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FLOTEK INDUSTRIES INC/CN/
Form 10QSB
November 12, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10 - QSB

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

FOR THE QUARTER ENDED SEPTEMBER 30, 2002

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

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) (I.R.S. Employer Identification
Number)

7030 Empire Central Drive, Houston TX 77040
(Address of Principal Executive Offices) (Zip Code)

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

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 and 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 No

The number of shares of the Registrant's common stock outstanding on November 12, 2002 was 4,910,812.

Transitional Small Business Disclosure Format (check one):

Yes No

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99.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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Item 1 - Financial Information

FLOTEK INDUSTRIES, INC. CONSOLIDATED BALANCE SHEETS

| | September 30, 2002 ----- (Unaudited) |
|---|---|
| ASSETS | |
| Current assets: | |
| Cash and cash equivalents..... | \$ 24,795 |
| Accounts receivable, less reserve of \$11,073 and \$208,333, as of September 30, 2002 and December 31, 2001, respectively..... | 2,804,376 |
| Inventories and work in progress..... | 2,494,943 |
| Other current assets..... | 190,127 |
| Total current assets..... | ----- 5,514,241 ----- |
| Property, plant and equipment, net..... | 4,449,050 |
| Goodwill, net..... | 12,866,346 |
| Patents and other intangible assets, net..... | 262,534 |
| Other assets..... | 36,824 |
| Total assets..... | ----- \$ 23,128,995 ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| Current liabilities: | |
| Accounts payable..... | \$ 2,409,454 |
| Accrued liabilities..... | 192,501 |
| Amounts due to related parties..... | 120,839 |
| Notes payable..... | 3,522,916 |
| Current portion of long-term debt..... | 1,162,615 |
| Capital lease obligations, current portion..... | 50,044 |
| Total current liabilities..... | ----- 7,458,369 ----- |
| Long-term debt..... | 3,069,632 |
| Capital lease obligations, long-term..... | 1,331,166 |
| Stockholders' equity: | |
| Preferred stock, \$.0001 par value, 100,000 shares authorized, no shares issued..... | - |
| Common stock, \$.0001 par value, 20,000,000 shares authorized, 4,910,812 and 4,850,696 shares issued and outstanding as of September 30, 2002 and December 31, 2001, respectively..... | 491 |
| Additional paid-in capital..... | 15,762,346 |
| Accumulated deficit..... | (4,493,009) |
| | ----- |

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| | |
|---|---------------|
| Total stockholders' equity..... | 11,269,828 |
| | ----- |
| Total liabilities and stockholders' equity..... | \$ 23,128,995 |
| | ===== |

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

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FLOTEK INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Sep |
|---|-------------------------------------|--------------|----------------|
| | 2002 | 2001 | 2002 |
| | ----- | ----- | ----- |
| Revenues..... | \$ 2,950,668 | \$ 4,893,622 | \$ 9,990,544 |
| Cost of revenues..... | 1,982,395 | 3,804,540 | 6,502,864 |
| | ----- | ----- | ----- |
| Gross margin..... | 968,273 | 1,089,082 | 3,487,680 |
| | ----- | ----- | ----- |
| Expenses: | | | |
| Selling, general and administrative.... | 1,596,687 | 325,461 | 4,883,663 |
| Depreciation and amortization..... | 179,468 | 198,847 | 498,322 |
| Research and development..... | 23,582 | 10,841 | 109,232 |
| | ----- | ----- | ----- |
| Total expenses..... | 1,799,737 | 535,149 | 5,491,217 |
| | ----- | ----- | ----- |
| Income (loss) from operations..... | (831,464) | 553,933 | (2,003,537) |
| Other income (expense): | | | |
| Interest expense..... | (191,282) | (58,715) | (467,697) |
| Interest income..... | 8 | 9,796 | 243 |
| Other, net..... | (3,484) | (23,666) | (2,608) |
| | ----- | ----- | ----- |
| Total other income (expense)..... | (194,758) | (72,585) | (470,062) |
| | ----- | ----- | ----- |
| Income (loss) before cumulative effect of change in accounting principle..... | \$ (1,026,222) | \$ 481,348 | \$ (2,473,599) |
| | ===== | ===== | ===== |

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| | | | |
|--|----------------|------------|----------------|
| Cumulative effect of change in accounting principle net of income tax benefit..... | - | - | (452,745) |
| | ----- | ----- | ----- |
| Net income (loss)..... | \$ (1,026,222) | \$ 481,348 | \$ (2,926,344) |
| | ===== | ===== | ===== |
| Basic and diluted income (loss) per common share before cumulative effect of change in accounting principle..... | \$ (.209) | \$.162 | \$ (.504) |
| | ===== | ===== | ===== |
| Cumulative effect of change in accounting principle..... | \$ - | \$ - | \$ (.092) |
| | ===== | ===== | ===== |

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FLOTEK INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (Continued)
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Sep |
|---|-------------------------------------|-----------|-------------|
| | 2002 | 2001 | 2002 |
| | ----- | ----- | ----- |
| Basic and diluted net income (loss) per common share..... | \$ (.209) | \$.162 | \$ (.596) |
| | ===== | ===== | ===== |
| Weighted average number of shares outstanding..... | 4,910,812 | 2,974,579 | 4,904,709 |
| | ===== | ===== | ===== |

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

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FLOTEK INDUSTRIES, INC.
 CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
 (UNAUDITED)

| | Common Stock | | Additional Paid-in Capital | Accumu Defi |
|--|--------------|--------|----------------------------------|----------------|
| | Shares | Amount | | |
| | ----- | ----- | ----- | ----- |
| Balance at December 31, 2001..... | 4,850,696 | \$ 485 | \$ 15,572,886 | \$ (1,566 |
| Common stock issued in acquisitions..... | 60,116 | 6 | 189,460 | |
| Net loss..... | - | - | - | (2,926 |
| | ----- | ----- | ----- | ----- |
| Balance at September 30, 2002..... | 4,910,812 | \$ 491 | \$ 15,762,346 | \$ (4,493 |
| | ===== | ===== | ===== | ===== |

