FLOTEK INDUSTRIES INC/CN/
Form 10-Q
May 09, 2018

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

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

For the quarterly period ended March 31, 2018

or

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

For the transition period from to

Commission File Number 1-13270

FLOTEK INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth 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 ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

As of April 30, 2018, there were 56,862,935 outstanding shares of Flotek Industries, Inc. common stock, $0.0001 par value.

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PART I — FINANCIAL INFORMATION

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

	March 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$2,865	$ 4,584
Accounts receivable, net of allowance for doubtful accounts of $694 and $733 at March 31, 2018 and December 31, 2017, respectively	45,331	46,018
Inventories, net	82,085	75,759
Income taxes receivable	2,809	2,826
Other current assets	7,972	9,264
Total current assets	141,062	138,451
Property and equipment, net	73,108	73,833
Goodwill	56,660	56,660
Deferred tax assets, net	20,373	12,713
Other intangible assets, net	47,619	48,231
TOTAL ASSETS	$338,822	$ 329,888
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$23,233	$ 22,048
Accrued liabilities	8,629	14,589
Interest payable	6	43
Long-term debt, classified as current	39,741	27,950
Total current liabilities and total liabilities	71,609	64,630
Commitments and contingencies		
Equity:		
Cumulative convertible preferred stock, $0.0001 par value, 100,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.0001 par value, 80,000,000 shares authorized; 61,161,291 shares issued and 56,784,694 shares outstanding at March 31, 2018; 60,622,986 shares issued and 56,755,293 shares outstanding at December 31, 2017	6	6
Additional paid-in capital	338,137	336,067
Accumulated other comprehensive income (loss)	(1,063)	(884)
Retained earnings (accumulated deficit)	(37,158)	(37,225)
Treasury stock, at cost; 3,599,267 and 3,621,435 shares at March 31, 2018 and December 31, 2017, respectively	(33,067)	(33,064)
Flotek Industries, Inc. stockholders’ equity	266,855	264,900
Noncontrolling interests	358	358
Total equity	267,213	265,258
TOTAL LIABILITIES AND EQUITY	$338,822	$ 329,888

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Three months ended March 31,	
	2018	2017
Revenue	$60,516	$79,954
Costs and expenses:		
Cost of revenue (excluding depreciation and amortization)	45,701	51,625
Corporate general and administrative	8,493	12,272
Segment selling and administrative	7,124	10,309
Depreciation and amortization	3,002	3,032
Research and development	2,924	3,141
Loss on disposal of long-lived assets	57	198
Total costs and expenses	67,301	80,577
Loss from operations	(6,785)	(623)
Other (expense) income:		
Interest expense	(516)	(594)
Other (expense) income, net	(285)	154
Total other expense	(801)	(440)
Loss before income taxes	(7,586)	(1,063)
Income tax benefit	7,653	320
Income (loss) from continuing operations	67	(743)
Loss from discontinued operations, net of tax	—	(11,235)
Net income (loss)	$67	$(11,978)
Basic earnings (loss) per common share:		
Continuing operations	$—	$(0.01)
Discontinued operations, net of tax	—	(0.19)
Basic earnings (loss) per common share	$—	$(0.20)
Diluted earnings (loss) per common share:		
Continuing operations	$—	$(0.01)
Discontinued operations, net of tax	—	(0.19)
Diluted earnings (loss) per common share	$—	$(0.20)
Weighted average common shares:		
Weighted average common shares used in computing basic earnings (loss) per common share	57,259	57,673
Weighted average common shares used in computing diluted earnings (loss) per common share	57,259	57,673

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Three months ended March 31,	
	2018	2017
Income (loss) from continuing operations	$67	$(743)
Loss from discontinued operations, net of tax	—	(11,235)
Net income (loss)	67	(11,978)
Other comprehensive income (loss):		
Foreign currency translation adjustment	(179)	(8)
Comprehensive income (loss)	$(112)	$(11,986)

