixed asset and other intangible impairment charges of $9.3 million. During 2009 and 2008, the Company recorded impairment charges for goodwill and other intangible assets of $18.5 million and $67.7 million, respectively. On July 11, 2007, the Company effected a two-for-one stock split in the form of a 100% stock dividend to the stockholders of record on July 3, 2007. All share and per share information has been retroactively adjusted to reflect the stock split.

	As of and for the Year ended December 31,				
	2011	2010	2009	2008	2007
	(in thousands, except per share data)				
Operating Data					
Revenue	$ 258,785	$ 146,982	$ 112,550	$ 226,063	$ 158,008
Income (loss) from operations	48,888	(6,267)	(33,103)	(30,751)	29,686
Net income (loss)	31,408	(43,465)	(50,333)	(34,242)	16,727
Earnings (loss) per share Basic	0.60	(1.94)	(2.68)	(1.79)	0.91
Earnings (loss) per share Diluted	0.56	(1.94)	(2.68)	(1.79)	0.88
Financial Position Data					
Total assets	$ 232,012	$ 184,807	$ 178,901	$ 234,959	$ 160,793
Convertible senior notes, long-term debt and capital lease obligations, less discount and current portion	100,613	126,682	119,190	120,281	52,377
Stockholders equity (deficit)	78,298	(3,453)	27,196	66,105	77,461

The 2009 and 2008 amounts have been restated upon the Company s adoption of the accounting guidance in Accounting Standards Update (ASU) No. 2009-15, *Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing.*

The table above reflects the results of equity or asset acquisitions of target companies from the respective dates of acquisitions in the following years:

2008 Teledrift, Inc.

2007 Triumph Drilling Tools, Inc., CAVO Drilling Motors Ltd Co., and Sooner Energy Service, Inc.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the related Notes to the Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K (Annual Report). The following information contains forward-looking statements, which are subject to risks and uncertainties. Should one or more of these risks or uncertainties materialize, actual results could differ from those expressed or implied by the forward-looking statements. See Forward-Looking Statements at the beginning of this Annual Report.

Executive Summary

Flotek Industries, Inc. (Flotek or the Company) is a diversified, global, technology-driven company that develops and supplies oilfield products, services and equipment to oil, gas and mining industries. The Company s strategic focus includes oilfield specialty chemicals and logistics, down-hole drilling tools and down-hole production related tools used in oil, gas and mining industries. Flotek also provides automated bulk material handling, loading facilities and blending capabilities. Our products and services enable customers to more efficiently drill wells, increase existing well production and decrease well operating costs. The Company operates in both domestic and international markets, including the

Gulf Coast, Southwest, Rocky Mountains, Northeastern and Mid-Continental regions of the United States (U.S.) as well as Canada, Mexico, Central America, South America, Europe, Africa and Asia and markets products domestically and internationally in over 20 countries. Customers include major integrated oil and natural gas companies, independent oil and natural gas companies, pressure-pumping service companies, national and state-owned oil companies and international supply chain management companies.

The Company s ability to compete in the oilfield services market is dependent upon the ability to differentiate and provide superior products and services while maintaining a competitive cost structure. Domestic operations are reactive to fluctuations in natural gas and oil well drilling activity, well depth and drilling conditions, number of well completions and level of work-over activity in North America. North American drilling activity is aligned with and responsive to the volatility of natural gas and crude oil commodity prices as well as market expectations of future prices. The Company s results of operations are also heavily dependent upon the sustainability of prices charged to customers, which is significantly impacted by drilling activity levels, availability of equipment and other resources and competitive pricing pressures.

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Historical market conditions are reflected in the table below:

	2011	2010	2009	2011 Vs 2010 % Change	2010 Vs 2009 % Change
Average Active Drilling Rigs					
United States	1,879	1,549	1,089	21.3 %	42.2 %
Canada	418	349	221	19.7 %	57.9 %
Total North America	2,297	1,898	1,310	21.0 %	44.9 %
Vertical Rigs (U.S.)	574	502	433	14.3 %	15.9 %
Horizontal Rigs (U.S.)	1,074	825	455	30.2 %	81.3 %
Directional Rigs (U.S.)	231	222	201	4.1 %	10.4 %
Total Drilling Type (U.S.)	1,879	1,549	1,089	21.3 %	42.2 %
Oil vs. Natural Gas Drilling Rigs					
Oil	1,263	795	382	58.9 %	108.1 %
Natural Gas	1,034	1,103	928	(6.3) %	18.9 %
Total North America	2,297	1,898	1,310	21.0 %	44.9 %
Average Commodity Prices					
West Texas Intermediate Crude Prices (per barrel)	$ 94.87	$ 79.40	$ 61.65	19.5 %	28.8 %
Natural Gas Prices ($/mmbtu)	$ 3.94	$ 4.25	$ 3.71	(7.3) %	14.6 %

Source: Rig count: Baker Hughes, Inc. (www.bakerhughes.com); West Texas Intermediate Crude and Natural Gas Prices: Department of Energy, Energy Information Administration (www.eia.doe.gov). Rig counts are the annual average of the reported weekly rig count activity. Gas prices are the annual average of the monthly average natural gas price.

Customers exploration and production budgets, in many instances, depend upon the revenue generated from the sale of oil and natural gas. Lower oil and natural gas prices usually translate into lower exploration and production budgets. The opposite is true for higher oil and natural gas prices.

Crude oil prices were relatively stable for most of 2010. Beginning with the latter part of 2010 and throughout the first six months of 2011 oil prices rose dramatically, becoming increasingly volatile in the second half of 2011 due to ongoing concerns regarding global economic recovery. Our current 2012 outlook forecasts continued oil price upward price pressure due to supply uncertainty offset by uncertainties of economic growth.

Natural gas drilling activity continues to be curtailed with natural gas working inventories at the end of December 2011 totaling 3,852 billion cubic feet (Bcf), approximately 24.4%, or 755 Bcf, above the ending December 2010 levels of 3,097 Bcf.

In 2011, the average monthly U.S. natural gas wellhead price of $3.94/mcf remained depressed

compared to historic highs and is expected to remain so throughout 2012 primarily due to record high natural gas inventories reported for the fourth quarter of 2011. Depressed natural gas prices, increased shale gas production levels and unusually warm 2011 North American winter temperatures contributed to the increased natural gas storage levels. The Company anticipates the rate of growth in natural gas production will continue in 2012, albeit at a slower growth rate than 2011, along with increased storage levels.

Despite this and heightened geopolitical uncertainties, the Company believes that, over the long-term, any major macroeconomic disruptions will ultimately correct themselves as the underlying trends of significant demand growth within developing countries, smaller and more complex reservoir activity, high depletion rates, and the need for continual reserve replacement support the Company s on-going strategic expansion initiatives with patented complex nano-fluid micro-emulsifier chemistries and with increased domestic and international market penetration. The accelerated shift in the latter part of 2010 from natural gas to oil and liquids-rich shale basins has resulted in increased product and service demands as well as increased patented complex nano-fluid chemistry and other technological reliance designed to promote efficiency within complex reservoirs. This trend continued throughout 2011, with horizontal oil-directed drilling activity being the fastest growing segment of the market.

While total worldwide rig count increased 16.1% from December 31, 2010 to December 31, 2011, horizontal-directed rig activity, which is representative of over 58.1% of total North American rigs, is approximately 86.4% higher than horizontal rig count peak levels attained in 2008. These trends have led to increased demand and improved pricing across a significant portion of the Company s products and services. Increased economic activity, particularly in the emerging Middle Eastern and Asian markets, combined with market predictions of continued economic growth within North American markets, remains supportive of a continued increase in demand for oil and stable natural gas. Spending by oil and natural gas exploration and production (E&P) companies is heavily influenced by expectations of future supply and forecast demand for oil and natural gas products, as well as forecast costs to find, develop and produce reserves. Changes in oil and natural gas exploration and production spending resulted in record demand for the Company s products and services for 2011 as compared to 2010.

Despite the shift from natural gas to liquids rich natural gas drilling, spending on natural gas-directed projects is supported by (1) hedges on prior period production transacted when futures prices were higher, (2) the need to drill and produce natural gas wells to hold leases acquired in earlier periods, (3) the influx of equity from companies interested in penetration and development of shale resource plays, and (4) associated production of natural gas liquids in certain basins. Further, E&P companies have improved discovery and production techniques to the point that despite current relatively depressed natural gas prices, drilling for natural gas continues to be economically viable for our customers.

The Company anticipates current economic conditions will continue throughout the first half of 2012 despite the market and economic uncertainties noted above. The Company remains cognizant that if further unfavorable economic conditions occur, the Company

could be impacted by additional drilling activity uncertainty. Going forward the Company believes current activity will ensure margin sustainability, but anticipates that growing cost pressures could mitigate forecast margin improvements in 2012.

As the outlook for E&P companies improves with favorable expectations of liquid-rich natural gas and crude oil prices, we remain optimistic that our customer s capital budgets for drilling and completion activities will continue to hold and possibly strengthen.

The Company expects that North American gas market activity will remain relatively stable in unconventional plays such as the Barnett, Marcellus and other basins that utilize the Company s products and services. Additionally, growing recognition of the beneficial use and corresponding increase in demand for the Company s patented, environmentally friendly (green) complex nano-fluid micro-emulsifiers is expected to continue. Product demand, driven by forecast market share growth, continues to trend favorably. The Company intends to continue to pursue strategic international initiatives and opportunities through 2012 and beyond.

Flotek s business is comprised of three reportable segments: Specialty Chemicals (Chemicals), Drilling Products (Drilling) and Artificial Lift. The Chemicals and Drilling segments provide drilling and completion related products and services, while the Artificial Lift and Chemicals segments provide production related products and services. Products and services, offered combined with increased geographic market penetration, have ensured diversified sources of cash flows; thereby reducing dependence upon any one segment. While each segment s technical expertise is unique, all segments are committed to provide customers with quality, competitively priced products and services.

The Chemicals segment is comprised of the Specialty Chemicals and Logistics divisions. Specialty Chemicals design, develop, manufacture, package and market specialty chemicals used in oil and natural gas well cementing, stimulation, acidizing, drilling and production activities, while the Logistics division manages automated material handling, loading facilities, and blending capabilities for oilfield services companies.

The Drilling segment rents, inspects, manufactures and markets down-hole drilling equipment necessary to energy, mining, water well and industrial drilling activities.

The Artificial Lift segment assembles and markets artificial lift equipment, notably our Petrovalve product line of rod pump components, electric submersible pumps, gas separators, valves and services that support coal bed methane production activities.

Flotek s on-going diversification of products and services offered as well as continued geographic market expansion realized from strategic acquisitions, organic growth and investments in complementary or competing businesses mitigates cyclical risk exposure by balancing drilling and production; rental and service; domestic and international; and natural gas and crude oil activities.

