FLOTEK INDUSTRIES INC/CN/
Form 10KSB/A
April 19, 2005

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

**FORM 10-KSB/A**

For Annual and Transition Reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

(Mark One)

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

**for the fiscal year ended December 31, 2004**

OR

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

**Commission File No. 1-13270**

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

| | |
|---|---|
| **Delaware** | **90-0023731** |
| (State or other jurisdiction of incorporation) | (I.R.S. Employer Identification Number) |
| **7030 Empire Central Drive, Houston, Texas** | **77040** |
| (Address of principal executive office) | (Zip Code) |

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

Securities registered pursuant to Section 12(b) of the Exchange Act:
(none)
Securities registered pursuant to Section 12(g) of the Exchange Act:

**Common Stock, $0.0001 par value**
(Title of Class)

Check 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 o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. o

Revenues for the Company's 2004 fiscal year were $21,881,289.

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately $33,285,000 on March 30, 2005 based upon the closing sale price of common stock on such date of $8.70 per share on the OTC Bulletin Board. As of March 30, 2005, the Registrant had 6,803,846 shares of common stock issued and out-standing.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portion's of the Registrant's Proxy Statement for its 2004 annual meeting of shareholders have been incorporated by reference into Part III of this form 10KSB.

Transitional small business disclosure format: Yes o No x

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**CERTIFICATIONS**

***Rule 13a-15(e) and 15d-15(e) Certification of Chief Executive Officer.*** **Exhibit 31.1**

***Rule 13a-15(e) and 15d-15(e) Certification of Chief Financial Officer.*** **Exhibit 31.2**

***Certification of Periodic Report by Chief Executive Officer.*** **Exhibit 32.1**

***Certification of Periodic Report by Chief Financial Officer.*** **Exhibit 32.2**

**Forward-Looking Statements**

Except for the historical information contained herein, the discussion in this Form 10-KSB includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. The words "anticipate", "believe", "expect", "plan", "intend", "project", "forecast", "could" and similar expressions are intended to identify forward-looking statements. All statements other than statements of historical facts included in this Form 10-KSB regarding the Company's financial position, business strategy, budgets and plans, and objectives of management for future operations are forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those in the forward-looking statements for various reasons, including the effect of competition, the level of petroleum industry exploration and production expenditures, world economic and political conditions, prices of, and the demand for crude oil and natural gas, weather, the legislative environment in the United States and other countries, adverse changes in the capital and equity markets, and other risk factors including those identified herein.

# PART I

## Item 1. *Description of Business*

### Business

Flotek Industries, Inc. and subsidiaries (the "Company" or "We") was originally incorporated under the laws of the Province of British Columbia on May 17, 1985. On October 23, 2001, we approved a change in our corporate domicile to Delaware and a reverse stock split of 120 to 1. On October 31, 2001, we completed a reverse merger with Chemical & Equipment Specialties, Inc. ("CESI").

We are a supplier of drilling and production products and services to the oil and natural gas industry on a worldwide basis. Our core focus is oilfield specialty chemicals and logistics, downhole drilling tools and downhole production tools. We are headquartered in Houston, Texas and our common stock is traded on the OTC Bulletin Board market under the stock ticker symbol, "FLTK" or "FLTK.OB". Our website is located at http://www.flotekind.com. Information contained in our website or links contained on our website are not part of this Form 10-KSB.

Our reportable segments are strategic business units that offer different products and services. Each business segment requires different technology and marketing strategies, and is managed independently.

- The Chemicals and Logistics segment is made up of two business units. The CESI Chemical business unit develops, manufactures, packages and sells chemicals used by other oilfield service companies in oil and gas drilling, cementing, stimulation and production. The Materials Translogistics business unit designs and manages automated bulk material handling, blending and loading facilities for oilfield service companies.

- The Drilling Products segment manufactures and markets our Turbeco line of casing centralizers, Turbo-Flo mud shaker screens and external casing packers for coal bed methane drilling.

- The Production Products segment manufactures and markets our Petrovalve line of downhole pump components.

Our products use patented and/or proprietary product designs to achieve greater efficiency and effectiveness than competing products.

### Chemicals and Logistics

The CESI Chemical business offers a full spectrum of oilfield specialty chemicals used for drilling, cementing, stimulation, and production. We have laboratory facilities in Oklahoma and Colorado which design, develop and test new chemical formulations and enhance existing products, often in partnership with our customers. The laboratory provides quality assurance to our manufacturing operations and expert technical support to our customers on existing product lines. The development of specialty chemicals with enhanced performance characteristics withstand a wide range of downhole pressures, temperatures and other well-specific conditions is key to the success of this business unit.

The customer base for the CESI Chemicals business is primarily oil and gas pumping service companies, including both major and independent oilfield service companies. The segment manufactures, packages and warehouses its products in Oklahoma. We distinguish ourselves through the strength of our innovative and proprietary products, dedication to product quality and superior customer service. The division's products provide measurable productivity increases and solutions to environmental problems.

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Our Materials Logistics business designs, project manages and operates automated bulk material handling and loading facilities for oilfield service companies, and serves as consulting engineers. The domestic customer base for this segment consists of one major independent oilfield service company which specializes in pressure pumping, cementing and stimulation services. We also contract with international customers to design and project manage the construction of bulk handling facilities. Our client's bulk facilities handle oilfield products including sand and other materials for well fracturing operations, as well as dry cement and additives for oil and gas well cementing and supplies and materials used in oilfield operations which we blend to specification.

**Drilling Products**

The Drilling Products segment manufactures and sells the Turbeco line of rigid body and integral joint centralizers, mud shaker screens and external casing packers for coal bed methane drilling.