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

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

Nine Months Ended
 September 30,

 2002

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| | | |
|---|----------------|----|
| Cash flows from operating activities: | | |
| Net loss..... | \$ (2,926,344) | \$ |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization..... | 498,322 | |
| Imputed interest expense..... | - | |
| (Gain)loss on sale of assets..... | 2,558 | |
| Impairment of goodwill..... | 452,745 | |
| (Increase) decrease in: | | |
| Accounts receivable..... | (614,810) | |
| Inventories and work in progress..... | 1,209,210 | (1 |
| Other current assets..... | (165,392) | |
| Accounts payable and accrued liabilities..... | (346,174) | |
| Net cash used in operating activities..... | (1,889,885) | |
| Cash flows from investing activities: | | |
| Acquisition of subsidiaries, net..... | (122,250) | (7 |
| Capital expenditures..... | (1,357,695) | (1 |
| Proceeds from sales of assets..... | 110,312 | |
| Deposits and other..... | 44,189 | |
| Net cash used in investing activities..... | (1,325,444) | (8 |
| Cash flows from financing activities: | | |
| Issuance of stock for cash..... | - | 4 |
| Proceeds from borrowings..... | 3,131,215 | 3 |
| Proceeds from sale/leaseback transaction..... | 761,000 | |
| Repayments of indebtedness..... | (865,945) | |
| Proceeds from (payments to) related parties..... | (12,016) | |
| Principal payments on capital leases..... | (14,568) | |
| Net cash provided by financing activities..... | 2,999,686 | 7 |
| Net decrease in cash and cash equivalents..... | (215,643) | (1 |
| Cash and cash equivalents - beginning of period..... | 240,438 | 1 |
| Cash and cash equivalents - end of period..... | \$ 24,795 | \$ |

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

| | Nine Months September |
|--|--------------------------|
| | ----- 2002 ----- |
| Supplemental schedule of noncash investing and financing activities: | |
| Land and building acquired under capital lease..... | \$ - ===== |
| Supplemental disclosures of cash flow information: | |
| Acquisition of subsidiaries: | |
| Assets (liabilities) acquired: | |
| Cash..... | \$ - |
| Accounts receivable..... | - |
| Inventories and work in progress..... | - |
| Other current assets..... | - |
| Property and equipment..... | - |
| Marketable securities..... | - |
| Patents and other intangibles..... | 104,466 |
| Goodwill..... | 207,250 |
| Other assets..... | - |
| Debt..... | - |
| Accounts payable and accrued liabilities..... | - |
| | ----- 311,716 |
| Common stock issued..... | (189,466) |
| Promissory notes issued..... | - ----- |
| Net cash paid to sellers and transaction costs..... | \$122,250 ===== |
| Cash paid for interest..... | \$467,697 ===== |

FLOTEK INDUSTRIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2002 (UNAUDITED) AND DECEMBER 31, 2001

Note 1 - General

The condensed consolidated financial statements included herein are unaudited and have been prepared by Flotek Industries, Inc. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information relating to the Company's organization and Note disclosures normally

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included in financial statements prepared in accordance with generally accepted accounting principles has been condensed or omitted in this Form 10-QSB pursuant to such rules and regulations. These financial statements reflect all adjustments which the Company considers necessary for the fair presentation of such financial statements for the interim periods presented and the Company believes that the disclosures included herein are adequate to make the interim information presented not misleading. These financial statements should be read in conjunction with the audited consolidated financial statements and Notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2001. The results of operations for interim periods are not necessarily indicative of the results expected for the full year.

Note 2 - Acquisitions

In January 2002, the Company issued 26,116 shares of common stock valued at \$82,309 to the former shareholders of Material Translogistics, Inc. ("MTI"). Under the original acquisition agreement, which had an effective date of June 29, 2001, the shareholders of MTI could receive up to 52,232 additional shares of common stock, contingent upon the execution of two future contracts. One of these contracts became effective in January 2002 and the shares issued above relate to that contract. The other contract had not been executed as of September 30, 2002.

On February 19, 2002, the Company acquired 100% of the common stock of IBS 2000, Inc. ("IBS"), a Denver-based company engaged in the development and manufacturing of environmentally neutral chemicals for the oil industry. IBS is in the development stage and has had limited operating history. The Company paid \$100,000 in cash and issued 34,000 shares of common stock valued at \$107,157 to acquire IBS. Including legal and other transaction costs, the acquisition resulted in the recording of approximately \$197,000 of goodwill and other intangibles. Revenue and operations of IBS were immaterial.

Note 3 - Stock Settlement

In early 2002, the Company became aware of an accounting issue regarding the application of the percentage of completion accounting method in one of the subsidiaries of CESI prior to the merger of Flotek and CESI (the "Merger"), during the time CESI was a private company. Further review resulted in adjustments to the financial statements to reflect a proper application of the percentage of completion accounting method. These adjusted financial statements differed materially from the ones provided to the Company by CESI prior to the Merger. After discussions with representatives of CESI, certain former shareholders of CESI agreed to surrender 180,000 of the common shares which were received by them pursuant to the Merger. On July 19, 2002, these shares were redistributed for the benefit of the shareholders of Flotek Industries, Inc. other than former CESI shareholders. This was accomplished by declaring a stock dividend to all shareholders and securing the agreement of all former CESI shareholders to waive their beneficial interest in the stock dividend. The stock dividend was also waived by all other shareholders who received shares subsequent to the Merger. The net effect of these transactions was to distribute 180,000 shares to the shareholders of Flotek Industries, Inc. Accordingly, with the cancellation of the 180,000 shares surrendered by certain CESI shareholders, there was no net change in the outstanding shares of the Company as a result of this settlement.

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Note 4 - Accounts Receivable

At September 30, 2002, the Company had approximately \$1,403,000 of accounts receivable from a customer in Venezuela, all of which arose from goods shipped in the first half of 2002. As a result of political instability and work disruptions in the country, these amounts have not been paid within the customary payment terms for this customer. The ultimate customer for these goods is PDVSA, the national oil company of Venezuela. Our customer holds a contract to deliver over \$5 million of our proprietary products to PDVSA during the next three years. However, PDVSA has delayed acceptance of the majority of the goods shipped until its field operations return to higher activity levels. Our customer is unable to pay for the goods until payment has been received from PDVSA. In the second quarter of 2002 we were informed by PDVSA that field operations would return to higher levels of activity and that acceptance of goods shipped would begin. During the second and third quarters of 2002, we received payments totaling \$200,000 and \$629,000, respectively, and PDVSA is continuing to accept goods previously shipped. We expect to collect the entire September 30, 2002 outstanding balance and have not provided a reserve for doubtful accounts associated with this balance.