We remain committed to chemical production capacity expansion to ensure responsiveness to increasing customer demand and also to the expansion of our drilling jar and shock subs fleets to further reduce sub-rental usage. The Company will continue to pursue and develop new and existing international market opportunities associated with our specialty chemical products and with our Teledrift division s measurement while drilling (MWD) products in 2012.

The Company anticipates drilling and completion activity will increase or remain comparable to levels realized during 2011. North American and international market conditions are forecast to improve slightly and pricing is expected to increase

or, at a minimum, remain competitive in 2012; however, growing cost pressures could moderate anticipated margin improvements.

The Company s commitment to research and development (R&D) efforts within the chemicals business has ensured the Company s ability to remain responsive to increased demand and growth in unconventional liquid rich and oil sand formation plays. As a result of success in unconventional areas such as the Marcellus Shale, Niobrara and Eagle Ford, the Company expects to continue to experience increased demand and growth, particularly with complex nano-fluid micro-emulsifier products. Further, the drilling business has adapted several designs in the Company s motor line of business in order to operate more successfully in areas such as Haynesville, Barnett and Bakken. Improvements in operational efficiencies have allowed the Company s artificial lift business to increase in market share, even as depressed natural gas prices have negatively impacted coal bed methane drilling activity.

Capital expenditures in the specialty Chemicals business totaled \$2.2 million in 2011 compared to \$1.2 million in 2010, or 1.6% and 1.8%, respectively, as a percentage of revenue. Capital expenditures in the Drilling products business totaled \$6.0 million in 2011 compared to \$4.7 million in 2010. In 2011, the Company responded to growth in customer demand with increased capital investment to meet customer expectations and to take advantage of market opportunities. For 2012, Chemicals and Drilling segment capital expenditures are forecast to be \$6.1 million and \$8.2 million, respectively, but could fluctuate with changing market demand and realized results of operations.

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Results of Operations (in thousands):

	Year ended December 31,		
	2011	2010	2009
Revenue	$ 258,785	$ 146,982	$ 112,550
Cost of revenue	(152,965)	(94,012)	(83,166)
Gross margin	105,820	52,970	29,384
Selling, general and administrative costs	(50,612)	(41,861)	(36,943)
Depreciation and amortization	(3,983)	(4,543)	(4,926)
Research and development costs	(2,337)	(1,441)	(2,118)
Impairment of long-lived assets	-	(8,898)	-
Loss on disposal of long-lived assets	-	(2,104)	-
Impairment of goodwill or other intangible assets	-	(390)	(18,500)
Income (loss) from operations	48,888	(6,267)	(33,103)
Change in fair value of warrant liability	9,571	(21,464)	465
Interest and other expense, net	(19,189)	(21,279)	(15,679)
Income (loss) before income taxes	39,270	(49,010)	(48,317)
(Provision) benefit for income taxes	(7,862)	5,545	(2,016)
Net Income (loss)	$ 31,408	$ (43,465)	$ (50,333)

Results for 2011 compared to 2010 Consolidated

Revenue for the year ended December 31, 2011 totaled $258.8 million, an increase of $111.8 million,

or 76.1%, compared to $147.0 million for the same period in 2010. The increase in revenue in 2011 was across all Company segments and was due to positive market fluctuations combined with strategic initiatives undertaken by the Company. Increased oil prices, drilling activity, customer demand and shifts to higher margin product mix contributed to the period over period increase. Company expansion into new and within existing markets with strategic product adaptation, product customization and new product development as well as cross marketing of products, revitalization of sales force, and price increases in certain product lines also contributed to increased revenue in 2011.

The consolidated gross margin as a percentage of sales increased by 4.9% to 40.9% for the year ended December 31, 2011 from 36.0% in 2010 due to strategic price increases, shift in customer demand to higher margin products, continued cost containment, sales force revitalization, product cross marketing initiatives and increased market penetration. Gross margin is calculated as revenue less associated cost of revenue, inclusive of personnel, occupancy, depreciation and other expenses directly associated with the generation of revenue.

Selling, general and administrative costs, (SG&A) are not directly attributable to products sold or services rendered. SG&A as a percentage of revenue for the year ended December 31, 2011 decreased by 8.9% to 19.6% from 28.5% for the same comparable period of 2010. SG&A costs totaled $50.6 million for the year ended December 31, 2011, an increase of $8.7 million, or 20.8%, compared to $41.9 million in 2010. The comparative period over period increase was due primarily to increased salaries and wages and cash and equity incentive compensation. Salary and wage expense increased as a result of a 21.5% increase in headcount, overtime expense related to increased segment activity ($3.8 million), and sales commission expense primarily related to increased sales activity within Drilling ($0.7 million). Cash and equity incentive compensation increased in 2011 ($1.7 million and $2.8 million, respectively) due to improved period over period operational performance.

Depreciation and amortization expense totaled $4.0 million for the year ended December 31, 2011, a decrease of approximately $0.5 million, or 12.5%, compared to 2010 primarily due an impairment and correspondent reduction in the depreciable basis of fixed assets in December 2010. No comparable activity occurred in 2011.

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Research and development (R&D) expenses totaled $2.3 million during 2011, an increase of $0.9 million, or 64.3%, compared to $1.4 million in 2010. The increase in R&D expense is attributable to increased research activity related to new product development. R&D is charged to expense as incurred.

During the year ended December 31, 2011, the warrant liability decreased by $9.6 million to $16.6 million. The decrease was recognized in the statement of operations as noncash income. The decrease is primarily related to the exercise of approximately 4.0 million warrants during 2011. Approximately 1.9 million warrants remain outstanding and unexercised for conversion into 1.9 million of the Company s common shares. This liability will never result in any cash settlement. All fluctuations in the warrant liability are recognized as noncash income or expense.

Interest and other expense totaled $19.2 million for the year ended December 31, 2011, a decrease of $2.1 million, or 9.8% compared with $21.3 million in 2010. The decrease was attributable to a $3.5 million period over period reduction in interest expense associated with early repayment of the Company s term loan in June 2011, partially offset by accelerated recognition of $1.7 million unamortized term loan debt issuance costs and $1.9 million unamortized debt discount, resulting in $5.2 million of losses from the early extinguishment of debt during 2011.

Income tax expense of $7.9 million was recorded for the year ended December 31, 2011, reflecting an effective tax rate of 20.0%, compared to a tax benefit of $5.5 million for the year ended December 31, 2010, reflecting an effective tax rate of (11.3%). The change in the Company s effective tax rate is primarily due to $9.6 million increase of non-cash fluctuations in the fair value of the Company s warrant liability and decrease in valuation allowance of $3.5 million in 2011 against the deferred tax asset of one of the filing jurisdictions.

Results for 2010 compared to 2009 Consolidated

Revenue for the year ended December 31, 2010 totaled $147.0 million, an increase of $34.4 million, or 30.6%, compared to $112.6 million for the same period in 2009. Revenue increased across all of the

Company s segments due to improved pricing, increased drilling activity, and recovery of industry demand for products.

Consolidated gross margins as a percentage of sales increased to 36.0% for the year ended December 31, 2010 from 26.1% for the same period in 2009. This favorable variance resulted from increased product sales ($21.5 million or 29.7%) and rental revenue ($13.5 million or 47.3%) combined with direct operational expense savings offset by a 13.0% increase in cost of revenue driven by increased costs of materials, rentals and freight proportionate to increased activity.

SG&A costs for the year ended December 31, 2010 were $41.9 million, an increase of 13.3%, compared to $36.9 million in 2009. The comparative period over period increase resulted from increased incentive stock compensation and professional fees of $4.0 million and $2.1 million, respectively. Non-cash incentive stock compensation increased in 2010 primarily due to recognition of $3.0 million of expense attributable to prior equity grants to the Company s former President and CEO, which vested at the time of his retirement from the Company on June 30, 2010 as well as vesting of other outstanding existing equity grants. The increase in professional fees primarily related to the Company s March 31, 2010 Senior Credit Facility financing and use of independent third party technical consultants (e.g., information technology; investment; and valuation experts).

Depreciation and amortization costs totaled $4.5 million for the year ended December 31, 2010, a decrease of approximately 8.1% compared to the same period in 2009.

Research and development (R&D) expenses totaled $1.4 million for the year ended December 31, 2010, a decrease of 33.3%, compared to $2.1 million during the same period in 2009. The reduction in R&D expense is attributable to realigned expenditures for key strategic initiatives resultant from the 2010 global economic recession and management cost containment efforts.

Costs associated with impairments were $8.9 million and $0.4 million, related to long-lived asset and other intangibles, for the year ended December 31, 2010, decreased $9.2 million or

49.8% compared to $18.5 million in 2009. The impairment valuation recognized during 2010 primarily related to long-lived assets within the Drilling segment. During the fourth quarter of 2010, revenue generation trends of certain identified rental assets were not performing as anticipated by management. Upon analysis, management determined the recoverability of the carrying value of identified assets to be less than the expected revenue generation capacity of identified assets. The Drilling segment recognized $18.5 million of goodwill impairment in 2009. Revenue within the Drilling segment increased $15.0 million, or 29.6% due to increased demand for products resulting from a shift in type of drilling activity as well as fluctuations in oil and natural gas commodity prices.

Interest expense totaled $19.4 million for the year ended December 31, 2010, an increase of $3.9 million or 25.0% compared with $15.5 million

in 2009 due to an increase in interest rate associated with the refinancing the Company s senior credit facility from 8.5% to 12.5% combined with recognition of related issuance costs of $2.0 million, commitment fee payments of $7.3 million and $0.4 million settlement of the Company s interest rate swap incurred during the year.

An income tax benefit of $5.5 million was recorded for the year ended December 31, 2010, reflecting an effective tax rate of (11.3)%, compared to a tax provision of $2.0 million for the year ended December 31, 2009, reflecting an effective tax rate of (4.2%). The change in the effective tax rate was primarily due to a $4.2 million increase in valuation allowance recorded in 2010 against the deferred tax asset of one of our filing jurisdictions and $7.5 million of permanent differences recorded in 2010 related to the warrant liability.

Results by Segment

	Year ended December 31,		
Chemicals (dollars in thousands)	2011	2010	2009
Revenue	$ 140,836	$ 66,121	$ 49,296
Gross margin	$ 56,115	$ 29,249	$ 21,667
Gross margin %	39.8 %	44.2 %	44.0 %
Income from operations	$ 43,549	$ 19,833	$ 12,964
Income from operations %	30.9 %	30.0 %	26.3 %

Results for 2011 compared to 2010 Chemicals

Chemicals 2011 revenue totaled $140.8 million, an increase of $74.7 million, or 113.0%, compared to $66.1 million in 2010 due to increased oil-directed and liquid-rich natural gas drilling activity driven by increased global crude oil prices and stabilized liquid-rich natural gas prices. Increased product sales volumes contributed to the period over period increase in revenue. Increased sales volumes of stimulation liquids contributed to $70.4 million of the 2011 increase. Strategic adaptation of proprietary natural gas effective complex nano-fluid micro-emulsifiers to oil effective complex nano-fluid micro-emulsifiers in conjunction with new and increased existing customer demand, domestic and international market penetration and industry growth,

particularly within the Bakken and Niobrara shale plays, contributed to the period over period increase in revenue. Increased cross-marketing sales efforts resulted in increased industry recognition of proven production efficiencies and environmental benefits derived from use of both new and existing products and increased demand for microemulsion product in both domestic and international markets. Strategic sales marketing efforts during 2011 further enhanced customer awareness and demand of a broader range of products and services available within the Company s overall portfolio. Additionally, a $4.3 million contribution to incremental year over year revenue resulted from existing project completions and newly contracted construction project activity.