Our Turbeco line of fixed rigid and integral joint centralizers is used in oil and gas well cementing programs to increase the effectiveness of such operations. Its primary products include the Cementing Turbulator, which we acquired and began distributing in 1994. The tool's main purpose is assuring the pipe is properly centered in the well bore thereby obtaining an effective bond with the formation. We were one of the first companies to distribute spiral-vane cementing turbulators. The Turbulator has gained widespread acceptance through its ability to improve oil and gas well cementing programs and is effective in deep, directional and horizontal well applications. Additional products that have been introduced in this segment are the Integral Pup Centralizer, the Integral Joint Bow Spring Centralizer, the Eccentric Turbulator (jointly developed and patented with Marathon Oil), and the patented Turbo-lok Centralizer.

We purchased from Phoenix E&P Technology, LLC, the manufacturing assets, inventory and intellectual property rights to produce oilfield shale shaker screens on January 28, 2005. We manufacture and market the Turbo-Flo high efficiency screens through our existing sales network. The screens feature a metal backed framing support with a proprietary synthetic coating and sealing which extends the screen life. The screens consist of two layers of stainless wire cloth as opposed to the conventional three layers, reducing "trampoline" effect and maximizing fluid throughput.

On February 14, 2005, we completed the acquisition of Spidle Sales and Services, Inc. ("Spidle"). Spidle is a downhole tool company with rental, sales and manufacturing operations throughout the Rocky Mountains. Spidle serves both the domestic and international downhole tool markets with a customer base extending into Canada, Mexico, South America, Europe, Asia and Africa. Spidle operates in the energy, mining, water and industrial drilling sectors.

Our customers in the Drilling Products segment are primarily oil and gas exploration and production companies, including major oil companies, which own producing oil and gas wells and are involved in the drilling and cementing of oil wells. Our active customer base is distributed among major oil companies and smaller independent operators. Marketing for our products is primarily focused in the Gulf of Mexico, Mid-Continent and Rocky Mountain regions of the United States.

**Production Products**

The Production Products segment manufactures and markets the patented Petrovalve line of downhole pump components. The Petrovalve line of downhole pump valves was originally designed in the mid-1980's and has undergone significant improvements in recent years. The Petrovalve product line provides longer and more reliable downhole pump performance than the traditional ball and seat valves which are the predominant product in the industry. Additionally, the Petrovalve has demonstrated more efficient flow characteristics and increased production volumes in many circumstances. Our "Gas Breaker" technology allows us to provide a solution to gas lock problems often encountered on wells with lower flow rates or high gas ratios. We outsource manufacturing of most of the machined valve components, but assemble and perform final quality assurance on all valves in Houston.

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The Petrovalve product line is comprised of rod pump manufacturers and pump maintenance and service shops using the industry standard API ball and seat product, as well as other proprietary valve products. Our customers in the Downhole Production Products segment are primarily major oil and gas exploration and production companies. The majority of the sales in this segment are international sales.

**Product Demand and Marketing**

The demand for our products and services is generally correlated to the level of oil and gas drilling activity, both in the United States and internationally. Drilling activity, in turn, is generally dependent on the price levels of oil and gas. Certain products, particularly the Petrovalve line and some of our specialty chemicals, are more closely related to the production of oil and gas and demand is less dependent on drilling activity.

We market our products primarily through direct sales to our customers by company managers and sales employees. We have established customer relationships which provides for repeat sales. Five customers accounted for 47% of consolidated revenues for the year ended December 31, 2004. The majority of these sales were in the Chemicals and Logistics segment and collectively accounted for 57% of the revenues in this segment.

**Government Regulation, Operating Risks and Insurance**

We are subject to federal, state and local environmental and occupational safety and health laws and regulations in the United States and other countries in which we do business. We strive to fully-comply with these requirements and are not aware of any material instances of noncompliance. However, these requirements are complex and assuring compliance is often difficult. The enforcement of these laws and regulations may become more stringent in the future and could have a material impact on our costs of operations. Non-compliance could also subject us to material liabilities, such as government fines, third-party lawsuits or even the suspension of operations.

Many of the products within our specialty chemicals segment are considered hazardous or flammable. The majority of such products are reasonably stable and generally require only ordinary care in handling and transportation. However, we do have risks in handling the materials in this segment and if a leak or spill occurs in connection with our operations, we could incur material costs, net of insurance, to remediate any resulting contamination.

In addition, our products are used for the exploration and production of oil and natural gas. Such operations are subject to hazards inherent in the oil and gas industry, such as fires, explosions, blowouts and oil spills. These hazards can cause personal injury or loss of life, damage to or destruction of property, equipment, environment, marine life and suspension of operations. Litigation arising from an occurrence at a location where our products or services are used or provided could, in the future, result in us being named as a defendant in lawsuits asserting potentially significant claims. We maintain insurance coverage that we believe to be reasonable and customary in the industry against these hazards.

We are currently not named or involved in any litigation.

**Research and Development and Intellectual Property**

We are actively involved in developing proprietary products to expand our existing product lines and in developing new technologies. We have followed a policy of seeking patent protection both within and outside the United States for products and methods that appear to have commercial significance and qualify for patent protection. The decision to seek patent protection considers whether such protection can be obtained on a cost-effective basis and is likely to be effective in protecting our commercial interests. We believe our patents and trademarks, together with our trade secrets and proprietary design, manufacturing and operational expertise, are reasonably adequate to protect our intellectual property and provide for the continued operation of our business. However, our competitors may attempt to circumvent these patent protections or develop new technologies which compete with our products.

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**International Operations**

The majority of our revenues and operations are currently derived and conducted within the United States. However, we have been expanding our international sales efforts and we expect international sales to continue to increase. Internationally, we operate primarily through agents in Canada, Mexico, Central and South America, the Middle East, Asia and Russia.