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Three months ended March 31, 2018	2017
Cash flows from operating activities:		
Net income (loss)	$67	$(11,978)
Loss from discontinued operations, net of tax	—	(11,235)
Income (loss) from continuing operations	67	(743)
Adjustments to reconcile income (loss) from continuing operations to net cash used in operating activities:		
Depreciation and amortization	3,002	3,032
Amortization of deferred financing costs	96	130
Provision for excess and obsolete inventory	1,175	89
Loss on sale of assets	57	198
Stock compensation expense	1,963	3,011
Deferred income tax benefit	(7,662)	(7,403)
Reduction in tax benefit related to share-based awards	3	66
Changes in current assets and liabilities:		
Accounts receivable, net	668	(15,788)
Inventories	(7,548)	(6,462)
Income taxes receivable	(1)	332
Other current assets	350	13,923
Accounts payable	1,132	5,671
Accrued liabilities	(5,018)	1,265
Income taxes payable	—	97
Interest payable	(37)	25
Net cash used in operating activities	(11,753)	(2,557)
Cash flows from investing activities:		
Capital expenditures	(1,787)	(1,877)
Proceeds from sale of assets	80	158
Purchase of patents and other intangible assets	(137)	(84)
Net cash used in investing activities	(1,844)	(1,803)
Cash flows from financing activities:		
Repayments of indebtedness	—	(750)
Borrowings on revolving credit facility	76,266	98,863
Repayments on revolving credit facility	(64,475)	(96,826)
Debt issuance costs	(8)	(106)
Purchase of treasury stock related to share-based awards	(3)	(102)
Proceeds from sale of common stock	146	251
Proceeds from exercise of stock options	—	7
Net cash provided by financing activities	11,926	1,337
Discontinued operations:		
Net cash used in operating activities	—	(353)
Net cash provided by investing activities	—	353
Net cash flows provided by discontinued operations	—	—
Effect of changes in exchange rates on cash and cash equivalents	(48)	26

Net decrease in cash and cash equivalents	(1,719)	(2,997)
Cash and cash equivalents at the beginning of period	4,584	4,823
Cash and cash equivalents at the end of period	$2,865	$1,826

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Common Stock		Treasury Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Non-controlling Interests	Total Equity
	Shares Issued	Par Value	Shares	Cost					
Balance, December 31, 2017	60,623	$ 6	3,621	$(33,064)	$336,067	$ (884)	$ (37,225)	$ 358	$265,258
Net income	—	—	—	—	—	—	67	—	67
Foreign currency translation adjustment	—	—	—	—	—	(179)	—	—	(179)
Stock issued under employee stock purchase plan	—	—	(28)	—	146	—	—	—	146
Restricted stock granted	538	—	—	—	—	—	—	—	—
Restricted stock forfeited	—	—	5	—	—	—	—	—	—
Treasury stock purchased	—	—	1	(3)	—	—	—	—	(3)
Stock compensation expense	—	—	—	—	1,924	—	—	—	1,924
Balance, March 31, 2018	61,161	$ 6	3,599	$(33,067)	$338,137	$ (1,063)	$ (37,158)	$ 358	$267,213

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

Note 1 — Organization and Significant Accounting Policies
Organization and Nature of Operations
Flotek Industries, Inc. (“Flotek” or the “Company”) is a global, diversified, technology-driven company that develops and supplies chemistries and services to the oil and gas industries, and high value compounds to companies that make food and beverages, cleaning products, cosmetics, and other products that are sold in consumer and industrial markets.
The Company’s oilfield business includes specialty chemistries and logistics which enable its customers in pursuing improved efficiencies in the drilling and completion of their wells. The Company also provides automated bulk material handling, loading facilities, and blending capabilities. The Company processes citrus oil to produce (1) high value compounds used as additives by companies in the flavors and fragrances markets and (2) environmentally friendly chemistries for use in numerous industries around the world, including the oil and gas (“O&G”) industry.
Flotek operates in over 20 domestic and international markets. Customers include major integrated O&G companies, oilfield services companies, independent O&G companies, pressure-pumping service companies, national and state-owned oil companies, and international supply chain management companies. The Company also serves customers who purchase non-energy-related citrus oil and related products, including household and commercial cleaning product companies, fragrance and cosmetic companies, and food manufacturing companies.
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.
Basis of Presentation
The accompanying Unaudited Condensed Consolidated Financial Statements and accompanying footnotes (collectively the “Financial Statements”) reflect all adjustments, in the opinion of management, necessary for fair presentation of the financial condition and results of operations for the periods presented. All such adjustments are normal and recurring in nature. The Financial Statements, including selected notes, have been prepared in accordance with applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting and do not include all information and disclosures required by accounting principles generally accepted in the United States of America (“U.S. GAAP”) for comprehensive financial statement reporting. These interim Financial Statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (“Annual Report”). A copy of the Annual Report is available on the SEC’s website, www.sec.gov, under the Company’s ticker symbol (“FTK”) or on Flotek’s website, www.flotekind.com. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for the year ending December 31, 2018.
During the fourth quarter of 2016, the Company classified the Drilling Technologies and Production Technologies segments as held for sale based on management’s intention to sell these businesses. The Company’s historical financial statements have been revised to present the operating results of the Drilling Technologies and Production Technologies segments as discontinued operations. The results of operations of Drilling Technologies and Production Technologies are presented as “Loss from discontinued operations” in the statement of operations and the related cash flows of these segments has been reclassified to discontinued operations for all periods presented. The assets and liabilities of the Drilling Technologies and Production Technologies segments have been reclassified to “Assets held for sale” and “Liabilities held for sale,” respectively, in the consolidated balance sheets for all periods presented.
During 2017, the Company completed the sale or disposal of the assets and transfer or liquidation of liabilities and obligations of each of the Drilling Technologies and Production Technologies segments.
Revenue Recognition
The Company recognizes revenues to depict the transfer of control of promised goods or services to its customers in an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services.
Refer to Note 4 — “Revenue from Contracts with Customers” for further discussion on Revenue.
The Company recognizes revenue based on the Accounting Standards Codification (“ASC”) 606 five-step model when all of the following criteria have been met: (i) a contract with a customer exists, (ii) performance obligations have