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Chemicals 2011 gross margin increased $26.9 million, or 91.5%; yet declined 4.4% as a percentage of revenue as compared to 2010. The period over period increased gross margin is primarily attributable to increased pricing instituted in June of 2011 combined with increased domestic and international market product penetration. The year over year decline in the gross margin as a percentage of revenue is attributable to increased raw material costs due to supply shortages in 2011, customer demand shift to lower margin products, increased transportation expense and increased international storage facility fees.

The Company s decision to expand the breadth of the suite of chemical offerings, combined with newly developed products in 2011 tailored to customer specifications, resulted in lower margins due to increased raw material costs and competitive pricing constraints. Although customer tailored product gross margins as a percentage of revenue are in general lower than traditional product margins, the favorable increase in product sales volumes and customer demand were contributory to the Company s bottom line. Identification of synergistic market opportunities, growth of domestic and international market share, and cost containment efforts remained a Company priority throughout 2011. Cost management initiatives and vendor pricing negotiations are expected to result in raw material price reductions and purchasing efficiencies in 2012. Direct operating costs as a percentage of revenue decreased 2.0% in 2011 to 3.3% versus 5.3% realized in 2010 and were indicative of the Company s continued oversight and management of operational costs.

Income from operations increased $23.7 million, or 119.6%, in 2011 compared to 2010 due to increased product sales and service volumes of 4.8 million gallons, average enacted price increases of approximately 7.0%, and a 18.5% increase in North

American drilling activity realized in 2011 as compared to 2010.

R&D activity increased $0.9 million, or 62.1%, in 2011 as compared to 2010 due to new product development and preservation of intellectual property rights.

Results for 2010 compared to 2009 Chemicals

Chemicals revenue for 2010 totaled $66.1 million, an increase of $16.8 million, or 34.1%, as compared to $49.3 million in 2009. Recovery of previously granted product and service price reductions, increased international sales and increased demand from new and existing customers for the Company s proprietary complex nano-fluid micro-emulsion products, as well as new product development drove the year over year increase in revenue. Increased product sales of $17.5 million were offset by $0.7 million of decreased service revenue in 2010 as compared to 2009 due to industry uncertainty regarding ramifications of the British Petroleum Deepwater Horizon oil disaster. Further, the 2010 Gulf of Mexico drilling moratorium significantly impacted a Logistics division contract in the Gulf of Mexico.

Gross margins increased $7.6 million, or 35% in 2010 as compared to 2009, yet as a percentage of revenue remained relatively flat at 44.2% in 2010 versus 44.0% in 2009 due to increased product sales volumes of more favorable year over year product mix margins.

Income from operations totaled $19.8 million in 2010, an increase of approximately $6.8 million, or 53.0%, compared to $13.0 million in 2009 and as a percentage of revenue increased to 30.0% from 26.3% in 2010 versus 2009, respectively. Favorable variance was attributable to increased product sales volumes and more favorable year over year product mix margins.

	Year ended December 31,		
Drilling Products (dollars in thousands)	2011	2010	2009
Revenue	$ 102,470	$ 65,782	$ 50,774
Gross margin	$ 43,607	$ 18,991	$ 4,781
Gross margin %	42.6 %	28.9 %	9.4 %
Income (loss) from operations	$ 23,035	$ (9,738)	$ (32,084)
Income (loss) from operations %	22.5 %	(14.8) %	(63.2) %

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Results for 2011 compared to 2010 Drilling

Drilling revenue for the year ended December 31, 2011 totaled $102.5 million, an increase of $36.7 million, or 55.8% compared to $65.8 million for the year ended December 31, 2010. The favorable variance resulted from domestic and international market share growth with both new and existing customers, change in customers product mix demands, increased rig count, increased lost in hole revenue, favorable crude oil commodity prices, new product development, specialized customer demand for existing product adaptation, continued cross segment sales marketing efforts, sales force revitalization, and competitive pricing relief.

Product revenue: 2011 product revenue increased $11.6 million as compared to 2010. Increased market share penetration of motor and centralizer products in new and existing markets combined with increased oil and horizontal rig drilling activity, cross segment sales marketing efforts and increased crude commodity prices resulted in $8.0 million of period over period incremental revenue. Raised drill pipe, collar and reamer equipment sales increased $3.6 million period over period from increased customer demand within gold and silver mining industries due to increased gold and silver commodity prices period over period. Gold and silver prices increased by approximately $312/oz. and $8.50/oz., respectively, driving increased demand of both domestic and international customers.

Rental revenue: 2011 rental revenue increased $21.4 million as compared to 2010. Increased market share penetration within new and existing domestic and international markets, product mix demand shift to Pro-Tools from legacy tools, and associated increased oil and horizontal rig drilling activity resulted in $8.7 million of incremental period over period revenue. Tool rentals increased by 26.2% from 3,118 rentals in 2010 to 3,934 rentals in 2011 and contributed to $7.6 million of the period over period increase. Increased rental prices and lost in hole revenue during 2011 contributed $4.9 million and $1.4 million, respectively. Increased lost in hole revenue was attributable to the overall increase in activity in 2011 as compared to 2010.

Service revenue: Incremental 2011 service revenue of $3.6 million as compared to 2010 was directly related to increased oil and horizontal rig drilling activity, increased prices of services, and increased international motor service.

Drilling s 2011 gross margin increased $24.0 million, or 129.6%, relative to 2010 driven by increased product, rental and service prices, product mix shift to higher margin products and continued cost containment. Efforts to market higher margin motors within targeted market growth areas also contributed to the period over period increase. Gross margins as a percentage of revenue increased 13.7%, from 28.9%, to 42.6%, in 2011 versus 2010, respectively. 2011 Drilling revenue increased 55.8% compared to 2010 with only a 20.5%, increase in associated cost of revenue due to continued cost containment efforts and focus on operational efficiencies.

Income from operations totaled $23.0 million in 2011, a recovery of $32.8 million, or 336.5%, as compared to the loss from operations of $9.8 million in 2010. Improved performance is attributable to an amalgamation of the afore referenced.

Results for 2010 compared to 2009 Drilling

Drilling revenue in 2010 increased 29.6% compared to 2009 due primarily to $13.6 million of increased rental activity and 16.0% increase in vertical rig count period over period. 2010 increased rental activity attributable to Teledrift and Spidle/Turbeco product lines was $6.4 million and $7.1 million, respectively. Teledrift product revenue growth was the result of incremental activity in the West Texas region, improved overall market conditions, focused sales marketing efforts and increased lost-in-hole revenue. Spidle/Turbeco product revenue growth resulted from increased motor rentals in both the Barnett and Bakken shale plays. Improved motor designs to increase functionality in historically difficult basins supported increased pricing and run rates throughout 2010. Increased product sales activity in 2010 versus 2009 contributed $1.3 million to the incremental period over period increase and was driven by increased product sales volumes within domestic and international copper mining industry markets due to 2010 escalation in the market price of copper.

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Drilling s gross margin increased to $19.0 million in 2010, an increase of $14.2 million, or 297.2%, compared to $4.8 million in 2009 and as a percentage of revenue increased 19.5% to 28.9% in 2010 from 9.4% in 2009 primarily due to increased rental volumes and favorable product mix margins.

Loss from operations was $9.8 million in 2010, an improvement of $22.3 million or 69.6% as compared

to $32.1 million loss in 2009. Improved performance was primarily attributable to a $9.6 million positive variance of $9.3 million impairment of long-lived and other intangible assets realized in 2010 as compared with the $18.5 million impairment of goodwill realized in 2009, combined with the $13.6 million increase in rental revenue in 2010.

	Year ended December 31,		
Artificial Lift (dollars in thousands)	2011	2010	2009
Revenue	$ 15,479	$ 15,079	$ 12,480
Gross margin	$ 6,098	$ 4,730	$ 2,936
Gross margin %	39.4 %	31.4 %	23.5 %
Income from operations	$ 4,296	$ 3,070	$ 1,161
Income from operations %	27.8 %	20.4 %	9.3 %

Results for 2011 compared to 2010 Artificial Lift

Artificial Lift revenue is primarily derived from coal bed methane (CBM) drilling activity, and is highly correlated to the price of natural gas. Artificial Lift revenue increased $0.4 million to $15.5 million in 2011 from $15.1 million in 2010 primarily due to $3.1 million of incremental year over year international revenue tempered with softened unit installation activity due to lower than expected 2011 natural gas prices, as compared to 2010. The Company anticipates international product sales activity will continue to be significant for the first six months of 2012.

Artificial Lift s gross margin increased $1.4 million, or 28.9% to $6.1 million in 2011 from $4.7 million in 2010 due to greater than average margins realized on international product sales which were partially offset by increased replacement inventory costs and the inability to pass incremental price increases on to certain customers due to industry pricing constraints. Cost of revenues decreased $1.3 million or 13.6% as a percentage of revenue primarily due to higher margins realized on international product sales.

Income from operations improved $1.2 million or 39.9% to $4.3 million in 2011 from $3.1 million in 2010 due to international product sales activity

coupled with tempered sales and unit installation activity due to continued natural gas price depression and increased replacement inventory costs.

Results for 2010 compared to 2009 Artificial Lift

Artificial Lift revenue for the year ended December 31, 2010 was $15.1 million, an increase of $2.6 million, or 20.8%, compared to $12.5 million for the year ended December 31, 2009. Throughout 2010, natural gas prices and natural gas drilling rig count steadily increased. The increase in natural gas prices and corresponding drilling activity resulted in increased unit installations.

Gross margin increased 61.1% in 2010 as compared to 2009 due to increased product revenue of $2.3 million or 19.9% period over period combined realized cost containment efficiencies. Raw materials and direct expenses decreased as a percentage of revenue to 69% in 2010 from 76% in 2009 due to the fixed nature business cost structure and management s cost containment efforts.

Income from operations improved 164.4% in 2010 compared to 2009 due to increased customer demand driven by the period over period increase in the average price of natural gas and the corresponding increase in drilling activity.

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Capital Resources and Liquidity

Overview

Ongoing capital requirements result from the Company s need to service debt, acquire and maintain equipment, and fund working capital requirements. During 2011, the Company funded capital requirements primarily with operating cash flows, sale of common shares, and conversion of shares of exercisable and contingent warrants.