International sales involve additional business and credit risks inherent in doing business in countries with legal and political policies different from those in the United States. Those risks can include war, boycotts, legal and political changes and fluctuations in foreign currency exchange rates.

**Employees**

As of March 30, 2005, we employed 107 full-time employees. None of our employees are covered by collective bargaining agreements.

**Risk Factors**

Our results of operations could be adversely affected if our business assumptions do not prove to be accurate or if adverse changes occur, including but not limited to the following areas:

*Business Risks*

- Decline in or increased volatility in oil and natural gas prices that would adversely affect our customers and the energy industry.
- Decline in drilling activity.
- Increase in prices for products used by us in our operations.
- Severe weather conditions. For example, hurricanes can have a direct impact on activity levels in the affected areas and oil and gas prices.
- The oilfield service industry is highly competitive, and we must compete with many companies possessing greater financial resources and better established market positions.
- The introduction of new products and technologies by competitors may adversely affect the demand for our products and services.
- The potential for unexpected litigation.

*Risks of Economic Downturn*. In the event of an economic downturn in the United States and/or globally there may be decreased demand and lower prices for oil and natural gas, and therefore for our products and services. Our customers are generally involved in the energy industry, and if these customers experience a business decline, we could be subject to increased exposure to credit risk. If an economic downturn occurs, our results of operations may be adversely affected.

*Risks from Operating Hazards*. Our operations are subject to hazards present in the oil and natural gas industry, which can cause personal injury and damage to property or the environment.

*Risks from Unexpected Litigation.* We have insurance coverage against operating hazards, which we believe is customary in the industry. This insurance has deductibles and contains certain coverage exclusions. Our insurance premiums can be increased or decreased based on the claims we make on our insurance policies. Results of operations could be adversely affected by unexpected claims not covered by insurance.

*Risks from International Operations*. Our international operations are subject to special risks that can materially affect the Company’s sales and profits. These risks include:

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- Limits on access to international markets.
- Unsettled political conditions, wars, civil unrest, and hostilities in some petroleum-producing and consuming countries and regions where we operate or seek to operate.
- Fluctuations and changes in currency exchange rates.
- Impact of inflation.
- Governmental action to the general legislative and regulatory environment, exchange controls, changes in global trade policies such as trade restrictions and embargos by the United States and other countries, and changes in international business, political and economic conditions.

Many of these risks are beyond our control. In addition, future trends for pricing, margins, revenue and profitability remain difficult to predict in the industries we serve and under current economic and political conditions.

**Item 2.** ***Description of Properties***

The following table sets forth certain information with respect to our principal properties:

| Location | Facility Size (Sq. Feet) | Tenure | Utilization |
|---|---|---|---|
| Marlow, Oklahoma | 15,500 | Owned | Specialty Chemicals Blending |
| Mason, Texas | 12,000 | Owned | Manufacturing Downhole Equipment |
| Houston, Texas | 9,000 | Leased | Corporate Office and Warehouse |
| Lafayette, Louisiana | 5,000 | Leased | Warehouse for Downhole Equipment |
| Raceland, Louisiana | 4,000 | Owned | Transload for Oilfield Services Material |
| Alice, Texas | 3,200 | Leased | Warehouse for Downhole Equipment |
| Denver, Colorado | 1,200 | Leased | Specialty Chemicals Sales Office |
| Raceland, Louisiana | 700 | Leased | Administrative Offices |

We consider our facilities to be in good condition and suitable for the conduct of our business. All of our owned facilities are subject to mortgages or security agreements as described in Note 8 and 9 of the Notes to the Consolidated Financial Statements. Commitments for our leased facilities are described in Note 13 of the Notes to Consolidated Financial Statements.

**Item 3.** ***Legal Proceedings***

We are involved, on occasion, in routine litigation incidental to our business. As of March 30, 2005, we were not named or involved in any litigation.

On June 27, 2004, we settled the patent infringement legal suit of Milam Tool Company and the Estate of Jack J. Milam vs. Flotek Industries, Inc., Turbeco, Inc. and Jerry Dumas, individually, C.A. No. H-02-1647, in the United States District Court, Southern District of Texas, Houston Division. We voluntarily elected to settle the litigation with Milam Tool Company for $75,000. The settlement agreement was finalized without any ruling against us. Mediation of the matter resulted in joint agreements to dismiss the suit without any admission of patent infringement by our Turbeco subsidiary.

**Item 4.** ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of security holders during our fourth quarter of 2004.

# PART II

**Item 5.** ***Market for Registrant's Common Equity and Related Stockholder Matters***

Our common stock is traded on the OTC Bulletin Board under the symbol “FLTK”. The following table sets forth, on a per share basis for the periods indicated, our high and low closing sales prices reported by the OTC Bulletin Board.

| **2004** | **High** | **Low** |
|---|---|---|
| Fourth quarter ended December 31, 2004 | $ 5.00 | $ 2.20 |
| Third quarter ended September 30, 2004 | $ 2.00 | $ 1.01 |
| Second quarter ended June 30, 2004 | $ 1.50 | $ 0.85 |
| First quarter ended March 31, 2004 | $ 1.75 | $ 0.75 |
| | | |
| **2003** | | |
| Fourth quarter ended December 31, 2003 | $ 1.30 | $ 0.55 |
| Third quarter ended September 30, 2003 | $ 1.30 | $ 0.60 |
| Second quarter ended June 30, 2003 | $ 1.30 | $ 0.55 |
| First quarter ended March 31, 2003 | $ 1.25 | $ 0.60 |

As of March 30, 2005, our closing stock price, as quoted on the OTC Bulletin Board, was $8.70. As of March 30, 2005, there were 6,803,846 common shares outstanding held by approximately 146 holders of record and an estimated 11 beneficial holders.