Note 5 - Inventories and Work in Progress

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 average cost method. The Company maintains a reserve for impaired or obsolete inventory, which is reviewed for adequacy on a periodic basis. Work in progress consists of percentage of completion revenues recognized in excess of customer billings plus any provision for estimated losses on contracts. The components of inventories and work in progress at September 30, 2002 and December 31, 2001 were as follows:

| | September 30, 2002 | December 31, 2001 |
|--|-----------------------|----------------------|
| | ----- | ----- |
| Raw materials..... | \$ 340,049 | \$ 496,332 |
| Finished goods..... | 1,572,113 | 1,856,011 |
| Manufacturing parts and materials..... | 272,405 | 708,036 |
| Work in progress..... | 660,614 | 1,000,799 |
| Inventory valuation reserve..... | (350,238) | (357,025) |
| | ----- | ----- |
| Inventories and work in progress, net..... | \$ 2,494,943 | \$ 3,704,153 |
| | ===== | ===== |

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FLOTEK INDUSTRIES, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2002 (UNAUDITED) AND DECEMBER 31, 2001

Note 6 - Property, Plant and Equipment

At September 30, 2002 and December 31, 2001, property, plant and equipment were comprised of the following:

| | September 30, 2002 | December 31, 2001 |
|---|-----------------------|-------------------|
| | ----- | ----- |
| Land | \$ 118,700 | \$ 145,000 |
| Buildings and leasehold improvements..... | 3,184,334 | 2,115,078 |
| Machinery and equipment..... | 1,148,741 | 1,195,632 |
| Furniture and fixtures..... | 67,936 | 67,936 |
| Transportation..... | 612,407 | 456,690 |
| Computer equipment..... | 116,850 | 76,497 |
| | ----- | ----- |
| Total property and equipment..... | 5,248,968 | 4,056,833 |
| Less accumulated depreciation..... | (799,918) | (384,894) |
| | ----- | ----- |
| Net property and equipment..... | \$ 4,449,050 | \$ 3,671,939 |
| | ===== | ===== |

Note 7 - Goodwill and Other Intangible Assets

The Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") effective January 1, 2002. This statement addresses accounting and reporting for acquired goodwill and intangible assets. In the third quarter, we completed our initial assessment of goodwill impairment as required under SFAS No. 142. In accordance with the transitional provisions of SFAS No. 142, the Company determined, with the assistance of an independent appraiser, that the carrying value of goodwill and related assets of the Equipment Specialties reporting unit exceeded its fair value. There was approximately \$1.3 million of goodwill attributable to the Equipment Manufacturing segment which consists of two reporting units, Equipment Specialties and MTI. As a result, the Company recognized a charge to income of \$452,745 (\$.092 loss per share) for the Equipment Specialties reporting unit which represents all of this unit's goodwill. Our test concluded there was no impairment for MTI. The goodwill impairment is reflected as the cumulative effect of change in accounting principle during the first quarter of 2002. As of the end of each period presented, all of the Company's other intangible assets had definitive lives and were being amortized accordingly.

Following is a reconciliation of goodwill:

| | |
|--|---------------|
| Beginning balance, December 31, 2001..... | \$13,111,840 |
| Acquisitions..... | 207,251 |
| Goodwill impairment, January 1, 2002 associated with the Equipment Specialties reporting unit..... | (452,745) |
| | ----- |
| Ending balance, September 30, 2002..... | \$ 12,866,346 |
| | ===== |

FLOTEK INDUSTRIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 SEPTEMBER 30, 2002 (UNAUDITED) AND DECEMBER 31, 2001

Following is a reconciliation of the reported net income (loss) to the adjusted net income (loss) reflecting the impact of the adoption of SFAS No. 142 on all periods presented:

| | Three Months Ended September 30, | | Nine Sep |
|--|-------------------------------------|------------|---------------|
| | 2002 | 2001 | 2002 |
| | ----- | ----- | ----- |
| Reported net income (loss): | | | |
| Reported net income (loss)..... | \$ (1,026,222) | \$ 481,348 | \$ (2,926,34) |
| Add back: Cumulative effect of accounting change for impairment of goodwill..... | - | - | 452,74 |
| Goodwill amortization..... | - | 101,293 | |
| | ----- | ----- | ----- |
| Adjusted net income (loss)..... | \$ (1,026,222) | \$ 582,641 | \$ (2,473,59) |
| | ===== | ===== | ===== |
| Basic and Diluted earnings per share: | | | |
| Reported net income (loss)..... | \$ (.209) | \$.162 | \$ (.59) |
| Add back: Cumulative effect of accounting change for impairment of goodwill..... | - | - | (.09) |
| Goodwill amortization..... | - | .034 | |
| | ----- | ----- | ----- |
| Adjusted net income (loss)..... | \$ (.209) | \$.196 | \$ (.50) |
| | ===== | ===== | ===== |

Since the impairment review was not performed until the third quarter of 2002, SFAS No. 142 requires that the result be recorded in the Company's first

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reporting period which is the quarter ended March 31, 2002. Thus, the first quarter's results were restated to reflect the impact of the impairment charge. The following table reports the effects of recording the goodwill impairment on previously reported net income (loss) for the three months and six months ended March 31, 2002 and June 30, 2002, respectively.