The global recession continued to affect the Company s financial performance and liquidity in 2011; favorably trending Crude oil commodity prices, well completions and horizontal rig count throughout 2011 and sales in conjunction with new and existing market share penetration initiatives, increased demand for products and services across all business segments.

At December 31, 2011, the Company remained compliant with debt covenants. Significant terms of the Company s term loan are discussed under Item 8. Financial Statements and Supplementary Data within Note 10 of the Notes to the Company s Consolidated Financial Statements.

At December 31, 2011, the Company remained compliant with the continued listing standards of the NYSE. The Company was not compliant during 2010 due to failure to maintain NYSE global market capitalization and stockholders equity requirements in 2009. In March 2010, the Company submitted a plan of action to the NYSE which outlined management s plan to achieve compliance during the 18-month cure period, allowed by the NYSE, which ended June 2011. During implementation and execution of the plan, the Company s common stock continued to be listed on the NYSE, subject to compliance with other NYSE continued listing requirements. On March 29, 2010, the NYSE accepted the Company s plan of action and on March 24, 2011, the NYSE notified the Company of compliance with listing standard requirements and full reinstatement.

Cash and cash equivalents totaled approximately $46.7 million at December 31, 2011 primarily attributable to cash flows from operations. During 2011, the Company received proceeds of $4.8 million from the exercise of Exercisable and Contingent Warrants, and $29.4 million from the

private placement of 3.6 million common shares. Additionally, the Company realized proceeds of $5.3 million primarily attributable to lost-in-hole and asset sales activity. During the first half of 2011 the Company paid down $32.6 million of principal on the term loan debt, $1.0 million of commitment fees and $0.7 million in capital lease payments. The Company also utilized $16.6 million in working capital requirements and $10.0 million in capital expenditures. Favorable operating cash results, forecast increased activity and level of products and services demand in conjunction with current cash position and future outlook attributed to a $2.2 million increase in 2012 budgeted capital expenditures to $14.4 million from budgeted capital expenditures of $12.2 million in 2011.

Sufficient cash reserves are expected to be available to meet anticipated operating and capital expenditure requirements during 2012; however, the Company continues to explore alternative options to secure more favorable debt and equity financing terms.

During January 2012 the Company repaid $36.0 million to settle in full outstanding obligations of the 5.25% convertible senior secured notes, 2010 Notes. Additional details of the repayment are discussed under Item 8. Financial Statements and Supplementary Data, Note 18 Subsequent Events. As of the end of January 2012, the Company had not drawn any funds against the revolving credit agreement.

Plan of Operations for 2012

The improvement in oil prices, tempered by liquid-rich natural gas price fluctuations increased oil and horizontal rig drilling activity and increased domestic and international market penetration initiatives during 2011 as compared to 2010 directly impacted the demand for Flotek s products and services. Forecasting the depth and length of the recovery cycle of the current economy is challenging due to worldwide financial uncertainties. The 2011 annual average North American drilling rig count increased by 399 rigs, or 21.0%, to 2,297 rigs from the 2010 annual average North American drilling rig count of 1,898. Increased drilling activity combined with market share growth primarily contributed to the period over period revenue growth of 76.1% and an

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increased gross margin percentage of 4.9% compared to 2010.

The Company s 2012 Plan of Operations anticipates sustained industry economic conditions and includes the following initiatives:

Explore funding opportunities/alternatives with financial advisors.

The capital expenditure budget for 2012 totals approximately $14.4 million, an increase of $2.2 million or 36.1% increase from the $12.2 million budgeted in 2011.

Expansion into identified/opportunistic foreign markets in order to realize strategic benefits for existing business segments. Continue to actively explore opportunities with existing and potential business partners to broaden geographic market penetration and/or use of new and existing products and services.

Strategic identification and sale of non-core assets and underperforming product lines. Continue identification of assets no longer aligned with strategic objectives and identify/quantify divestiture alternatives. In addition to providing liquidity, the sale of non-strategic assets would continue to concentrate efforts and resources on improvements and expansion of marketable products.

Emphasis on development of product lines that could be contributory to gross margin improvement.

Continue assessment of both outsourcing and insourcing opportunities to support operational improvements

Manage operating cash flows with receivables, payables and inventory management. Increased cash flow from inventory management will continue as demand for products increases. Continue management of working capital and revisit pricing strategies/adjust prices to obtain the most favorable market positions that conditions and environments allow.

Manage asset utilization to enhance and increase operational and market sale synergies across all business and product lines to remain responsive to market demand or products and services.

Emphasize technological advancement and differentiation across all business segments. Maintain current and ongoing R&D activities supporting Chemicals complex nano-fluid technology and chemical additive solutions and Drilling s product design differentiation to remain responsive and proactive to specifically identified opportunities and customer product and service within expanding geographic markets.

Implement a new ERP system to more actively manage internal controls, reduce current accounting constraints and enhance operational responsiveness.

Continue to simplify existing tax structure, while taking advantage of existing NOL s and automating intercompany and consolidation processes.

Cash Flows

Cash flow metrics from the consolidated statements of cash flows are as follows (in thousands):

	Year ended December 31,		
	2011	2010	2009
Net cash provided by operating activities	$ 32,423	$ 12,099	$ 2,186
Net cash used in investing activities	(4,942)	(600)	(3,699)
Net cash provided by (used in) financing activities	(521)	1,900	7,812
Effect of exchange rate fluctuations	(141)	(21)	(7)
Net increase in cash and cash equivalents	$ 26,819	$ 13,378	$ 6,292

Operating Activities

During 2011, 2010 and 2009, cash from operating activities totaled $32.4 million, $12.1 million and $2.2 million, respectively. Consolidated net earnings

for 2011 totaled $31.4 million compared to a consolidated net loss of $43.5 million for 2010 and a consolidated net loss of $50.3 million for 2009.

Noncash items recognized in 2011 totaled $17.5 million, which consisted of asset depreciation and amortization ($10.1 million), amortization of deferred financing costs and accretion of debt discount ($8.4 million), stock compensation expense ($7.4 million), loss on the extinguishment of debt ($3.2 million) and deferred for income tax provision ($1.9 million) offset by a reduction in the fair market value of the warrant liability ($9.6 million), net gain on the sale of assets of ($3.4 million) and an increase in the tax benefit related to share-based awards ($0.6 million).

Noncash items in 2010 totaled $55.9 million, consisted of an increase in the fair market value of warrant liability ($21.5 million), asset depreciation and amortization ($13.8 million), impairment of long-lived assets and other intangibles ($9.3 million), amortization of deferred financing costs and accretion of debt discount ($8.9 million), stock compensation expense ($4.7 million), reduction in the tax benefit of share-based awards ($1.7 million) and a loss on the extinguishment of debt ($1.0 million) offset by a net gain on the sale of assets of $1.3 million and a deferred income tax benefit ($3.6 million).

Noncash items in 2009 were $49.4 million and consisted of an impairment of goodwill ($18.5 million), asset depreciation and amortization ($14.2 million), deferred income tax provision ($10.5 million), amortization of deferred financing costs and accretion of debt discount ($6.4 million), and stock compensation expense ($1.7 million), offset by a net gain on the sale of long-lived assets ($1.4 million).

During 2011 changes in working capital used $16.5 million of cash. The change in working capital was primarily due to working capital utilization to meet increased demands of the improved global economic environment. Use of working capital was evidenced by increased accounts receivable ($17.9 million), increased inventory ($10.0 million) and increased other current asset ($0.9 million) offset by reductions in working capital obligations within accounts payable ($5.0 million) and federal income tax payable ($7.6 million).

During 2010 changes in working capital used $0.4 million in cash. The change in working capital is primarily due to working capital utilization to meet increased economic demands offset by efforts to match customer collection activity with vendor

payments. Use of working capital is evidenced by increased accounts receivable and inventory balances ($12.7 million and $0.6 million, respectively) offset by reductions in working capital obligations in accounts payable ($5.5 million), accrued liabilities ($4.6 million) and income tax receivables ($3.6 million).

Investing Activities

During 2011, 2010 and 2009, capital expenditures were $10.0 million, $6.1 million and $6.6 million, respectively. Capital expenditures for 2011 increased due to the investment in capital infrastructure required to meet increased customer products and service demands, as well as increased drilling and market activity. Capital expenditures remained relatively consistent between 2010 and 2009 given the economic uncertainty during both years in addition to the Company closely monitoring and maintaining available cash. Capital expenditures in 2010 were for motors, shocks, jars, subs and instruments as well as fleet service vehicles to meet and support increased customer demand. Capital expenditures in 2009 were made to expand the Company s rental tool fleet (primarily mud motors, MWD tools, shock subs and drilling jars), construct a larger facility for Teledrift operations and purchase additional plant and machinery, primarily machines to repair motors and for use in R&D activities. Cash flows used in investing activities during 2011, 2010 and 2009 were primarily offset with proceeds from the sale of assets of $5.3 million, $5.5 million, and $2.9 million, respectively.

Financing Activities

During 2011, financing activities used net cash of $0.5 million. During 2010 and 2009, financing activities provided net cash of $1.9 million and $7.8 million, respectively.

During 2011, the Company repaid $32.6 million outstanding Term Loan principal and made $0.7 million of capital lease payments. Additional cash used during 2011 consisted of $1.0 million of commitment fees related to the Term Loan, $0.4 million of Revolving Credit Facility origination fees, and $0.8 million of common stock repurchases associated with vesting of equity grants and corresponding tax payments settled in equity. Offsetting cash used were $29.4 million of proceeds from the sale of 3.6 million shares of the Company s common stock on May 11, 2011, $4.8 million in proceeds from warrant exercises, $0.6 million of increased excess tax benefits related to stock-based compensation and $0.1 million of proceeds from the exercise of stock options.

During 2010, the Company entered into a new term loan ($40.0 million) and received cash as a result of the exercise of contingent and exercisable stock warrants ($4.5 million). Repayments of indebtedness included settlement of the Company s existing senior credit facility with Wells Fargo ($32.0 million) and required principal payments under the Whitebox financing term loan of ($6.4 million). The Company used proceeds received as payment for associated debt issuance costs ($2.0 million). The Company also recognized a reduction in excess tax benefits related to share-based awards ($1.7 million).

During 2009, the Company received net advances ($21.8 million) from existing credit facilities and proceeds from the issuance of preferred stock ($16.0 million). Repayments include payments made on indebtedness ($27.8 million), expenses related to debt issuance costs ($0.9 million), and costs related to issuance of preferred stock and warrants ($1.2 million).

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 December 31, 2011, 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 is material to investors.

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.

Material contractual obligations consist of repayment of amounts borrowed through the 2008 Notes, Senior Credit Facility debt, capital and operating lease obligations. Contractual obligations at December 31, 2011 are as follows (in thousands):

	Payments Due by Period				
	Total	1 year	2 - 3 years	4 -5 years	More than 5 years
Secured convertible senior notes (1)	$ 36,004	$ -	$ 36,004	$ -	$ -
Unsecured senior convertible notes	70,500	-	70,500	-	-
Interest expense on convertible notes (2)	8,387	5,591	2,796	-	-
Capital lease obligations	1,642	767	875	-	-
Operating lease obligations	4,902	1,762	1,141	586	1,413
Total	$ 121,435	$ 8,120	$ 111,316	$ 586	$ 1,413

(1) The Company repaid in January 2012. $36.0 million to eliminate obligations pursuant to the Secured convertible senior notes. See Note 18. for more details surrounding repayment of the 2010 Notes.