**Dividend Policy**

We have not historically paid cash dividends on our common stock. We intend to retain future earnings to meet our working capital requirements and to finance the future operations of our business. Therefore, we do not plan to declare or pay cash dividends to holders of our common stock in the foreseeable future. In addition, some of our credit agreements contain provisions that limit our ability to pay cash dividends on our common stock.

**Recent Issuance of Unregistered Securities**

In January 2004, we issued 133,334 shares of our common stock in a private offering to “accredited investors” in exchange for $100,000 of cash subscription proceeds, which was paid by tender to us. During 2004, a total of 15,000 stock options were exercised by directors, officers and employees.

On April 3, 2003, a stock grant of 125,000 shares was awarded to Mr. Jerry D. Dumas, Sr., our Chairman and CEO, which resulted in $75,000 of compensation expense. Also, during 2003, we issued 875,000 shares of our common stock in a private offering to “accredited investors” in exchange for $525,000 of cash subscription proceeds, which was paid by tender to us. We received $150,000 of the total $525,000 from two of our directors, one of which is a principal stockholder.

The foregoing issuances of common stock were made in reliance upon the exemption from registration set forth in Section 4(2) of the Securities Act of 1933 for transactions not involving a public offering. No underwriters were engaged in connection with the foregoing sales of securities. The sales were made without general solicitation or advertising. Each purchaser was an "accredited investor" or a "sophisticated investor" with access to all relevant information necessary to evaluate the investment, who represented to us that sales were being acquired for investment.

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table summarizes information regarding our equity securities that are authorized for issuance under individual non-qualified stock option compensation agreements:

**Equity Compensation Agreement Information**

| Plan category | Number of securities to be issued upon exercise of outstanding options and warrants (a) | Weighted-average exercise price of outstanding options and warrants (b) | Number of securities remaining available for future issuance under equity compensation agreements (excluding securities reflected in column (a)) (c) |
|---|---|---|---|
| Equity compensation agreements not approved by security holders: | | | |
| Individual stock compensation agreement | 1,041,757 | $ 2.13 | -- |
| Warrants | 56,029 | $ 15.79 | -- |
| Total | 1,097,786 | $ 2.83 | -- |

**Item 6.** ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with "Item 7. Financial Statements" contained herein.

We provide a broad range of products and services worldwide, for use in the exploration and production of crude oil and natural gas. We compete in the specialty chemical, bulk handling and logistics, downhole drilling tool and downhole production tool oilfield products and services.

We were incorporated in 1985 and currently trade on the OTC Bulletin Board market. Our headquarters are in Houston, Texas, and we have manufacturing operations in Texas, Oklahoma and Louisiana. We market our products domestically and internationally in over 20 countries.

Our product lines are divided into three segments within the oilfield service industry:

- The Chemicals and Logistics segment is made up of two business units:
  - o The CESI Chemical business unit develops, manufactures, packages and sells chemicals used by oilfield service companies in oil and gas well cementing, stimulation, drilling and production. Our applied research laboratories support the specific drilling and production needs of our customers.
  - o The Materials Translogistics business unit designs and manages automated bulk material handling, loading facilities, and blending capabilities for oilfield service companies.
- The Drilling Products segment manufactures and markets our Turbeco line of casing centralizers, Turbo-Flo mud shaker screens and external casing packers for coal bed methane drilling.
- The Production Products segment manufactures and markets our Petrovalve line of downhole pump components.

The customers for our products and services include the major integrated oil and natural gas companies, independent oil and natural gas companies and state-owned national oil companies. Our ability to compete in the oilfield services market is dependent on our ability to differentiate our products and services, provide superior quality and service, and maintain a competitive cost structure. Activity levels in our three segments are driven primarily by current and expected commodity prices, drilling rig count, oil and gas production levels, and customer capital spending allocated for drilling and production.

We continue to actively seek profitable acquisition or merger candidates in our core business to either decrease costs of providing products or add new products and customer base to diversify our market.

**Critical Accounting Policies and Estimates**

Our financial statements are prepared in conformity with accounting principles generally accepted in the United States of America and require us to make estimates and assumptions during their preparation which requires judgment. Our critical accounting policies and procedures include but are not limited to the following:

***Cash and Cash Equivalents***

We consider all short-term investments with an original maturity of three months or less to be cash equivalents.

***Restricted Cash***

As of December 31, 2004, we had $37,038 of restricted cash which serves as collateral for a standby letter of credit that provides financial assurance that we will fulfill our obligations related to an international contract to design and project manage the construction of a bulk handling facility in Mexico.

***Inventories***

Inventories consist of raw materials, finished goods and parts and materials used in manufacturing and construction operations. Finished goods inventories include raw materials, direct labor and production overhead. Inventories are carried at the lower of cost or market using the weighted average cost method. The Company maintains a reserve for slow-moving and obsolete inventories, which is reviewed for adequacy on a periodic basis.

***Property, Plant and Equipment***

Property, plant and equipment are stated at cost. The cost of ordinary maintenance and repairs is charged to operations, while replacements and major improvements are capitalized. Depreciation or amortization is provided at rates considered sufficient to amortize the cost of the assets using the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Buildings and leasehold improvements | 3-24 years |
| Machinery and equipment | 2-3 years |
| Furniture and fixtures | 3-7 years |
| Transportation equipment | 3 years |
| Computer equipment | 3-5 years |

We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds either the fair value or the estimated discounted cash flows of the assets, whichever is more readily measurable. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

***Goodwill and Intangible Assets***

Goodwill represents the excess of the aggregate price paid by us in acquisitions over the fair market value of the tangible and identifiable intangible net assets acquired. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, “Goodwill and Other Intangible Assets” separable intangible assets that are not deemed to have indefinite lives will be amortized over their useful lives.