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FLOTEK INDUSTRIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 SEPTEMBER 30, 2002 (UNAUDITED) AND DECEMBER 31, 2001

Restated operating results for effect of cumulative change in accounting principle:

| | Three Months Ended March 31, 2002 | Six M June |
|--|--------------------------------------|---------------|
| | ----- | ----- |
| Reported loss before cumulative effect of change in accounting principle..... | \$ (266,754) | \$(1, |
| Goodwill impairment..... | (452,745) | (|
| | ----- | ----- |
| Net loss..... | \$ (719,499) | \$(1, |
| | ===== | ===== |
| Reported basic and diluted loss per common share before cumulative effect of change in accounting principle..... | \$ (.055) | \$ |
| Cumulative effect of change in accounting principle..... | (.092) | ----- |
| | ----- | ----- |
| Restated basic and diluted net loss per common share..... | \$ (.147) | \$ |
| | ===== | ===== |

The Company evaluates the recoverability of its intangible assets subject to amortization in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). SFAS No. 144 requires long-lived assets to be reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment is recognized in the event that the net book value of an asset exceeds the sum of the future undiscounted cash flows attributable to such asset or the business to which such asset relates and the net book value exceeds fair value. The impairment amount is measured as the amount by which the carrying amount of a long-lived asset (asset group) exceeds its fair value. As of September 30, 2002, the Company did not recognize any impairment associated with its long-lived assets.

FLOTEK INDUSTRIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 SEPTEMBER 30, 2002 (UNAUDITED) AND DECEMBER 31, 2001

Other intangible assets are comprised of the following:

| | September 30, 2002 | | Decem |
|------------------------|---|-----------------------------|-----------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carry Amount |
| Patents..... | \$ 266,148 | \$ 87,185 | \$ 266,14 |
| Other Intangibles..... | 104,464 | 20,893 | |
| Total..... | <u>\$ 370,612</u> | <u>\$ 108,078</u> | <u>\$ 266,14</u> |
| | Aggregate Expense for the Three Months Ended | | Aggregate E Mo |
| | September 30, 2002 | September 30, 2001 | September 3 2002 |
| Patents..... | \$ 6,463 | \$ - | \$ 12,37 |
| Other Intangibles..... | 10,446 | - | 20,89 |
| Total..... | <u>\$ 16,909</u> | <u>\$ -</u> | <u>\$ 33,26</u> |

Estimated Amortization Expense:

| | |
|--------------------------------------|-----------|
| For the year ended December 31, 2003 | \$ 68,400 |
| For the year ended December 31, 2004 | \$ 57,954 |
| For the year ended December 31, 2005 | \$ 26,616 |
| For the year ended December 31, 2006 | \$ 26,616 |
| For the year ended December 31, 2007 | \$ 26,616 |

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Note 8 - Capital Lease Obligation

On February 28, 2002, the Company sold its rights and obligation to purchase the land and buildings covered by a capital lease obligation, together with capital improvements to the property totaling approximately \$750,000, to Oklahoma Facilities, LLC ("Facilities"). An officer of the Company has a minority investment interest in and is an officer of Facilities. The total consideration at closing was \$1,400,000, with net cash proceeds to the Company of \$761,000. The transaction did not generate any gain or loss. The Company simultaneously entered into a capital lease agreement with Facilities under which it is obligated to pay average rent of \$18,000 per month for a fixed term of ten years. The Company has the right to buy the property at any time during the first two years of the lease for a fixed price of \$1,400,000. The Company also has the option to purchase the building for a fixed price of \$420,000 at the end of the ten-year lease term.

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FLOTEK INDUSTRIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 SEPTEMBER 30, 2002 (UNAUDITED) AND DECEMBER 31, 2001

Note 9 - Notes Payable

Notes payable at September 30, 2002 and December 31, 2001 consisted of the following:

| | September 30, 2002 ---- |
|---|-------------------------------|
| Revolving line of credit, secured by accounts receivable and inventory, bearing interest at the prime rate plus 1.25%, due in May 2003, with maximum borrowings of \$1,414,035 (1)..... | \$ 1,414,035 |
| Revolving line of credit, secured by accounts receivable and inventory, bearing interest at the prime rate plus 1.25%, due in January 2003, with maximum borrowings of \$1,608,100 (2)..... | 1,578,881 |
| Note payable, secured by accounts receivable, bearing interest at the prime rate plus 4.25%, payable in monthly installments of \$8,045 including interest, due upon collection of the pledged accounts receivable or August 1, 2003, whichever is earlier..... | 500,000 |
| Other notes payable..... | 30,000 |
| | ----- |
| Total notes payable..... | \$ 3,522,916 ===== |

On July 25, 2002, the Company borrowed \$500,000 under a promissory note from Oklahoma Facilities LLC ("Facilities"). An officer of the Company has a minority investment interest in and is an officer of Facilities. The note is secured by

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an account receivable from the Company's major customer in Venezuela. The note requires payments of interest only for the first three months and fixed payments of \$8,045 per month thereafter. The note is due upon the collection of the account receivable, but in any event must be paid in full by August 1, 2003. Proceeds from the loan will be used to meet general corporate purposes.

At September 30, 2002, the Company was not in compliance on its borrowing base requirements for its revolving lines of credit. This noncompliance is attributable to two items as follows:

1. Over 90 day accounts receivable are to be excluded in the calculation of eligible asset base in the borrowing base calculation. The majority, approximately \$1,403,000, of the over 90 day accounts receivable relates to amounts due from a customer in Venezuela as further explained in Note 4 to the Consolidated Financial Statements. On October 7, 2002, the Lender for the revolving lines of credit granted the Company a 90 day waiver from excluding over 90 accounts receivable in the borrowing base calculation. The waiver expires on January 1, 2003. With the wavier the Company is in compliance with its revolving line credit agreements; however,
2. Even with the over 90 accounts receivable waiver mentioned above, the Company's borrowings against its revolving lines of credit exceeded the eligible asset base by approximately \$140,000 at September 30, 2002. The Lender has not determined the impact of the event on the Company's revolving lines of credit.

(1) Limited to a borrowing base amount calculated as 60% of eligible accounts receivable and inventory.

(2) Limited to a borrowing base amount calculated as 50% of eligible accounts receivable and inventory.