(2) Interest at 5.25%, payable semi-annually on February 15 and August 15, with principal repayment on February 15, 2013, the date of the holder s first put option.

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Critical Accounting Policies and Estimates

The Company s consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). Preparation of these statements requires management to make judgments, estimates and assumptions that affect the amounts of assets and liabilities in the financial statements and revenue and expenses during the reported periods. Significant accounting policies are described in Note 2 Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements. The Company believes the following accounting policies are critical due to the significant, subjective and complex judgments and estimates required when preparing the consolidated financial statements. The Company regularly reviews the judgments, assumptions and estimates related to the critical accounting policies.

Revenue Recognition

Revenue for product sales and services are recognized when all of the following criteria have been met: (a) persuasive evidence of an arrangement exists, (b) products are shipped or services rendered to the customer and all significant risks and rewards of ownership have passed to the customer, (c) the price to the customer is fixed and determinable, and (d) collectability is reasonably assured. The Company s products and services are sold based on a purchase order and/or contract and have fixed or determinable prices. There is typically no right of return or any significant post delivery obligations. Probability of collection is assessed on a customer-by-customer basis.

Revenue and associated accounts receivable in the Chemicals, Drilling and Artificial Lift segments are recorded at the agreed price when the aforementioned conditions are met. Generally a signed proof of obligation is obtained from the customer (delivery ticket or field bill for usage). Deposits and other funds received in advance of delivery are deferred until the transfer of ownership is complete.

The Logistics division of chemicals recognizes revenue related to design and construction oversight contracts using the percentage-of-completion method of accounting, measured by the percentage of costs incurred to date proportionate to the total estimated costs of completion. This calculated percentage is applied to the total estimated revenue at completion to calculate revenue earned to date. Contract costs include all direct labor and material

costs, as well as indirect costs related to manufacturing and construction operations. General and administrative costs are charged to expense as incurred. Changes in job performance metrics and estimated profitability, including those arising from contract bonus and penalty provisions and final contract settlements, may periodically result in revisions to revenue and expenses and are recognized in the period in which such revisions become probable. Known or anticipated losses on contracts are recognized when such amounts become probable and estimable.

Within the Drilling segment, rental equipment that is damaged or lost-in-hole is billed to customers at the contractually negotiated replacement value of the rental equipment. The billed amount is recognized as revenue and the carrying value of the equipment is charged to cost of sales.

Revenue for equipment sold by the Artificial Lift segment is recorded net of any credit issued for return of an item for refurbishment under the equipment exchange program.

Sales tax collected from customers is not included in revenue but rather is accrued as a liability for future remittance to the respective taxing authorities.

Allowance for Doubtful Accounts

The Company performs ongoing credit evaluations of customers and grants credit based upon historical payment history, financial condition and industry expectations as available. Determination of the collectability of amounts due from customers requires the Company to use estimates and make judgments regarding future events and trends, including monitoring customers payment history and current credit worthiness in order to determine that collectability is reasonably assured. The Company also considers the overall business climate in which its customers operate.

These uncertainties require the Company to make frequent judgments and estimates regarding a customers ability to pay amounts due in order to assess and quantify an appropriate allowance for doubtful accounts. The primary factors used to quantify the allowance are customer delinquency, bankruptcy, and the Company s estimate of its ability to collect outstanding receivables based on

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the number of days a receivable has been outstanding.

Substantially all of the Company s customers operate in the energy industry. The cyclical nature of the industry may affect customers operating performance and cash flows, which could impact the Company s ability to collect on these obligations. Additionally, some customers are located in international areas that are inherently subject to risks of economic, political and civil instability.

During 2011, the Company strengthened its process of assessment of customer credit worthiness. The Company continued to monitor the economic climate in which its customers operate and the aging of its accounts receivable. The allowance for doubtful accounts is based on the aging of accounts and an individual assessment of each invoice outstanding for 90 days. Each invoice for customers with an identified problem is also assessed individually. At December 31, 2011, the allowance was 1.3% of accounts receivable, compared to an allowance of 1.0% a year earlier. International sales are increasing and were 14.1% of revenue for the year ended December 31, 2011, compared to 13.4% and 13.2% for 2010 and 2009, respectively.

While credit losses have historically been within expectations and the provisions established, should actual write-offs differ from estimates, revisions to the allowance would be required.

Inventory Reserves

Inventories consist of raw materials, work-in-process and finished goods and are stated at the lower of cost, determined using the weighted-average cost method, or market. Finished goods inventories include raw materials, direct labor and production overhead. The Company s inventory reserve represents the excess of the inventory carrying value over the amount expected to be realized from the ultimate sale or other disposal of the inventory.

The Company regularly reviews inventory quantities on hand and records provisions for excess or obsolete inventory based on the Company s forecast of product demand, historical usage of inventory on hand, market conditions, production and procurement requirements and technological developments. Significant or unanticipated changes in market conditions or Company forecasts could affect the amount and timing of provisions for excess and obsolete inventory.

Significant changes have not been made in the methodology used to estimate the reserve for excess and obsolete inventory during the past three years. Specific assumptions are updated at the date of each evaluation to consider Company experience and current industry trends. Significant judgment is required to predict the potential impact which the current business climate and evolving market conditions could have on the Company s assumptions. Changes which may occur in the energy industry are hard to predict and they may occur rapidly. To the extent that changes in market conditions result in adjustments to management assumptions, impairment losses could be realized in future periods.

During 2011, the Company enhanced the usage of its item age composition report to specifically identify slow moving and potentially obsolete items. The enhanced methodology follows the basic premises previously used and applies the analysis to specific inventory items. At December 31, 2011, the reserve for excess and obsolete inventory was $2.7 million or 6.6% of inventory. A year earlier the reserve was $2.6 million or 8.6% of inventory. Inventory turns increased to 4.7 times in 2011 compared to a year earlier when inventory turns were 3.4 times. The provision for excess and obsolete inventory was $1.0 million and $0.8 million, respectively, in 2011 and 2010. During the industry downturn in 2009, inventory turned only 2.5 times and the provision for excess and obsolete inventory was $6.3 million.

Goodwill

Goodwill is not subject to amortization, but is tested for impairment annually during the fourth quarter, or more frequently if an event occurs or circumstances change that would indicate a potential impairment. These circumstances may include, but are not limited to, a significant adverse change in the business climate, unanticipated competition, or a change in projected operations or results of a reporting unit. Goodwill is tested for impairment at a reporting unit level. At December 31, 2011, only two reporting units, Chemicals and Logistics and Teledrift, have an unamortized goodwill balance.

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During annual goodwill impairment testing in 2011, the Company first assessed qualitative factors to determine whether it was necessary to perform the two-step goodwill impairment test that the Company has historically used. Based on its qualitative assessment, the Company concluded that there was no indication of the need for an impairment of goodwill as of the fourth quarter of 2011, and therefore, no further testing was required.

Impairment testing in 2010 and 2009 consisted of a two-step process. The first step is to compare the estimated fair value of each reporting unit which has goodwill to its carrying amount, including goodwill. To determine fair value estimates, the Company uses the income approach based on discounted cash flow analyses, combined with a market-based approach. The market-based approach considers valuation comparisons of recent public sale transactions of similar businesses and earnings multiples of publicly traded businesses operating in industries consistent with the reporting unit. If the fair value of a reporting unit is less than its carrying value, the second step of the impairment test is performed to determine the amount of impairment, if any. The second step compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill. If the carrying amount of the reporting unit s goodwill exceeds its implied value, an impairment loss is recognized in an amount equal to that excess.

The Company determines fair value using widely accepted valuation techniques, including discounted cash flows and market multiples analyses, and through use of independent fixed asset valuation firms, as appropriate. These types of analyses contain uncertainties as they require management to make assumptions and to apply judgments regarding industry economic factors and the profitability of future business strategies. The Company s policy is to conduct impairment testing based on current business strategies, taking into consideration current industry and economic conditions, as well as the Company s future expectations. Key assumptions used in the discounted cash flow valuation model include, among others, discount rates, growth rates, cash flow projections and terminal value rates. Discount rates and cash flow projections are the most sensitive and susceptible to change as they require significant management judgment. Discount rates are determined using a weighted average cost of

capital (WACC). The WACC considers market and industry data, as well as Company-specific risk factors for each reporting unit in determining the appropriate discount rate to be used. The discount rate utilized for each reporting unit is indicative of the return an investor would expect to receive for investing in a similar business. Management uses industry considerations and Company-specific historical and projected results to develop cash flow projections for each reporting unit. Additionally, as part of the market multiples approach, the Company utilizes market data from publicly traded entities whose businesses operate in industries comparable to the Company s reporting units, adjusted for certain factors that increase comparability.

During the 2010 annual impairment testing, the estimated fair value of the Chemicals and Logistics reporting unit exceeded its total carrying value by approximately $81.3 million. The estimated fair value of the Teledrift reporting unit exceeded its total carrying value by approximately $21.3 million. As a result, the second step of the evaluation process was not required. To evaluate the sensitivity of the fair value calculations of the reporting units, the Company applied a hypothetical 10% unfavorable change in the weighted average cost of capital, which would have reduced the estimated fair value of the Chemicals and Logistics and Teledrift reporting units by approximately $2.8 million and $2.2 million, respectively. In addition, the Company applied a hypothetical 10% reduction to the Company s market multiples, key financial measures and estimated future cash flows utilized in the Company s impairment analyses. This would have reduced the estimated fair value of the Chemicals and Logistics and Teledrift reporting units by approximately $20.0 million and $11.0 million, respectively. Neither of these sensitivity analyses indicated impairment.

Due to macro-economic conditions affecting the oil and gas industry and declining financial performance of the Company s reporting units during 2009, management tested for evidence of goodwill impairment during the second and third quarters of 2009 and again during annual impairment testing in the fourth quarter. Based on this testing, a goodwill impairment charge of $18.5 million related to the Teledrift reporting unit was recorded in the second quarter of 2009. The Company s testing did not indicate an impairment of goodwill for the Chemicals and Logistics reporting unit.

The Company cannot predict the occurrence of events or circumstances that could adversely affect the fair value of goodwill. Such events may include, but are not limited to, deterioration of the economic environment, particularly in the oil and gas industry, increases in the Company s weighted average cost of capital, material negative changes in relationships with significant customers, reductions in valuations of other public companies in the Company s industry, or strategic decisions made in response to economic and competitive conditions. If actual results are not consistent with the Company s current estimates and assumptions, impairment of goodwill could be required.