***Financial Instruments***

We consider the fair value of all financial instruments (primarily long-term debt) not to be materially different from their carrying values at the end of each fiscal year based on management's estimate of our ability to borrow funds under terms and conditions similar to those of our existing debt and because the majority of our debt carries a floating rate.

We have no off-balance sheet debt or other off-balance sheet financing arrangements. We have not entered into derivative or other financial instruments.

***Revenue Recognition***

Revenue for product sales is recognized when all of the following criteria have been met: (i) evidence of an agreement exists, (ii) products are shipped or services rendered to the customer and all significant risks and rewards of ownership have passed to the customer, (iii) the price to the customer is fixed and determinable and (iv) collectibility is reasonably assured. Accounts receivable are recorded at that time net of any discounts. Earnings are charged with a provision for doubtful accounts based on a current review of collectibility of the accounts receivable. Accounts receivable deemed ultimately uncollectible are applied against the allowance for doubtful accounts. Deposits and other funds received in advance of delivery are deferred until the transfer of ownership is complete. Our Material Translogistics business unit ("MTI") recognizes revenues of its 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 revenues earned to date. Contract costs include all direct labor and material costs and those indirect costs related to manufacturing and construction operations. General and administrative costs are charged to expense as incurred. Changes in job performance and estimated profitability, including those arising from contract bonus or penalty provisions and final contract settlements, may result in revisions to costs and income and are recognized in the period in which such revisions appear probable. All known or anticipated losses on contracts are recognized in full when such amounts become apparent. MTI bulk material transload revenue is recognized as services are performed for the customer.

***Foreign Currency***

We have sales that are denominated in currencies other than the United States dollar. Any foreign currency transaction gains or losses are included in our results of operations. We have not entered into any forward foreign exchange contracts to hedge the potential impact of currency fluctuations on our foreign currency denominated sales.

***Research and Development Costs***

Expenditures for research activities relating to product development and improvement are charged to expense as incurred.

***Income Taxes***

Income taxes are computed under the liability method. We provide deferred income tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts and the respective tax basis of assets and liabilities. These deferred assets and liabilities are based on enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred income tax assets to amounts which are more likely than not to be realized.

***Earnings Per Share***

Earnings per common share is calculated by dividing net income or loss attributable to common stockholders by the weighted average number of common shares outstanding. Dilutive income or loss per share is calculated by dividing net income or loss attributable to common stockholders by the weighted average number of common shares outstanding and dilutive effect of stock options.

***Stock-Based Compensation***

We recognize compensation expense associated with stock-based awards under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, “Accounting for Stock Issued to Employees”, and related interpretations. The difference between the quoted market price as of the date of the grant and the contractual purchase price of shares is charged to operations over the vesting period. No compensation expense has been recognized for stock options with fixed exercise prices equal to the market price of the stock on the dates of grant. We provide supplemental disclosure of the effect on net income (loss) and earnings (loss) per share as if the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure" had been applied in measuring compensation expense. Under SFAS 123R, we will be required to measure the cost of employee services received in exchange for stock based on the grant date at fair value (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide services in exchange for the award (usually the vesting period). The fair value will be estimated using an option-pricing model. Excess tax benefits, as defined in SFAS 123R, will be recognized as an addition to additional paid-in capital. The Standard is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. We are currently in the process of evaluating the impact of SFAS 123R on our financial statements, including different option-pricing models.

***Recent Accounting Pronouncements***

In January 2003, the FASB issued FASB Interpretation No. 46 (“FIN 46”), “Consolidation of Variable Interest Entities”. FIN 46 clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements*,* to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In December 2003, the FASB issued FIN 46R which revised certain provisions in the original interpretation and permitted multiple effective dates based upon the nature and formation date of the variable interest entity. Adoption of the provisions of FIN 46R did not have any impact on our financial position, results of operations or cash flows as all of our subsidiaries are wholly-owned.

In December 2004, the FASB published the following two final FASB Staff Positions, effective immediately. FAS 109-1, "Application of FASB Statement No.109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004," giving guidance on applying FASB Statement No. 109, Accounting for Income Taxes, to the tax deduction on qualified production activities provided by the American Jobs Creation Act of 2004. FAS 109-2 "Accounting and Disclosure Guidance for that Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" provides guidance on the Act's repatriation provision. We are in the process of reviewing the FAS 109-1 and FAS 109-2; however, at this time, we do not believe that the adoption of FAS 109-1 or FAS 109-2 will have a material impact on our consolidated financial position, results of operations or cash flows.

In November 2004, the FASB Emerging Issues Task Force, or EITF, reached a consensus in applying the conditions in Paragraph 42 of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets, in Determining Whether to Report Discontinued Operations" (EITF 03-13). Evaluation of whether operations and cash flows have been eliminated depends on whether (1) continuing operations and cash flows are expected to be generated, and (2) the cash flows, based on their nature and significance, are considered direct or indirect. This consensus should be applied to a component that is either disposed of or classified as held-for-sale in fiscal periods beginning after December 15, 2004. We do not believe that the adoption of EITF 03-13 will have a material impact on our consolidated financial position, results of operations or cash flows.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs—An Amendment of ARB No. 43, Chapter 4" (SFAS No. 151). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and re-handling costs be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005 and is required to be adopted by us in the first quarter of fiscal 2006, beginning on January 1, 2006. We are currently evaluating the effect that the adoption of SFAS No. 151 will have on our consolidated financial position, results of operations and cash flows, but do not expect SFAS No. 151 to have a material impact.