been identified, (iii) the price to the customer has been determined, (iv) the price to the customer has been allocated to the performance obligations, and (v) performance obligations are satisfied.

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

Products and services are sold with fixed or determinable prices. Certain sales include right of return provisions, which are considered when recognizing revenue and deferred accordingly. Deposits and other funds received in advance of delivery are deferred until the transfer of control is complete.

For certain contracts, the Company recognizes revenue 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. For the three months ended March 31, 2018 and March 31, 2017, the percentage-of-completion revenue accounted for less than 0.1% of total revenue during the respective time periods. This resulted in immaterial unfulfilled performance obligations and immaterial contract assets and/or liabilities for which the Company did not record adjustments to opening retained earnings as of December 31, 2015 or for any periods previously presented.

As an accounting policy election, the Company excludes from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer.

Shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are accounted for as a fulfillment cost and are included in cost of revenues.

Use of Estimates

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

Reclassifications

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

Note 2 — Recent Accounting Pronouncements

Application of New Accounting Standards

Effective January 1, 2018, the Company adopted the accounting guidance in Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers.” This standard supersedes most of the existing revenue recognition requirements in U.S. GAAP under Accounting Standards Codification (“ASC”) 605 and establishes a new revenue standard, ASC 606. This new standard requires entities to recognize revenue at an amount that reflects the consideration to which the Company expects to be entitled in exchange for transferring goods or services to a customer. The new standard also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity’s nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company adopted ASC 606 using the full retrospective method. The adoption of this standard did not have a material impact on the Company’s consolidated financial statements. Refer to Note 4 — “Revenue from Contracts with Customers” for further information surrounding adoption of this new standard.

Effective January 1, 2018, the Company adopted the accounting guidance in ASU No. 2016-15, “Classification of Certain Cash Receipts and Cash Payments.” This standard addressed eight specific cash flow issues with the objective of reducing the existing diversity in practice. Implementation of this standard did not have a material effect on the consolidated financial statements and related disclosures. The Company applied this standard prospectively, where applicable, as there were no historical transactions affected by this implementation.

Effective January 1, 2018, the Company adopted the accounting guidance in ASU No. 2017-01, “Clarifying the Definition of a Business.” This standard provided additional guidance on whether an integrated set of assets and activities constitutes a business. Implementation of this standard did not have a material effect on the consolidated financial statements and related disclosures. The Company applied this standard prospectively and, therefore, prior periods were not adjusted. In addition, the Company had no activity during the three months ended March 31, 2018 that was required to be treated differently under this ASU than previously issued guidance.

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

Effective January 1, 2018, the Company adopted the accounting guidance in ASU No. 2017-09, "Scope of Modification Accounting." This standard provided guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting under Topic 718. Implementation of this standard did not have a material effect on the consolidated financial statements and related disclosures. The Company applied this standard prospectively and, therefore, prior periods presented were not adjusted. There were no changes to the terms or conditions of current share-based payment awards during the three months ended March 31, 2018.