Long-Lived Assets Other than Goodwill

Long-lived assets other than goodwill consist of property and equipment and intangible assets which have determinable lives. The Company makes judgments and estimates regarding the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods to be applied, estimated useful lives and possible impairments. The Company has no intangible assets with indefinite lives. Property and equipment and intangible assets with determinable lives are tested for impairment whenever events or changes in circumstances indicate the carrying value of the asset may not be recoverable.

For property and equipment, events or circumstances indicating possible impairment may include a significant decrease in market value or a significant change in the business climate. An impairment loss is recognized when the carrying amount of an asset exceeds the estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition. The amount of the impairment loss is the excess of the asset s carrying value over its fair value. Fair value is generally determined using an appraisal by an independent valuation firm or by using a discounted cash flow analysis.

For intangible assets with definite lives, events or circumstances indicating possible impairment may include an adverse change in the extent or manner in which the asset is being used or a change in the assessment of future operations. The Company

assesses the recoverability of the carrying amount by preparing estimates of future revenue, margins and cash flows. If the sum of expected future cash flows (undiscounted and without interest charges) is less than the carrying amount, an impairment loss is recognized. The impairment loss recognized is the amount by which the carrying amount exceeds the fair value. Fair value of these assets may be determined by a variety of methodologies, including discounted cash flows.

The development of future net undiscounted cash flow projections requires management projections of future sales and profitability trends and the estimation of remaining useful lives of assets. These projections are consistent with those projections the Company uses to internally manage operations. When potential impairment is identified, a discounted cash flow valuation model similar to that used to value goodwill at the reporting unit level, incorporating discount rates commensurate with risks associated with each asset, is used to determine the fair value of the asset in order to measure potential impairment. Discount rates are determined by using a WACC. Estimated revenue and WACC assumptions are the most sensitive and susceptible to change in the long-lived asset analysis as they require significant management judgment. The Company believes the assumptions used are reflective of what a market participant would have used in calculating fair value.

Valuation methodologies utilized to evaluate long-lived assets other than goodwill for impairment were consistent with prior periods. Specific assumptions discussed above are updated at each test date to consider current industry and Company-specific risk factors from the perspective of a market participant. The current business climate is subject to evolving market conditions and requires significant management judgment to interpret the potential impact to the Company s assumptions. To the extent that changes in the current business climate result in adjustments to management projections, impairment losses may be recognized in future periods.

No impairment was recorded for property and equipment and intangible assets with determinable lives during 2011 and 2009. However in 2010, the Company recognized an impairment loss of $0.4 million of other intangible assets, as well as, impairment of certain rental fixed assets within the

Drilling segment due to shifts in industry demand. Consequently, the Company recognized an impairment of rental tool assets of $8.9 million.

Warrant Liability

The Company evaluates financial instruments for freestanding and embedded derivatives. The warrant liability does not have a readily determinable fair value, and therefore its valuation requires significant management judgment and estimation. The Company used the Black-Scholes option-pricing model to estimate the fair value of the warrant liability at the end of each reporting period. Changes in the fair value of the warrant liability during each reporting period are recorded in the statement of operations. Inputs into the Black-Scholes option-pricing model require using estimates, including such items as estimated volatility based upon historical volatilities of the Company s stock and an identified group of peer companies and estimated life of the financial instruments being valued.

Fair Value Measurements

Fair value is defined as the amount that would be received for the sale of an asset or paid for the transfer of a liability in an orderly transaction between unrelated third party market participants at the measurement date. In determination of fair value measurements for assets and liabilities the Company considers the principal, or most advantageous market, and assumptions that market participants would use when pricing the asset or liability. The Company categorizes financial assets and liabilities using a three-tiered fair value hierarchy, based upon the nature of the inputs used in the determination of fair value. Inputs refer broadly to the assumptions that market participants would use in pricing an asset or liability and may be observable or unobservable. Significant judgments and estimates are required, particularly when inputs are based on pricing for similar assets or liabilities, pricing in non-active markets or when unobservable inputs are required.

Income Taxes

The Company s estimates tax provision is subject to judgments and estimates necessitated by the complexity of existing regulatory tax statutes and the effect of these upon the Company due to

operations in multiple tax jurisdictions. Income tax expense is based on taxable income, statutory tax rates and tax planning opportunities available in the various jurisdictions in which the Company operates. The Company s income tax expense will fluctuate from year to year as the amount of pre-tax income fluctuates. Changes in tax laws, and the Company s profitability within and across the jurisdictions may impact the Company s tax liability. While the annual tax provision is based on the best information available to the Company at the time of preparation, several years may elapse before the ultimate tax liabilities are determined.

Deferred tax assets and liabilities are recognized related to the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of the Company s assets and liabilities using statutory tax rates at the applicable year end. A valuation allowance is recorded to reduce previously recorded tax assets when it becomes more-likely-than-not such assets will not be realized. At December 31, 2011, the Company recorded a deferred tax assets valuation allowance of $19.5 million.

The Company periodically identifies and evaluates uncertain tax positions. This process considers the amounts and probability of various outcomes that could be realized upon final settlement. Liabilities for uncertain tax positions are based on a two-step process. The actual benefits ultimately realized may differ from the Company s estimates. Changes in facts, circumstances, and new information may require a change in recognition and measurement estimates for certain individual tax positions. Any changes in estimates are recorded in results of operations in the period in which the change occurs. At December 31, 2011, the Company performed an evaluation of its various tax positions and concluded that it did not have significant uncertain tax positions requiring disclosure.

Share-Based Compensation

The Company has stock-based incentive plans which are authorized to issue stock options, restricted stock and other incentive awards. Stock-based compensation expense for stock options is determined based upon estimated grant-date fair value. This fair value is calculated using the Black-Scholes option-pricing model and is recognized as expense over the requisite service period. The option-pricing model requires the input of highly subjective assumptions, including expected stock price volatility and expected option life. In addition, the Company estimates an expected forfeiture rate and recognizes expense only for those shares expected to vest. The estimated forfeiture rate is based on historical experience. To the extent actual forfeiture rates differ from the estimate, stock-based compensation expense is adjusted accordingly.

Loss Contingencies

The Company is subject to a variety of loss contingencies that could arise during the Company s conduct of business. Management considers the likelihood of a loss or the impairment of an asset or the incurrence of a liability, as well as the Company s ability to reasonably estimate the amount of loss in determining potential loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. Accruals for loss contingencies have not been recorded during the past three years. The Company regularly evaluates current information available to determine whether such accruals should be made or adjusted.

Seasonality

Due to increased customer spending at calendar year end, Chemicals results of operations are historically highest in the fourth quarter of the calendar year and lowest during the first quarter. The results of operations of the Artificial Lift operating results of operations generally trend lowest during the second quarter of the calendar year due to federal land drilling restrictions the migratory/breeding season of certain protected bird species.

Recent Accounting Pronouncements

Recent accounting pronouncements which may impact the Company are described in Part II, Item 8 Financial Statements and Supplementary Data, Note 2 Summary of Significant Accounting Policies; in the Notes to Consolidated Financial Statements.

Item 7A. 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. Market risk is measured as the potential negative impact on earnings, cash flows or fair values resulting from a hypothetical change in interest rates or foreign currency exchange rates over the next year. The Company manages exposure to market risks at the corporate level. The portfolio of interest-sensitive assets and liabilities is monitored and adjusted to provide liquidity necessary to satisfy anticipated short-term needs. The Company s risk management policies allow the use of specified financial instruments for hedging purposes only; speculation on interest rates or foreign currency rates is not permitted. The Company does not consider any of these risk management activities to be material.

Interest Rate Risk

The Company is exposed to the impact of interest rate changes on any outstanding indebtedness under the revolving credit facility agreement which has a variable interest rate. At December 31, 2011, the Company had not borrowed against the revolving credit facility agreement which permits borrowing up to $35.0 million.

Warranty Liability

The Company is required to account for investor warrants as derivative liabilities at the end of each reporting period. Warrant liability is presented as a long-term liability on the balance sheet and totaled $16.6 million and $26.2 million as of December 31, 2011 and 2010, respectively. The periodic change in the value of the warrant liability is recorded as either non-cash income (when the value of the warrants decrease) or as non-cash expense (when the value of the warrants increase). Although the value of the warrants are affected by interest rates, the remaining contractual conversion period and stock volatility, the primary cause of the change in the warrants value is the price of the Company s common stock. With an increase in common share price, the value of the derivatives will generally

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increase conversely, a decrease in the common share price will generally result in a decrease in the value of the derivatives, holding all other factors constant. The Company s stock has historically been volatile; as a result, periodic non-cash gain or loss from change in fair value of derivative liabilities may be material.

The change in fair-value of derivatives is disclosed in the Consolidated Statements of Operations within the Other Income (expenses) and is discussed above

and in Part II, Item 8 Financial Statements and Supplementary Data, Note 10 Fair Value Measurements and Note 13 Convertible Preferred Stock and Stock Warrants in the Notes to Consolidated Financial Statements. The non-cash gain from the change in the fair value of warrants was $9.6 million or 36.1% of net income for the year ended December 31, 2011. A non-cash loss from the change in fair value of warrants totaled $21.5 million or 42.9% of net loss for the year ended December 31, 2010.

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Item 8. Financial Statements and Supplementary Data.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Flotek Industries, Inc.

We have audited Flotek Industries, Inc. s (the Company) internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management s Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

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

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

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

In our opinion, Flotek Industries, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Flotek Industries, Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders equity (deficit) and cash flows for each of the two years in the period ended December 31, 2011, and our report dated March 7, 2012 expressed an unqualified opinion.

/s/ HEIN & ASSOCIATES LLP

Houston, Texas

March 7, 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Flotek Industries, Inc.

We have audited the accompanying consolidated balance sheets of Flotek Industries, Inc. and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders equity (deficit) and cash flows for each of the two years in the period ended December 31, 2011. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Flotek Industries, Inc. and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Flotek Industries, Inc. and subsidiaries internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 7, 2012 expressed an unqualified opinion on the effectiveness of Flotek Industries, Inc. s internal control over financial reporting.