**Results of Operations**

| | For the Years Ended December 31, 2004 | 2003 |
|---|---|---|
| Revenues | $ 21,881,289 | $ 14,844,431 |
| Cost of revenues | 12,529,631 | 9,264,091 |
| Gross margin | 9,351,658 | 5,580,340 |
| Gross margin % | 42.7% | 37.6% |
| | | |
| Selling, general and administrative | 5,349,594 | 4,788,749 |
| Goodwill impairment | -- | 5,120,633 |
| Depreciation and amortization | 689,901 | 713,531 |
| Research and development | 300,074 | 46,654 |
| Total expenses | 6,339,569 | 10,669,567 |
| Income (loss) from operations | 3,012,089 | (5,089,227) |
| Income (loss) from operations % | 13.8% | (34.3)% |
| | | |
| Interest expense | (691,568) | (618,438) |
| Other, net | 46,264 | 26,985 |
| Total income (expense) | (645,304) | (591,453) |
| | | |
| Income (loss) before income taxes | 2,366,785 | (5,680,680) |
| Provision for income taxes | (213,096) | -- |
| Income (loss) from continuing operations | 2,153,689 | (5,680,680) |
| | | |
| Loss from discontinued operations, net of tax | -- | (545,592) |
| Loss on disposal of discontinued operations, net of tax | -- | (1,157,835) |
| Net income (loss) | $ 2,153,689 | $ (7,384,107) |
| Net income (loss) % | 9.8% | (49.7)% |

Total revenues increased by $7,036,858 or 47.4% in 2004 from 2003. As discussed in the segment analysis that follows, this significant increase in revenues was due to strong performance by our Chemicals and Logistics segment, particularly with our line of proprietary chemicals. Currently, international sales make up approximately 15% of total revenues. We have expanded our international geographic footprint and customer base as evidenced by penetration into new markets this year in Russia, Mexico and the Middle East. We will continue to focus on growing international revenues.

Gross margin increased 67.6%, from $5,580,340 in 2003 to $9,351,658 in 2004. More importantly, gross margin as a percentage of revenues increased from 37.6% in 2003 to 42.7% in 2004. Improved margins in the Chemical and Logistics segment were primarily responsible for the improvement in margins. The gross margin is best analyzed on a segment by segment basis, discussed below, as gross margin varies significantly between operating segments and can vary significantly from year to year in certain operating segments.

Selling, general and administrative are costs not directly attributable to products sold or services rendered. Selling, general and administrative costs increased to $5,349,594 in 2004 from $4,788,749 in 2003, however decreased as a percentage of revenue. Measured as a percentage of revenue, selling, general and administrative dropped from 32.3% in 2003 to 24.4% in 2004. Significant emphasis continues to be placed on growing sales while containing selling, general and administrative costs across the organization.

Interest expense increased slightly from $618,438 in 2003 to $691,568 in 2004. The increase was caused by higher interest rates, which were offset by lower overall debt levels. The majority of our indebtedness carries a variable interest rate tied to the prime rate, adjusted on a quarterly basis.

Research and development costs increased due to expansion of our applied research facilities, including increased personnel costs. The higher personnel costs are due to increased staffing in our applied research laboratories, reflecting our strategy to continue to develop proprietary specialty chemicals. Over the years, we have made a number of technological advances, including the development of an environmentally benign line of specialty chemicals. Substantially all of the new technologies have resulted from requests and guidance from our clients, particularly major oil companies. Research and development expenditures are charged to expense as incurred. We intend to continue committing financial resources and effort to the development and acquisition of new products and services.

Based on our improved profitability, a $213,096 provision for income taxes was recorded in 2004. The provision was made for estimated state income tax and alternative minimum tax, which can not be offset by our net operating loss carryforwards. The result of these taxes reduced earnings per share by $0.03. The effective income tax rate differs from the statutory rate primarily as a result of utilization of our net operating loss carryforwards.
As of December 31, 2003, we had various net deferred tax assets made up primarily of the expected future tax benefit of net operating loss carryforwards. A valuation allowance was provided in full against these net deferred tax assets based upon the Company’s historical losses. During 2004, we reduced the valuation allowance related to the remaining net tax assets by $1,160,000. The reduction reflects our ability to utilize this amount of net deferred tax assets based on 2004 operating results. The benefit from this reduction was recorded as a decrease in current income tax provision.
As of December 31, 2004, we had estimated net operating loss carryforwards which may be available to offset future taxable income of approximately $8.8 million, expiring in 2017 through 2023.

***Results by Segment***

***<u>Chemicals and Logistics</u>***

| | For the Years Ended December 31, 2004 | 2003 |
|---|---|---|
| Revenues | $ 17,982,880 | $ 11,919,350 |
| Gross margin | $ 7,466,881 | $ 4,131,606 |
| Gross margin % | 41.5% | 34.7% |
| | | |
| Operating income | $ 4,731,486 | $ 1,822,525 |
| Operating margin % | 26.3% | 15.3% |

Chemicals and Logistics revenues increased $6,063,530 or 50.9%, in 2004 compared to 2003. The increase in sales is attributable to continued increase in drilling activity and expanded market penetration in the U.S., Canada, Mexico and Russia. The most significant revenue growth relates to our environmental friendly “green” chemicals in the U.S., which have more than tripled from $1,103,680 in 2003 to $3,952,841 in 2004. CESI Chemical's focus on applied research has resulted in the penetration of new markets, continual expansion of our customer base, product portfolio and increased margins. Recently our applied research resulted in the development and subsequent sale of products to the drilling fluids industry, a new sales segment for us. CESI Chemical differentiates itself through the strength of its innovative and proprietary products, the depth of the laboratory staff, dedication to product quality, and superior customer service.