FLOTEK INDUSTRIES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 SEPTEMBER 30, 2002 (UNAUDITED) AND DECEMBER 31, 2001

Note 10 - Long-Term Debt

Long-term debt at September 30, 2002 and December 31, 2001, consisted of the following:

| | September 30, 2002 ---- |
|--|-------------------------------|
| Notes payable to shareholders of acquired businesses, unsecured, bearing interest at 9% payable quarterly, due in five annual installments of \$200,000 each beginning January 2002..... | \$ 800,000 |
| Note payable to bank, bearing interest at the prime rate plus 1%, payable in monthly installments of \$39,812 including interest, due in January 2008 | 2,114,425 |
| Note payable to bank, bearing interest at the prime rate plus 1%, payable | |

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| | |
|--|--------------|
| in monthly installments of \$14,823 including interest, due in September 2004..... | 348,582 |
| Construction loan payable to bank, bearing interest at the prime rate plus 1%, payable in monthly installments of \$25,923 including interest, due in January 2005..... | 663,273 |
| Mortgage note on property, bearing interest at 10%, payable in monthly installments of \$1,451 including interest, with final payment of \$111,228 due in December 2002..... | 111,366 |
| Notes payable to Duncan Area Economic Development Foundation, unsecured, interest at 6%, payable in monthly installments of \$1,934 including interest, due in May 2006..... | 74,469 |
| Secured vehicle and other equipment loans..... | 120,132 |
| | ----- |
| Total..... | 4,232,247 |
| Less current maturities..... | 1,162,615 |
| | ----- |
| Long-term debt..... | \$ 3,069,632 |
| | ===== |

The revolving lines of credit and bank notes payable are owed to the Company's primary lending bank and are secured by substantially all of the assets of the Company. They have also been personally guaranteed by an officer of the Company.

Note 11 - Net Income (Loss) Per Common Share

Net income (loss) per common share is calculated by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding. Diluted income (loss) per share is calculated by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares and dilutive potential common shares outstanding. There were no potentially dilutive common shares as of September 30, 2002 or December 31, 2001.

FLOTEK INDUSTRIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2002 (UNAUDITED) AND DECEMBER 31, 2001

Note 12 - Segment Information

The Company has three reportable segments, as follows:

- o The Specialty Chemicals segment develops, manufactures, packages and sells chemicals used by other oilfield service companies in oil and gas well stimulation, cementing and production.
- o The Equipment Manufacturing segment designs, manufactures and rebuilds specialized cementing and stimulation equipment, including heavy vehicles used for pressure pumping, blending and bulk material transport. This segment also designs, constructs and manages automated bulk material handling and loading facilities for other oilfield service companies.

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- o The Downhole Equipment segment manufactures and markets the Petrovalve line of downhole pump components and the Turbeco line of casing centralizers.

The Company's reportable segments disclosed in Form 10-KSB are strategic business units that offer different products and services. Each business segment requires different technology and marketing strategies and is managed independently. The accounting policies used in each of the segments are the same as those described in the significant accounting policies disclosed in Form 10-KSB. The Company evaluates the performance of its operating segments based on operating income excluding unusual charges. Intersegment sales and transfers are not material.

The following table presents the revenues and operating income by business segment and on a comparable basis:

| | Three Months Ended September 30, | | Nine Sep |
|---------------------------------------|-------------------------------------|--------------|----------------|
| | 2002 | 2001 | 2002 |
| Revenues: | | | |
| Specialty Chemicals..... | \$ 2,000,633 | \$ 1,934,128 | \$ 4,900,972 |
| Equipment Manufacturing..... | 618,173 | 2,959,494 | 2,824,655 |
| Downhole Equipment..... | 331,862 | - | 2,264,917 |
| | ----- | ----- | ----- |
| Consolidated..... | \$ 2,950,668 | \$ 4,893,622 | \$ 9,990,544 |
| | ----- | ----- | ----- |
| Income (loss) from operations: | | | |
| Specialty Chemicals..... | \$ 412,051 | \$ 370,271 | \$ 672,783 |
| Equipment Manufacturing..... | (557,049) | 266,033 | (1,427,252) |
| Downhole Equipment..... | (252,779) | - | 143,892 |
| Corporate and Other..... | (433,687) | (82,371) | (1,392,960) |
| | ----- | ----- | ----- |
| Consolidated..... | \$ (831,464) | \$ 553,933 | \$ (2,003,537) |
| | ----- | ----- | ----- |

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

Business Overview

Flotek was established in 1985 and is currently traded on the OTC Bulletin Board market. On October 31, 2001, the Company completed a Merger with Chemical & Equipment Specialties, Inc. ("CESI"). The Merger has been accounted for as a reverse acquisition using the purchase method of accounting. In the Merger, the

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shareholders of the acquired company, CESI, received the majority of the voting interests in the surviving consolidated company. Accordingly, CESI was deemed to be the acquiring company for financial reporting purposes and the historical financial statements of the Company are the historical financial statements of CESI. All of the assets and liabilities of Flotek were recorded at fair value on October 31, 2001, the date of the Merger, and the operations of Flotek have been reflected in the operations of the combined company only for periods subsequent to the date of the Merger.

CESI was incorporated on June 27, 2000 to acquire businesses in the specialty chemical and equipment manufacturing segments of the oilfield service industry. It had no revenues or operations prior to the acquisitions of Esses, Inc., Plainsman Technology, Inc., Neal's Technology, Inc., and Padko International, Inc. in January 2001. It subsequently acquired Material Translogistics, Inc. in June 2001. These five companies are referred to collectively as the "CESI Acquired Businesses".

The Company's product lines are divided into three segments within the oilfield service industry:

- o The Specialty Chemicals segment develops, manufactures, packages and sells chemicals used by other oilfield service companies in oil and gas well stimulation, cementing and production.
- o The Equipment Manufacturing segment designs, manufactures and rebuilds specialized cementing and stimulation equipment, including heavy vehicles used for pressure pumping, blending and bulk material transport. This segment also designs, constructs and manages automated bulk material handling and loading facilities for other oilfield service companies.
- o The Downhole Equipment segment manufactures and markets the Petrovalve line of downhole pump components and the Turbeco line of casing centralizers.

All of the Company's businesses serve the oil and gas industry and are affected by changes in the worldwide demand for and price of oil and natural gas. The majority of our products are dependent on the level of exploration and development activity and the completion phase of oil and gas well drilling. Other products and services, such as our Petrovalve downhole pump products and a small number of our specialty chemicals are more closely tied to the production of oil and gas and are less dependent on drilling activity.