/s/ HEIN & ASSOCIATES LLP

Houston, Texas

March 7, 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Flotek Industries, Inc. and Subsidiaries:

We have audited the accompanying Consolidated Statements of Operations, Stockholders Equity and Cash Flows of Flotek Industries, Inc. and Subsidiaries (the Company) for the year ended December 31, 2009. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated results of operations and cash flows of Flotek Industries, Inc. and Subsidiaries for the year ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

/s/ UHY LLP

Houston, Texas

May 21, 2010

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FLOTEK INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	December 31, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 46,682	$ 19,863
Restricted cash	150	150
Accounts receivable, net of allowance for doubtful accounts of $571 and $262 at December 31, 2011 and 2010, respectively	44,567	27,310
Inventories, net	37,888	27,845
Deferred tax assets, net	841	575
Income taxes receivable	-	2,973
Other current assets	1,933	1,041
Total current assets	132,061	79,757
Property and equipment, net	43,914	42,524
Goodwill	26,943	26,943
Deferred tax assets, net	-	117
Other intangible assets, net	29,094	35,466
TOTAL ASSETS	$ 232,012	$ 184,807
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 18,562	$ 13,520
Accrued liabilities	8,397	11,956
Income taxes payable	3,876	-
Interest payable	2,097	2,185
Current portion of long-term debt	767	6,454
Deferred tax liabilities, net	-	117
Total current liabilities	33,699	34,232
Convertible senior notes, net of discount	99,738	98,555
Long-term debt, less current portion	875	28,127
Warrant liability	16,622	26,193
Deferred tax liabilities, net	2,780	1,153
Total liabilities	153,714	188,260
Commitments and contingencies		
Stockholders equity (deficit):		
Cumulative convertible preferred stock, at accreted value; $0.0001 par value, 100,000 shares authorized; zero and 11,205 shares issued and outstanding at December 31, 2011 and 2010, respectively; liquidation preference of $1,000 per share	-	7,280
Common stock, $0.0001 par value, 80,000,000 shares authorized; 51,957,652 shares issued and 49,153,495 shares outstanding at December 31, 2011; 36,753,891 shares issued and 35,327,893 shares outstanding at December 31, 2010	5	4

Additional paid-in capital	166,814	103,408
Accumulated other comprehensive income (loss)	(44)	97
Accumulated deficit	(86,810)	(113,350)
Treasury stock, at cost; 1,358,299 and 565,199 shares at December 31, 2011 and 2010, respectively	(1,667)	(892)
Total stockholders equity (deficit)	78,298	(3,453)
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)	$ 232,012	$ 184,807

See accompanying Notes to Consolidated Financial Statements.

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FLOTEK INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Year ended December 31, 2011	2010	2009
Revenue	$ 258,785	$ 146,982	$ 112,550
Cost of revenue	(152,965)	(94,012)	(83,166)
Gross margin	105,820	52,970	29,384
Expenses:			
Selling, general and administrative	(50,612)	(41,861)	(36,943)
Depreciation and amortization	(3,983)	(4,543)	(4,926)
Research and development	(2,337)	(1,441)	(2,118)
Impairment of long-lived assets	-	(8,898)	-
Loss on disposal of long-lived assets	-	(2,104)	-
Impairment of goodwill and intangible assets	-	(390)	(18,500)
Total expenses	(56,932)	(59,237)	(62,487)
Income (loss) from operations	48,888	(6,267)	(33,103)
Other income (expense):			
Change in fair value of warrant liability	9,571	(21,464)	465
Interest expense	(15,960)	(19,399)	(15,524)
Loss on extinguishment of debt	(3,225)	(995)	-
Other financing costs	-	(816)	-
Other expense, net	(4)	(69)	(155)
Total other income (expense)	(9,618)	(42,743)	(15,214)
Income (loss) before income taxes	39,270	(49,010)	(48,317)
Income tax (provision) benefit	(7,862)	5,545	(2,016)
Net income (loss)	31,408	(43,465)	(50,333)
Accrued dividends and accretion of discount on preferred stock	(4,868)	(6,543)	(2,231)
Net income (loss) attributable to common stockholders	$ 26,540	$ (50,008)	$ (52,564)
Basic and diluted earnings (loss) per common share:			
Basic earnings (loss) per common share	$ 0.60	$ (1.94)	$ (2.68)
Diluted earnings (loss) per common share	$ 0.56	$ (1.94)	$ (2.68)
Weighted average common shares used in computing basic and diluted earnings (loss) per common share:			
Weighted average common shares used in computing basic earnings (loss) per common share	44,229	25,731	19,595
Weighted average common shares used in computing diluted earnings (loss) per common share	47,638	25,731	19,595

See accompanying Notes to Consolidated Financial Statements.

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FLOTEK INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Common Stock		Preferred Stock		Treasury Stock			Accumulated Other Comprehensive	Retained Earnings	
	Shares Issued	Value	Shares	Value	Shares	Cost	Additional Paid-in Capital	Income (Loss)	(Accumulated Deficit)	Total
Balance, December 31, 2008	23,174	$ 2	-	$ -	159	$ (497)	$ 77,253	$ 125	$ (10,778)	$ 66,105
Net loss	-	-	-	-	-	-	-	-	(50,333)	(50,333)
Foreign currency translation adjustment	-	-	-	-	-	-	-	(7)	-	(7)
Comprehensive loss										(50,340)
Sale of preferred stock and detachable warrants	-	-	16	10,806	-	-	-	-	-	10,806
Issuance costs of preferred stock and detachable warrants	-	-	-	-	-	-	(1,199)	-	-	(1,199)
Accretion of discount on preferred stock	-	-	-	1,331	-	-	-	-	(1,331)	-
Preferred stock dividends	-	-	-	-	-	-	-	-	(900)	(900)
Beneficial conversion discount on preferred stock	-	-	-	(5,194)	-	-	5,194	-	-	-
Restricted stock forfeited	-	-	-	-	152	-	-	-	-	-
Stock options exercised	100	-	-	-	-	-	30	-	-	30
Restricted shares issued and treasury stock purchase in payment of 2008 bonus	471	-	-	-	35	(48)	481	-	-	433
Restricted stock granted	423	-	-	-	-	-	-	-	-	-
Reduction in tax benefit of share-based awards	-	-	-	-	-	-	(195)	-	-	(195)
Stock compensation expense	-	-	-	-	-	-	1,731	-	-	1,731
Tax benefit related to convertible debt bifurcation	-	-	-	-	-	-	725	-	-	725
Balance, December 31, 2009	24,168	2	16	6,943	346	(545)	84,020	118	(63,342)	27,196
Net loss	-	-	-	-	-	-	-	-	(43,465)	(43,465)
Foreign currency translation adjustment	-	-	-	-	-	-	-	(21)	-	(21)
Comprehensive loss										(43,486)
Common stock issued in payment of debt issuance costs	4,042	1	-	-	-	-	5,095	-	-	5,096
Common stock issued in exchange of convertible notes	1,569	-	-	-	-	-	1,992	-	-	1,992
Accretion of discount on preferred stock	-	-	-	5,132	-	-	-	-	(5,132)	-
Preferred stock dividends, net of forfeitures	-	-	-	-	-	-	-	-	(1,411)	(1,411)
Stock warrants exercised	3,923	1	-	-	-	-	4,452	-	-	4,453
Stock options exercised	140	-	-	-	-	-	114	-	-	114
Restricted stock granted	827	-	-	-	-	-	-	-	-	-
Restricted stock forfeited	-	-	-	-	23	-	-	-	-	-
Treasury stock purchased	-	-	-	-	196	(347)	-	-	-	(347)
Reduction in tax benefit related to share-based awards	-	-	-	-	-	-	(1,744)	-	-	(1,744)
Stock compensation expense	-	-	-	-	-	-	4,684	-	-	4,684

Conversion of preferred stock into common stock	2,085	-	(5)	(4,795)	-	-	4,795	-	-	-
Balance, December 31, 2010	36,754	4	11	7,280	565	(892)	103,408	97	(113,350)	(3,453)
Net income	-	-	-	-	-	-	-	-	31,408	31,408
Foreign currency translation adjustment	-	-	-	-	-	-	-	(141)	-	(141)
Comprehensive income			`							31,267
Sale of common stock, net of issuance cost	3,665	-	-	-	-	-	29,438	-	-	29,438
Common stock issued in payment of term loan debt	171	-	-	-	-	-	1,398	-	-	1,398
Common stock issued in payment of convertible notes	559	-	-	-	-	-	5,165	-	-	5,165
Accretion of discount on preferred stock	-	-	-	3,925	-	-	-	-	(3,925)	-
Common stock issued in payment of preferred stock dividends	624	-	-	-	-	-	3,254	-	-	3,254
Preferred stock dividends, net of forfeitures	-	-	-	-	-	-	-	-	(943)	(943)
Stock warrants exercised	3,961	-	-	-	-	-	4,793	-	-	4,793
Stock options exercised	64	-	-	-	-	-	147	-	-	147
Restricted stock granted	1,288	-	-	-	-	-	-	-	-	-
Restricted stock forfeited	-	-	-	-	11	-	-	-	-	-
Treasury stock purchased	-	-	-	-	81	(775)	-	-	-	(775)
Excess tax benefit related to share-based awards	-	-	-	-	-	-	570	-	-	570
Stock compensation expense	-	-	-	-	-	-	7,437	-	-	7,437
Conversion of preferred stock into common stock	4,872	1	(11)	(11,205)	-	-	11,204	-	-	-
Return of borrowed shares under share lending agreement	-	-	-	-	701	-	-	-	-	-
Balance, December 31, 2011	51,958	$ 5	-	$ -	1,358	$ (1,667)	$ 166,814	$ (44)	$ (86,810)	$ 78,298

See accompanying Notes to Consolidated Financial Statements.

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FLOTEK INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2011	**2010**	**2009**
Cash flows from operating activities:			
Net income (loss)	$ 31,408	$ (43,465)	$ (50,333)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	10,105	13,768	14,186
Amortization of deferred financing costs	3,126	3,914	1,552
Accretion of debt discount	5,295	4,946	4,798
Change in fair value of warrant liability	(9,571)	21,464	(465)
Provision for doubtful accounts	661	94	45
Gain on sale of assets	(3,378)	(1,261)	(1,365)
Impairment of goodwill, intangible assets or fixed assets	-	9,288	18,500
Stock compensation expense	7,437	4,684	1,731
Reduction in (excess) tax benefit related to share-based awards	(570)	1,744	195
Deferred income tax provision (benefit)	1,218	(3,611)	10,500
Unrealized gain on interest rate swap	-	-	(199)
Loss on extinguishment of debt	3,225	995	-
Change in current assets and liabilities:			
Restricted cash	-	(140)	(1)
Accounts receivable	(17,918)	(12,792)	22,548
Inventories	(10,043)	(613)	10,795
Income taxes, net	7,563	3,634	(6,607)
Accounts payable	5,041	5,499	(14,645)
Other current assets	(892)	(170)	449
Accrued liabilities	(255)	4,608	(9,768)
Interest payable	(29)	(487)	270
Net cash provided by operating activities	32,423	12,099	2,186
Cash flows from investing activities:			
Capital expenditures	(9,984)	(6,060)	(6,555)
Proceeds from sale of assets	5,286	5,460	2,858
Purchase of patents and other intangible assets	(244)	-	(2)
Net cash used in investing activities	(4,942)	(600)	(3,699)
Cash flows from financing activities:			
Repayments of indebtedness	(33,273)	(38,572)	(27,764)
Proceeds from the sale of common stock	29,438	-	-
Proceeds from exercise of warrants	4,793	4,453	-
Debt issuance costs	(1,421)	(2,004)	(819)
Purchase of treasury stock	(775)	(236)	(48)
Excess (reduction in) tax benefit related to share-based awards	570	(1,744)	(195)
Proceeds from exercise of stock options	147	3	30
Proceeds from borrowings	-	40,000	21,807
Proceeds from preferred stock offering	-	-	16,000
Issuance costs of preferred stock and detachable warrants	-	-	(1,199)

Net cash (used in) provided by financing activities	(521)	1,900	7,812
Effect of exchange rate changes on cash and cash equivalents	(141)	(21)	(7)
Net increase in cash and cash equivalents	26,819	13,378	6,292
Cash and cash equivalents at the beginning of year	19,863	6,485	193
Cash and cash equivalents at the end of year	$ 46,682	$ 19,863	$ 6,485

See accompanying Notes to Consolidated Financial Statements.