New Accounting Requirements and Disclosures

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-02, "Leases." This standard requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous U.S. GAAP. The pronouncement is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period and should be applied using a modified retrospective transition approach, with early application permitted. The Company is currently evaluating the impact the pronouncement will have on the consolidated financial statements and related disclosures.

In June 2016, the FASB issued ASU No. 2016-13, "Measurement of Credit Losses on Financial Instruments." This standard replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The pronouncement is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption for the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact the pronouncement will have on the consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU No. 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This standard allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the 2017 Tax Cuts and Jobs Act. The pronouncement is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted in any interim period. The Company is currently evaluating the impact the pronouncement will have on the consolidated financial statements and related disclosures.

Note 3 — Discontinued Operations

During the fourth quarter of 2016, the Company initiated a strategic restructuring of its business to enable a greater focus on its core businesses in energy chemistry and consumer and industrial chemistry. The Company executed a plan to sell or otherwise dispose of the Drilling Technologies and Production Technologies segments. An investment banking advisory services firm was engaged and actively marketed these segments.

Disposal of the Drilling Technologies and Production Technologies reporting segments represented a strategic shift that would have a major effect on the Company's operations and financial results. The Company met all of the criteria to classify the Drilling Technologies and Production Technologies segments' assets and liabilities as held for sale in the fourth quarter of 2016. Effective December 31, 2016, the Company classified the assets, liabilities, and results of operations for these two segments as "Discontinued Operations" for all periods presented.

On May 22, 2017, the Company completed the sale of substantially all of the assets and transfer of certain specified liabilities and obligations of the Company's Drilling Technologies segment to National Oilwell Varco, L.P. ("NOV") for $17.0 million in cash consideration, subject to normal working capital adjustments, with $1.5 million held back by NOV for up to 18 months to satisfy potential indemnification claims.

On May 23, 2017, the Company completed the sale of substantially all of the assets and transfer of certain specified liabilities and obligations of the Company's Production Technologies segment to Raptor Lift Solutions, LLC ("Raptor Lift") for $2.9 million in cash consideration, with $0.4 million held back by Raptor Lift to satisfy potential indemnification claims.

On August 16, 2017, the Company completed the sale of substantially all of the remaining assets of the Company's Drilling Technologies segment to Galleon Mining Tools, Inc. for $1.0 million in cash consideration and a note

receivable of $1.0 million due in one year.
The sale or disposal of the assets and transfer or liquidation of liabilities and obligations of these segments was completed in 2017. The Company has no continuing involvement with the discontinued operations.

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

The following summarized financial information has been segregated from continuing operations and reported as Discontinued Operations for the three months ended March 31, 2017 (in thousands):

Drilling Technologies	
Revenue	$6,797
Cost of revenue	(4,655)
Selling, general and administrative	(3,031)
Gain on disposal of long-lived assets	73
Loss from operations	(816)
Other expense	(71)
Loss on write-down of assets held for sale	(6,560)
Loss before income taxes	(7,447)
Income tax benefit	2,713
Net loss from discontinued operations	$(4,734)
Production Technologies	
Revenue	$3,153
Cost of revenue	(2,483)
Selling, general and administrative	(873)
Research and development	(271)
Loss from operations	(474)
Other expense	(36)
Loss on write-down of assets held for sale	(9,717)
Loss before income taxes	(10,227)
Income tax benefit	3,726
Net loss from discontinued operations	$(6,501)
Drilling Technologies and Production Technologies	
Loss from discontinued operations, net of tax	$(11,235)

At December 31, 2017, all remaining assets and liabilities of the discontinued operations were assumed by the Company's continuing operations. These balances included $0.3 million of net accounts receivable, $1.4 million of sales price hold-back that will be received during 2018, and $1.4 million of accrued liabilities to be settled in 2018.

Note 4 — Revenue from Contracts with Customers

Effective January 1, 2018, the Company adopted ASC 606 using the full retrospective method applied to those contracts which were not completed as of December 31, 2015. As a result of electing the full retrospective adoption approach, results for reporting periods beginning after December 31, 2015 are presented under ASC 606.

There was no material impact upon the adoption of ASC 606. As revenue is primarily related to product sales accounted for at a point in time and service contracts that are primarily short-term in nature (typically less than 30 days), the Company did not record any adjustments to opening retained earnings at December 31, 2015 or for any periods previously presented.