The oil and gas industry has been subject to significant volatility in recent years due to changes in the demand, supply and pricing of oil and natural gas. The U.S. rig count, as measured by Baker Hughes Incorporated, began 2001 at around 1,100 active rigs and reached a peak of almost 1,300 in July 2001. During the third quarter of 2001, the demand for oil and natural gas began to weaken in response to slowing growth in worldwide economies. This resulted in a slowdown in North American drilling rig activity, with a steady decline in the rig count during the second half of 2001 until it had reached a level of just under 900 active rigs at December 31, 2001. During the quarter ended September 30, 2002, the U.S. rotary rig count was 875. This was a slight increase compared to the 847 rigs working at the end of the second quarter. Natural gas and crude oil prices have continued their upward trend moving from \$3.40 per MCF and \$27.00 per barrel, respectively, at the end of the second quarter to \$4.14 per MCF and \$30.59 per barrel, respectively, at the quarter ended September 30, 2002. Although our business will steadily benefit from these oil and gas commodity prices, we are not seeing increased spending in the short term from our customers as a result of these higher commodity prices.

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Results of Operations

| Nine months ended September 30, | 2002 | 2001 |
|--|----------------|--------------|
| | ----- | ----- |
| Revenues..... | \$ 9,990,544 | \$10,100,060 |
| Cost of revenues..... | 6,502,864 | 7,063,038 |
| | ----- | ----- |
| Gross margin..... | 3,487,680 | 3,037,022 |
| | ----- | ----- |
| Gross margin %..... | 34.9% | 30.1% |
| Selling, general and administrative..... | 4,883,663 | 2,544,716 |
| Depreciation and amortization..... | 498,322 | 493,173 |
| Research and development..... | 109,232 | 16,205 |
| | ----- | ----- |
| Total expenses..... | 5,491,217 | 3,054,094 |
| | ----- | ----- |
| Operating loss..... | (2,003,537) | (17,072) |
| | ----- | ----- |
| Operating loss %..... | (20.1%) | (.017%) |
| Interest expense..... | (467,697) | (282,955) |
| Interest income..... | 243 | 47,547 |
| Other, net..... | (2,608) | (20,435) |
| | ----- | ----- |
| Other income (expense), net..... | (470,062) | (214,973) |
| | ----- | ----- |
| Pre-tax income (loss) before cumulative effect of change in accounting principle..... | \$ (2,473,599) | \$ (232,045) |
| | ===== | ===== |

Total revenues decreased by \$109,516 or 1.1%, in the first nine months of 2002 compared to the comparable period in 2001. As discussed in the segment analysis below, the Specialty Chemicals segment and the Equipment Manufacturing segment experienced a significant decrease in revenues in 2002 compared to 2001, while the Downhole Equipment segment had higher revenues in the first nine months of 2002. The Downhole Equipment increase resulted primarily from business combinations, as discussed earlier in this Business Overview, whose operations were not reflected in the first nine months of 2001.

On an aggregate basis, the gross margin as a percentage of revenues increased from 30.1% in 2001 to 34.9% in 2002. The gross margin is best analyzed on a segment by segment basis, discussed below, as the margin varies significantly between operating segments and can vary significantly from period to period in certain of our operating segments.

Selling, general and administrative ("SG&A") costs represent the costs of selling, operations and overhead expenses not directly attributable to products sold or services rendered. The revenues from services are less than 10% of consolidated revenues and the direct costs of providing these services are included in cost of revenues. SG&A amounted to 48.9% of revenues in 2002, an increase of 23.7% of revenues from the level of 25.2% in 2001. The costs of administration have increased as a result of the merger and the increased size and complexity of the Company. Also, administration costs increased in the second quarter of 2002 due to activities associated with the stock settlement as explained in Note 3 to the Consolidated Financial Statements. Actions have been

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and continue to be taken to reduce these costs to the optimum level as we work to grow the business.

Interest expense increased approximately \$185,000 in the first nine months of 2002 compared to same period in 2001. The average amount of outstanding debt under the Company's credit agreements was significantly higher in 2002 as a result of the financing of capital expenditures and increased working capital needs during the year. In addition, payments associated with the long-term capital lease mentioned in Note 8 to the Consolidated Financial Statements started in the second quarter of 2002. The majority of the Company's indebtedness carries a variable interest rate tied to the prime rate and is adjusted on a quarterly basis.

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As more fully discussed in Note 7 to the Consolidated Financial Statements, we completed in the third quarter, our initial assessment, with the assistance of a third-party appraiser, of goodwill impairment as required under SFAS No. 142. There was approximately \$1.3 million of goodwill attributable to the Equipment Manufacturing segment, of which we have identified two reporting units, Equipment Specialties and MTI. Our test concluded that all of the goodwill attributable to Equipment Specialties, totaling \$452,745, was impaired. Consequently, we have recognized this impairment loss as of the first interim period which was March 31, 2002. Our test concluded that no impairment loss existed for the MTI reporting unit.

Results by Segment

Specialty Chemicals

| | Three Months Ended September 30, | | Nine M Sept |
|----------------------------------|-------------------------------------|--------------|----------------|
| | 2002 | 2001 | 2002 |
| Revenues..... | \$ 2,000,633 | \$ 1,934,128 | \$ 4,900,972 |
| Gross margin..... | \$ 871,245 | \$ 803,756 | \$ 2,057,056 |
| Gross margin percentage..... | 43.5% | 41.6% | 42.0% |
| Operating income..... | \$ 412,051 | \$ 370,271 | \$ 672,783 |
| Operating margin percentage..... | 20.6% | 19.1% | 13.7% |

Specialty Chemical revenues decreased \$851,666, or 15%, in the first nine months of 2002 compared to the same period in 2001. Sales in this segment are heavily dependent on drilling activity and the decrease in revenue is primarily attributable to sharply lower (32%) drilling activity in the first nine months of 2002 compared to 2001. Average product pricing levels in this segment declined as lower demand caused our pricing to come under pressure.