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FLOTEK INDUSTRIES, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Organization and Nature of Operations

Flotek Industries, Inc. (Flotek or the Company) is a global developer and supplier of drilling and production related products and services. Flotek s strategic focus, and that of its diversified wholly-owned subsidiaries (collectively referred to as the Company), includes oilfield specialty chemicals and logistics, down-hole drilling tools and down-hole production tools used in the energy and mining industries. The Company also manages automated material handling, loading facilities and blending capabilities for a variety of bulk materials. The Company s products and services enable customers to drill wells more efficiently, to increase production from existing wells and to decrease well operating costs. Major customers include leading

oilfield service providers, major, as well as, independent oil and gas exploration and production companies, and onshore and offshore drilling contractors.

The Company is headquartered in Houston, Texas, and has operational locations in Colorado, Louisiana, New Mexico, North Dakota, Oklahoma, Pennsylvania, Texas, Utah, Wyoming and The Netherlands. Products are marketed domestically and internationally in over 20 countries.

Flotek was initially incorporated under the laws of the Province of British Columbia on May 17, 1985. On October 23, 2001, Flotek changed its corporate domicile to the state of Delaware.

Note 2 Summary of Significant Accounting Policies

Accounting Principles

The Company s consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America (US GAAP).

Principles of Consolidation

The consolidated financial statements include the accounts of Flotek Industries, Inc. and all wholly-owned subsidiary corporations. All significant intercompany accounts and transactions have been eliminated in consolidation. The Company does not have investments in any unconsolidated subsidiaries.

Cash Equivalents

Cash equivalents consist of highly liquid investments with maturities of three months or less at the date of purchase.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable arise from product sales, product rentals and services and are stated at estimated net realizable value. This value incorporates an allowance for doubtful accounts to reflect any loss anticipated on accounts receivable balances. The Company regularly evaluates its accounts receivable to estimate amounts that will not be collected and records the appropriate provision for doubtful accounts as a charge to operating expenses. The allowance for doubtful accounts is based on a combination of the age of the receivables, individual customer circumstances, credit conditions and historical write-offs and collections. The Company writes off specific accounts receivable when they are determined to be uncollectible.

Substantially all of the Company s customers are engaged in the energy industry. The cyclical nature of the energy industry can affect customers operating performance and cash flows, which directly impact the Company s ability to collect on outstanding obligations. Additionally, certain customers are located in international areas that are inherently subject to risks of economic, political and civil instability, which can impact the collectability of receivables.

FLOTEK INDUSTRIES, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Changes in the allowance for doubtful accounts are as follows (in thousands):

	Year ended December 31, 2011	2010	2009
Beginning balance	$ 262	$ 948	$ 1,465
Charge to expenses	661	94	45
Write-offs	(352)	(780)	(562)
Ending balance	$ 571	$ 262	$ 948

Inventories

Inventories consist of raw materials, work-in-process and finished goods and are stated at the lower of cost, determined using the weighted-average cost method, or market. Finished goods inventories include raw materials, direct labor and production overhead. The Company regularly reviews inventories on hand and records a provision for excess and obsolete inventory based primarily on forecasts of product demand, historical trends, market conditions, production or procurement requirements and technological developments and advancements.

Property and Equipment

Property and equipment are stated at cost. The cost of ordinary maintenance and repair is charged to operating expense, while replacement of critical components and major improvements are capitalized. Depreciation or amortization of property and equipment, including assets held under capital leases, is calculated using the straight-line method over the asset s estimated useful life:

Buildings and leasehold improvements	2-30 years
Machinery, equipment and rental tools	7-10 years
Furniture and fixtures	3 years
Transportation equipment	2-5 years
Computer equipment and software	3-7 years

Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate the carrying value of an asset or asset group may not be recoverable. Indicative events or

circumstances include a significant decline in market value and a significant change in business climate. An impairment loss is recognized when the carrying value of an asset exceeds the estimated undiscounted future cash flows from the use of the asset and its eventual disposition. The amount of impairment loss recognized is the excess of the asset s carrying value over its fair value. Assets to be disposed of are reported at the lower of the carrying value or the fair value less cost to sell. Upon sale or other disposition of an asset, the Company recognizes a gain or loss on disposal measured as the difference between the net carrying value of the asset and the net proceeds received.

Internal Use Computer Software Costs

Direct costs incurred to purchase and develop computer software for internal use are capitalized during the application development and implementation stages. These software costs have been for enterprise-level business and finance software that is customized to meet the Company s specific operational needs. Capitalized costs are included in property and equipment and are amortized on a straight-line basis over the estimated useful life of the software beginning when the software project is substantially complete and placed in service. Costs incurred during the preliminary project stage and costs for training, data conversion and maintenance are expensed as incurred.

Goodwill

Goodwill is the excess of cost of an acquired entity over the amounts assigned to identifiable assets acquired and liabilities assumed in a business combination. Goodwill is not subject to amortization,

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but is tested for impairment annually during the fourth quarter, or more frequently if an event occurs or circumstances change that would indicate a potential impairment. These circumstances may include an adverse change in the business climate or a change in the assessment of future operations of a reporting unit.

Beginning with the annual testing in 2011, the Company assesses whether a goodwill impairment exists using both qualitative and quantitative assessments. The qualitative assessment involves determining whether events or circumstances exist that indicate it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. If, based on this qualitative assessment, it is determined that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, the Company does not perform a quantitative assessment.

If the qualitative assessment indicates that it is more likely than not that the fair value of a reporting unit is less than its carrying amount or if the Company elects not to perform a qualitative assessment, a quantitative assessment or two-step impairment test is performed to determine whether a goodwill impairment exists at the reporting unit.

Goodwill is tested for impairment at a reporting unit level. Impairment testing for goodwill consists of a two-step process. The first step is to compare the estimated fair value of each reporting unit with goodwill to its carrying amount, including goodwill. To determine fair value estimates, the Company uses the income approach based on discounted cash flow analyses, combined with a market-based approach. The market-based approach considers valuation comparisons of recent public sale transactions of similar businesses and earnings multiples of publicly traded businesses operating in industries consistent with the reporting unit. If the fair value of a reporting unit is less than its carrying amount, the second step of the impairment test is performed to determine the amount of impairment loss, if any. The second step compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying

amount of the reporting unit s goodwill exceeds its implied fair value, an impairment loss is recognized in an amount equal to that excess.

Other Intangible Assets

The Company s other intangible assets have determinable lives and primarily consist of customer relationships, but also include purchased patents and a purchased brand name. The cost of intangible assets with determinable lives is amortized using the straight-line method over the estimated period of economic benefit, ranging from two to 20 years. Asset lives are adjusted whenever there is a change in the estimated period of economic benefit. No residual value has been assigned to these intangible assets. The Company has no intangible assets with indefinite lives.

Intangible assets with definite lives are tested for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. These conditions may include a change in the extent or manner in which the asset is being used or a change in future operations. The Company assesses the recoverability of the carrying amount by preparing estimates of future revenue, margins and cash flows. If the sum of expected future cash flows (undiscounted and without interest charges) is less than the carrying amount, an impairment loss is recognized. The impairment loss recognized is the amount by which the carrying amount exceeds the fair value. Fair value of these assets may be determined by a variety of methodologies, including discounted cash flow models.

Warrant Liability

The warrant liability does not have a readily determinable fair value. Each reporting period, the Company uses the Black-Scholes option-pricing model to estimate the fair value of its warrant liability. Changes in the fair value of the warrant liability are recognized in the statement of operations.

Fair Value Measurements

The Company categorizes financial assets and liabilities using a three-tier fair value hierarchy,

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based on the nature of the inputs used to determine fair value. Inputs refer broadly to assumptions market participants would use to value an asset or liability and may be observable or unobservable. The hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). Level 1 measurements are measurements using quoted prices in active markets for identical assets and liabilities. Level 2 measurements are measurements using quoted prices in markets that are not active or that are based on quoted prices for similar assets or liabilities. Level 3 measurements are measurements that use significant unobservable inputs which require a company to develop its own assumptions. When determining the fair value of assets and liabilities, the Company uses the most reliable measurement available.

Revenue Recognition

Revenue for product sales and services is recognized when all of the following criteria have been met: (i) persuasive evidence of an arrangement exists, (ii) products are shipped or services rendered to the customer and significant risks and rewards of ownership have passed to the customer, (iii) the price to the customer is fixed and determinable and (iv) collectability is reasonably assured. Products and services are sold with fixed or determinable prices and do not include right of return provisions or other significant post delivery obligations. Deposits and other funds received in advance of delivery are deferred until the transfer of ownership is complete. Shipping and handling costs are reflected in cost of revenue. Taxes collected are not included in revenue, rather taxes are accrued for future remittance to governmental authorities.

The Logistics division recognizes revenue from design and construction oversight contracts under the percentage-of-completion method of accounting, measured by the percentage of costs incurred to date to the total estimated costs of completion. This percentage is applied to the total estimated revenue at completion to calculate proportionate revenue earned to date. Contracts for services are inclusive of direct labor and material

costs, as well as, indirect costs of operations. General and administrative costs are charged to expense as incurred. Changes in job performance metrics and estimated profitability, including contract bonus or penalty provisions and final contract settlements, are recognized in the period such revisions appear probable. Known or anticipated losses on contracts are recognized in full when amounts are probable and estimable. Bulk material loading revenue is recognized as services are performed.

Drilling revenue is recognized upon receipt of a signed and dated field billing ticket from the customer. Customers are charged contractually agreed amounts for oilfield rental equipment damaged or lost-in-hole (LIH). LIH proceeds are recognized as revenue and associated carrying value is charged to cost of sales. LIH revenue totaled $4.5 million, $3.1 million and $2.9 million for the years ended December 31, 2011, 2010 and 2009, respectively.

The Company generally is not contractually obligated to accept returns, except for defective products. Typically products determined to be defective are replaced or the customer is issued a credit memo. Based on historical return rates, no provision is made for returns at the time of sale. All costs associated with product returns are expensed as incurred.

Foreign Currency Translation

Financial statements of foreign subsidiaries are prepared using the local currency as the functional currency. Assets and liabilities of foreign subsidiaries are translated into US dollars at exchange rates in effect as of the end of identified reporting periods. Revenue and expense transactio