Revenues are recognized when control of the promised goods or services is transferred to the customer, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. In recognizing revenue for products and services, the Company determines the transaction price of purchase orders or contracts with customers, which may consist of fixed and variable consideration. Determining the transaction price may require significant judgment by management, which includes identifying performance obligations, estimating variable consideration to include in the transaction price, and determining whether promised goods or services can be distinguished in the context of the contract. Variable consideration typically consists of product returns and is estimated based on the amount of consideration the Company expects to receive. Revenue accruals are recorded on an ongoing basis to reflect updated variable consideration information.

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

For certain contracts, the Company recognizes revenue 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. For the three months ended March 31, 2018 and March 31, 2017, the percentage-of-completion revenue accounted for less than 0.1% of total revenue during the respective time periods. This resulted in immaterial unfulfilled performance obligations and immaterial contract assets and/or liabilities, for which the Company did not record adjustments to opening retained earnings as of December 31, 2015 or for any periods previously presented.

The vast majority of the Company’s products are sold at a point in time and service contracts are short-term in nature. Sales are billed on a monthly basis with payment terms customarily 30 days from invoice receipt. In addition, sales taxes are excluded from revenues.

Disaggregation of Revenue

The Company has disaggregated revenues by product sales (point-in-time revenue recognition) and service revenue (over-time revenue recognition), where product sales accounted for over 95% of total revenue for the three months ended March 31, 2018 and March 31, 2017.

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

	Three months ended March 31,	
	2018	2017
Revenue:		
Products	$59,250	$78,514
Services	1,266	1,440
	$60,516	$79,954
Cost of revenue (excluding depreciation and amortization):		
Products	$44,514	$50,691
Services	1,187	934
	$45,701	$51,625

Arrangements with Multiple Performance Obligations

The Company’s contracts with customers may include multiple performance obligations. For such arrangements, the total transaction price is allocated to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised goods or services underlying each performance obligation. Standalone selling prices are generally determined based on the prices charged to customers (“observable standalone price”) or an expected cost plus a margin approach. For combined products and services within a contract, the Company accounts for individual products and services separately if they are distinct (i.e. if a product or service is separately identifiable from other items in the contract and if a customer can benefit from it on its own or with other resources that are readily available to the customer). The consideration is allocated between separate products and services within a contract based on the prices at the observable standalone price. For items that are not sold separately, the expected cost plus a margin approach is used to estimate the standalone selling price of each performance obligation.

Contract Balances

Under revenue contracts for both products and services, customers are invoiced once the performance obligations have been satisfied, at which point payment is unconditional. Accordingly, no revenue contracts give rise to contract assets or liabilities under ASC 606.

Practical Expedients and Exemptions

The Company has elected to apply several practical expedients as discussed below:

- Sales commissions are expensed when incurred because the amortization period would have been one year or less. These costs are recorded within segment selling and administrative expenses.

- The majority of the Company’s services are short-term in nature with a contract term of one year or less. For those contracts, the Company has utilized the practical expedient in ASC 606-10-50-14, exempting the Company from disclosure of the

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

transaction price allocated to remaining performance obligations if the performance obligation is part of a contract that has an original expected duration of one year or less.

- The Company's payment terms are short-term in nature with settlements of one year or less. The Company has utilized the practical expedient in ASC 606-10-32-18, exempting the Company from adjusting the promised amount of consideration for the effects of a significant financing component given that the period between when the Company transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.
- In most service contracts, the Company has the right to consideration from a customer in an amount that corresponds directly with the value to the customer of the Company's performance completed to date. For these contracts, the Company has utilized the practical expedient in ASC 606-10-55-18, allowing the Company to recognize revenue in the amount to which it has a right to invoice.

Accordingly, the Company does not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which the Company recognizes revenue at the amount to which it has the right to invoice for services performed.

Note 5 — Supplemental Cash Flow Information

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

	Three months ended March 31, 2018	2017
Supplemental non-cash investing and financing activities:		
Value of common stock issued in payment of accrued liability	$—	$188
Exercise of stock options by common stock surrender	—	7
Supplemental cash payment information:		
Interest paid	$457	$553
Income taxes paid, net of refunds (received, net of payments)	71	(114)

Note 6 — Inventories

Inventories are as follows (in thousands):

	March 31, 2018	December 31, 2017
Raw materials	$44,754	$ 42,750
Work-in-process	3,459	3,284
Finished goods	35,415	30,293
Inventories	83,628	76,327
Less reserve for excess and obsolete inventory	(1,543)	(568)