The gross margin in this segment also declined from 43.5% for the first nine months of 2001 to 42.0% in the same comparable period for 2002. In certain cases, in trying to maintain sales levels and market share, we sold our products at a lower gross margin. The combination of lower revenues due to reduced drilling activities and lower gross margins had a significant adverse effect on our operating margin and overall levels of operating income.

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Operating income fell \$409,210, or 38%, in the first nine months of 2002 compared to the same period in 2001, primarily as a result of lower revenues and gross margins. We took actions to reduce selling, general and administrative expenses in this segment to keep these costs in line with the reduced revenue levels. However, these costs could not be reduced at the same rate as revenue resulting in a significant decrease in operating income margin percentage in this segment from 18.8% in 2001 to 13.7% in 2002.

Operating results for the third quarter of 2002 compared to the same period in 2001 were higher due to a 3% increase in revenue between periods driven primarily by the sale of new products. Gross margins improved between periods by 1.9% from 41.6% in 2001 to 43.5% in 2002 primarily due to changes in product mix and the sale of new products with higher margins.

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Equipment Manufacturing

| | Three Months Ended September 30, | | Nine M Sept |
|----------------------------------|-------------------------------------|--------------|----------------|
| | 2002 | 2001 | 2002 |
| Revenues..... | \$ 618,173 | \$ 2,959,494 | \$ 2,824,655 |
| Gross margin..... | \$ 13,419 | \$ 285,326 | \$ 258,467 |
| Gross margin percentage..... | 2.2% | 9.6% | 9.2% |
| Operating income (loss)..... | \$ (557,049) | \$ 266,033 | \$ (1,427,252) |
| Operating margin percentage..... | (90.1%) | 9.0% | (50.5%) |

Equipment Manufacturing revenues decreased \$1,522,767, or 35.0%, in the first nine months of 2002 over 2001 levels. This decrease primarily resulted from an overall slow down in equipment manufacturing activity due to sharply lower (32%) drilling activity in the first nine months of 2002 compared to the same period in 2001. This lower activity, combined with various economic and political uncertainties, has caused many of our customers to curtail or stop spending on the manufacture or refurbishment of cementing and stimulation equipment and automated bulk handling and loading facilities. This decrease was partially offset by the addition of MTI, a company that was acquired on June 29, 2001. Under purchase accounting, MTI's results of operations are included only for periods subsequent to the acquisition; therefore, it is only reflected in the year-to-date results for 2001 from June 29, 2001 forward. During the first six months of 2002, MTI had revenues of \$1,076,000 and positive operating income of \$48,000. We continued, in the third quarter, to experience poor operating results in our Equipment Specialties operations (formerly Neal's Technology, Inc.) primarily due to a lack of work. However, in the third quarter of this year, we also experienced a slow down in construction projects for MTI, which has been partially offset by positive operating results from the start-up of our MTI Transload facility in the Gulf Coast. Actions have been and continue to be taken to reduce operating expenses and improve efficiencies in this segment in

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line with expected revenues.

Gross margins also decreased 3.1% between years from 12.3% in 2001 to 9.2% in 2002. This year-to-date decrease is primarily due to the decline in business discussed above and poor operating performance earlier in 2002. There has and continues to be significant focus placed on improving operational controls and work processes.

Operating losses, although 17% less, continued into the third quarter from the second quarter primarily due to the significant decrease (44%) in revenue between these periods. This revenue reduction is a direct result of customers curtailing or stopping capital spending on equipment and construction projects. Operating expenses have been reduced between the second and third quarters of this year, but have not been taken below a core infrastructure to service expected customer needs in the fourth quarter and beyond. A positive aspect of this segment is the Transload facility in the Gulf Coast. This facility off loads and blends bulk commodities for a major oil and gas service company. It became fully operational midway through the third quarter and is yielding positive operating results. Near term results have been impacted, though not significantly, by the recent storms in the Gulf Coast.

Operating results for the third quarter of 2002 compared to the same period in 2001 were lower for much of the same reasons mentioned above regarding the first nine months of 2002.

The current market outlook for this segment is guarded. Orders and opportunities to bid have declined significantly from the second quarter of 2002; however, we have either been awarded or are in negotiations on some significant projects for both Equipment Specialties and MTI, with start dates in the fourth quarter of

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this year. The Company cannot give assurance that it will not continue to experience losses in its Equipment Manufacturing operations, or in the Equipment Manufacturing segment as a whole.

As more fully discussed in Note 7 to the Consolidated Financial Statements, we completed in the third quarter, our initial assessment, with the assistance of a third-party appraiser, of goodwill impairment as required under SFAS No. 142. There was approximately \$1.3 million of goodwill attributable to this segment, of which we have identified two reporting units, Equipment Specialties and MTI. Our test concluded that all of the goodwill attributable to Equipment Specialties, totaling \$452,745, was impaired. Consequently, we have recognized this impairment loss as of the first interim period which was March 31, 2002. Our test concluded that no impairment loss existed for the MTI reporting unit.

Downhole Equipment

| | Three Months Ended September 30, | | Nine Mont Septemb |
|------------------------------|-------------------------------------|------|----------------------|
| | 2002 | 2001 | 2002 |
| Revenues..... | \$ 331,862 | \$ - | \$ 2,264,917 |
| Gross margin..... | \$ 83,608 | \$ - | \$ 1,172,157 |
| Gross margin percentage..... | 25.2% | - | 51.8% |

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| | | | | |
|----------------------------------|--------------|----|---|------------|
| Operating income (loss)..... | \$ (252,779) | \$ | - | \$ 143,892 |
| Operating margin percentage..... | (76.2%) | | - | 6.4% |

The Downhole Equipment segment became part of the consolidated group after the Merger became effective on October 31, 2001. These operations, which consist of manufacturing and marketing the Petrovalve line of downhole pump components and the Turbeco line of casing centralizers, were the original operations of Flotek Industries, Inc. prior to the Merger. Since the Merger was recorded for accounting purposes as a reverse merger, the results of operations of this segment were included in the consolidated results of operations only for periods subsequent to the Merger and are not reflected in the first nine months of 2001. Consolidating the 2002 results of operations for this segment has a significant impact on gross margins for the consolidated company.