The gross margin increased from $4,131,606 in 2003 to $7,466,881 in 2004. Not only did gross margin increase, but gross margin as a percentage of revenues increased from 34.7% in 2003 to 41.5% in 2004. The increase in margin is attributable to increased sales of our novel and proprietary chemicals that command higher margins. Increased volume at our logistics facility in Raceland, Louisiana also contributed to our improved margins in 2004.

Operating income increased $2,908,961, or 160%, in 2004 compared to 2003, primarily as a result of increased sales in the Chemical division and improved gross margins in the Chemical and Logistics business unit. Expansion of our proprietary product line and customer base has driven the increase in sales and margin during 2004.

***Drilling Products***

| | For the Years Ended December 31, | | | |
|---|---|---|---|---|
| | | 2004 | | 2003 |
| Revenues | $ | 3,315,520 | $ | 2,700,374 |
| Gross margin | $ | 1,592,923 | $ | 1,419,520 |
| Gross margin % | | 48.0% | | 52.6% |
| | | | | |
| Operating income | $ | 358,649 | $ | 394,347 |
| Operating margin % | | 10.8% | | 14.6% |

Drilling Products revenues, increased $615,146 or 22.8% in 2004 compared to 2003. The increase in sales was driven by product line and geographic expansion. Gross margin also increased from $1,419,520 to $1,592,923 but decreased year over year as a percentage of revenue. The decrease in gross margin percentage from 52.6% in 2003 to 48.0% in 2004 was primarily due to a shift in product sales mix.

The decision to expand this segment during 2004, both in products and geographic footprint, resulted in several one-time start-up costs. Prior to 2004, the geographic coverage primarily included the Gulf Coast of Texas and Louisiana. We actively expanded our sales efforts into West Texas, North Texas and internationally, and incurred increased sales and marketing costs as a result. Historically the segment had variations of a single product. The drilling products group introduced an integral bow spring and other bow spring tools. These tools are outsourced for manufacturing, resulting in reduced margins. Introductory pricing was lower for these new products, but has improved based on product performance.

In February 2005, we completed the purchase of Spidle, a privately held downhole tool company with rental, sales and manufacturing operations throughout the Rocky Mountains, by acquiring all of the outstanding capital stock of Spidle for a total purchase price of $8.1 million. Spidle's results of operations are not included in the consolidated financial statements for any of the periods presented. Spidle will be merged with Turbeco into our Drilling Products segment. Spidle serves both the domestic and international downhole tool markets with a customer base extending into Canada, Mexico, South America, Europe, Asia and Africa. Spidle operates in the energy, mining, water well and industrial drilling sectors. As a result of the acquisition, we are expected to (i) expand our product, customer and geographic base in the downhole drilling tools market and (ii) provide operational synergies with our other business units.

***Production Products***

**For the Years Ended December 31,**

| | **2004** | **2003** |
|---|---|---|
| Revenues | $ 582,889 | $ 224,707 |
| Gross margin | $ 291,035 | $ 29,214 |
| Gross margin % | 49.9% | 13.0% |
| Operating (loss) | $ (355,656) | $ (5,547,601) |
| Operating loss % | (61.0)% | (2,468.8)% |

Production Products revenues increased $358,182 in 2004 compared to 2003 as a result of the new management team expanding its customer base. Additionally, sales to Venezuela resumed marginally in 2004. Gross margin percentage also increased significantly from 13.0% in 2003 to 49.9% in 2004. We are focused on increasing total revenues in 2005 by expanding the customer and geographic base. Petrovalve is actively marketed in the U.S., Canada, Mexico, Central America, South America, the Middle East, Russia and Asia. Currently Petrovalve has representation in 18 countries.

Data provided by Petrovalve customers subsequent to valve installation indicate an increase in productions as much as 40% over prior performance of conventional valves. This improvement stems from the patented and unique design of the Petrovalve that allows greater volumes of hydrocarbons to be lifted per pump stroke. This enables the operator the option of slowing the pump stroke rate while maintaining consistent production levels, which reduces wear on all parts of the lifting mechanism, extending the life of the entire system. The “Gas Breaker” version of the Petrovalve, has been proven to be successful in eliminating “gas locking” which prior to the Gas Breaker installation completely stopped production and required workover of the well. The Petrovalve can effectively lift highly viscous oil in heavy oil or tar sand production zones.

In 2003, we fully impaired $5,120,633 of goodwill for Petrovalve based on lower than expected sales in 2003 and political instability in Venezuela.

**Capital Resources and Liquidity**

Our capital resources and liquidity significantly improved during 2004. In 2004, we produced net income of $2,153,689 and had positive cash flows from operations of $1,398,847. This turnaround from 2003 is a result of significant improvements in operating results for our reporting units due to increased sales and operational efficiencies. The positive cash flows from operations is a result of higher net income offset by increased net working capital requirements to grow operations in 2004.

We reported $284,801 of cash and cash equivalents and $37,038 of restricted cash as of December 31, 2004. This significant increase compared to prior years is a result of improved operational performance results and strict cash flows management.

Both accounts receivable and inventories increased due to increased sales levels during the year. Accounts payable decreased $320,228 primarily due to an aggressive effort to pay down long outstanding payables associated with professional fees and payables associated with the discontinued operations. The reduction in accounts payable was offset by an increase in accrued liabilities of $994,756. The increase in accrued liabilities was due to increased income taxes payable, incentive compensation payable, and amounts accrued, but not yet paid, related to the earn-out provision of our 2000 acquisition. Current assets increased $2,184,863 during 2004, while current liabilities decreased $3,382,301 over the same period, strengthening our balance sheet. In February 2005, we obtained a new senior credit facility from Wells Fargo Bank. Based on the terms negotiated, a portion of our debt has been reclassified to long-term based on the new maturities.

Capital expenditures in 2004 totaled $113,108 and were used for furniture and fixture purchases, expansion of laboratory facilities, and the purchase of a new vehicle. Capital expenditures were below budgeted levels due to capital constraints. Capital expenditures for 2003 totaled $575,260. These expenditures were primarily for improvements at the Materials Translogistics facility in Raceland, Louisiana, and the purchase of a new financial software package and related hardware. In February 2005, we successfully obtained a new senior credit facility with Wells Fargo Bank, N.A. As part of the terms negotiated, we obtained approval for a capital expenditures budget of $2,000,000 for 2005 allowing us to expand our operations.

In January 2004, we issued 133,334 shares of our common stock in a private offering to “accredited investors” in exchange for $100,000 subscription proceeds, which was paid by the tender to us. In addition, 15,000 stock options were exercised with proceeds of $9,100.

We made debt service payments of $1,137,837 and repayments to related parties of $114,750 during 2004. We also actively renegotiated the terms of our debt agreements during 2004. The new credit facility obtained in February 2005 has significantly better terms and greater capacity, reducing our weighted average cost of capital by more than 300 basis points.

**Item 7. Financial Statements**

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

Independent Auditors' Report

Consolidated Balance Sheets for the Years Ended December 31, 2004 and 2003

Consolidated Statements of Operations for the Years Ended December 31, 2004 and 2003

Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2004 and 2003

Consolidated Statements of Cash Flows for the Years Ended December 31, 2004 and 2003

Notes to Consolidated Financial Statements

**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 Balance Sheet of Flotek Industries, Inc. and Subsidiaries as of December 31, 2004, and the related Consolidated Statement of Operations, Changes in Stockholders' Equity and Cash Flows for the year then ended. 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 of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Flotek Industries, Inc. and Subsidiaries as of December 31, 2004, and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

UHY MANN FRANKFORT STEIN & LIPP CPAs, LLP

Houston, Texas
March 30, 2005

**INDEPENDENT AUDITORS' REPORT**

The Board of Directors
Flotek Industries, Inc. and Subsidiaries
Houston, Texas

We have audited the accompanying Consolidated Balance Sheet of Flotek Industries Inc. and Subsidiaries as of December 31, 2003, and the related Consolidated Statement of Operations, Changes in Stockholders' Equity and Cash Flows for the year then ended. 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 audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Flotek Industries Inc. and Subsidiaries as of December 31, 2003, and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements as of December 31, 2003 have been prepared assuming that Flotek Industries Inc. and Subsidiaries will continue as a going concern. The Company had incurred accumulated operating losses and had a working capital deficit from operations as of December 31, 2003. These conditions raised substantial doubt about the Company's ability to continue as a going concern as of December 31, 2003. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

WEINSTEIN SPIRA & COMPANY, P.C.

Houston, Texas
March 30, 2005

**FLOTEK INDUSTRIES, INC.**
**CONSOLIDATED BALANCE SHEETS**

| | For the Years Ended December 31, | |
|---|---|---|
| | **2004** | **2003** |
| **ASSETS** | | |
| | | |
| Current assets: | | |
| Cash and cash equivalents | $ 284,801 | $ -- |
| Restricted cash | 37,038 | -- |
| Accounts receivable, net | 3,372,236 | 1,977,926 |
| Inventories, net | 2,447,390 | 1,905,070 |
| Other current assets | 39,721 | 113,326 |
| Total current assets | 6,181,186 | 3,996,322 |
| | | |
| Property, plant and equipment, net | 2,116,796 | 2,644,860 |
| Goodwill | 7,465,725 | 7,145,713 |
| Intangible assets, net | 193,380 | 183,443 |
| Total assets | $ 15,957,087 | $ 13,970,338 |
| | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 2,641,577 | $ 2,961,805 |
| Accrued liabilities | 1,617,762 | 623,006 |
| Notes payable | -- | 3,482,325 |
| Current portion of long-term debt | 1,136,467 | 1,596,221 |
| Amounts due to related parties | 466,401 | 581,151 |
| Total current liabilities | 5,862,207 | 9,244,508 |
| | | |
| Long-term debt | 5,271,987 | 2,165,726 |
| | | |
| Stockholders' equity: | | |
| Preferred stock, $.0001 par value, 100,000 shares authorized, no shares issued | -- | -- |
| Common stock, $.0001 par value, 20,000,000 shares authorized, 6,670,004 and 6,521,670 shares issued and outstanding as of December 31, 2004 and 2003, respectively | 667 | 652 |
| Additional paid-in capital | 17,082,141 | 16,973,056 |
| Accumulated deficit | (12,259,915) | (14,413,604) |
| Total stockholders' equity | 4,822,983 | 2,560,104 |
| Total liabilities and stockholders' equity | $ 15,957,087 | $ 13,970,338 |

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

**FLOTEK INDUSTRIES, INC.**
**CONSOLIDATED STATEMENTS OF OPERATIONS**

| | For the Years Ended December 31, | | | |
|---|---|---|---|---|
| | | 2004 | | 2003 |
| **Revenues** | $ | 21,881,289 | $ | 14,844,431 |
| | | | | |
| **Cost of revenues** | | 12,529,631 | | 9,264,091 |
| Gross margin | | 9,351,658 | | 5,580,340 |
| | | | | |
| **Expenses:** | | | | |
| Selling, general and administrative | | 5,349,594 | | 4,788,749 |
| Goodwill impairment | | -- | | |