Petrovalve sales, totaling \$1,503,000 in the first nine months of 2002, were exclusively to one customer in Venezuela, except for \$100,000 to various other customers. As more fully discussed in Note 4 of the Notes to Consolidated Financial Statements and the Capital Resources and Liquidity section, below, this customer has not paid for these goods within the customary payment terms. These sales carry a high gross margin and are significantly profitable to this segment. Operating results for this reporting unit declined between the second and third quarter of 2002 due to a lack of large sales to the international market. We expect to receive orders totaling \$300,000 to \$600,000 in the fourth quarter which would yield improved operating profits for this portion of the Downhole segment.

Sales of the Turbeco line of casing centralizers, which constitute the balance, \$762,000, of the revenues in this segment, are very dependent on the level of drilling activity and have suffered from the drilling decline and lower demand this year. However, sales have increased 19% between the second quarter and third quarter of 2002 and we are positive about the outlook for the balance of the year.

Capital Resources and Liquidity

In the first nine months of 2002, the Company sustained a loss, before the cumulative effect of change in accounting principle, of \$2,473,599 and had negative cash flow from operations of \$1,889,885. These losses resulted primarily from the poor operating results in the Equipment Manufacturing segment, and general corporate expenses. Management has taken and will continue

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to take appropriate steps to improve performance and attempt to limit the losses/return to profitability in the Equipment Manufacturing segment. The negative cash flow resulted primarily from the operating losses mentioned previously and from delays in collecting accounts receivable from sales to a Venezuelan customer, as discussed below, and delay in shipment of an export equipment sale totaling approximately \$521,000.

As of September 30, 2002, net working capital was negative \$1,944,128, resulting in a current ratio of .74 to 1. Inventories have decreased significantly, approximately \$1,209,000, during the first nine months of 2002, primarily due to completion of manufactured equipment and bulk construction projects, and a concerted effort to move slow moving inventory.

As disclosed in Note 4 of the Notes to Consolidated Financial Statements, at September 30, 2002, the Company had approximately \$1,403,000 of accounts receivable from a customer in Venezuela, all of which arose from goods shipped

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in the first half of 2002. As a result of political instability and work disruptions in the country, these amounts have not been paid within the customary payment terms for this customer. The ultimate customer for these goods is PDVSA, the national oil company of Venezuela. Our customer holds a contract to deliver over \$5 million of our proprietary products to PDVSA during the next three years. However, PDVSA has delayed acceptance of the majority of the goods shipped until its field operations return to higher activity levels. Our customer is unable to pay for the goods until payment has been received from PDVSA. In the second quarter of 2002 we were informed by PDVSA that field operations would return to higher levels of activity and that acceptance of goods shipped would begin. During the second and third quarters of 2002, we received payments totaling \$200,000 and \$629,000, respectively, and PDVSA is continuing to accept goods previously shipped. We fully expect to collect the entire outstanding balance and have not provided a reserve for doubtful accounts associated with this balance. The delay in collecting this accounts receivable balance has had a significant adverse effect on the cash flow of the Company. Additionally, all invoice amounts, as discussed in Note 9 of the Notes to Consolidated Financial Statements, which are greater than 90 days old cannot be included in the borrowing base under our lines of credit.

On February 28, 2002, the Company sold its rights and obligation to purchase the land and buildings covered by a capital lease obligation, together with capital improvements to the property totaling approximately \$750,000 to Oklahoma Facilities, LLC ("Facilities"). An officer of the Company has a minority investment interest in and is an officer of Facilities. This transaction resulted in net cash proceeds to the Company of \$761,000. The Company simultaneously entered into an agreement to lease back the facility over ten years. This transaction has been recorded as a capital lease as discussed in Note 8 of the Notes to Consolidated Financial Statements.

The Company has borrowed \$3.13 million in the first nine months of 2002 under its line of credit arrangements, including a new \$1.6 million line of credit which was executed in January of 2002 and short-term borrowing of \$500,000 executed in July 2002. In addition, our primary lending bank has extended a \$1.4 million line of credit until May 29, 2003. The Company has borrowings which have exceeded its eligible asset base by approximately \$140,000 at September 30, 2002. We also made total debt service payments of approximately \$865,000 during the first nine months of this year. The company has estimated minimum debt service obligations in 2002 of \$1.3 million. This amount includes the minimum principal and interest payments on the new credit agreements mentioned above and in Note 9 of the Consolidated Financial Statements and the capital lease obligation incurred during the first quarter of 2002.

Capital expenditures in the first nine months of 2002 were \$1,357,695. The majority of these capital expenditures relate to a bulk material transload facility which the Company is constructing in Raceland, Louisiana and a paint shop for Equipment Specialties in Duncan, Oklahoma. With the exception of an additional \$300,000 in capital expenditures required to complete the construction and possible expansion of the Raceland transload facility, the Company does not at this time expect to have any major requirements for capital expenditures for the remainder of 2002.

The Company believes its operations are capable of generating sufficient cash flow to meet its debt service obligations if we successfully collect amounts due from our Venezuelan customer and our export equipment sale. The export sale has shipped. However, the collection of these amounts, and certain other factors involved in executing our business strategy, are beyond our control. In addition, we face a challenging near-term industry environment. As a result, we believe the Company will need to raise additional capital through the sale of

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its debt or equity securities. There can be no assurance that the Company will be able to secure such financing on acceptable terms.

It is uncertain that we will be able to collect the amounts from our Venezuelan customer, limit our losses in the Equipment Manufacturing segment, reduce corporate expenses in line with revenue, and/or obtain additional equity or debt financing. Accordingly, investors are advised that the Company faces significant financial risks in the near future as we attempt to meet these challenges.

Forward Looking Statements

Except for the historical information contained herein, the discussion in this Form 10-QSB 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-QSB regarding the Company's financial position, business strategy, budgets and plans and objectives of management for future operations are forward-looking statements. Forward-looking information involves risks and uncertainties and reflects our best judgment based on current information. Our results of operations can be affected by inaccurate assumptions we make or by known or unknown risks and uncertainties. In addition, other factors may affect the accuracy of our forward-looking information. As a result, no forward-looking information can be guaranteed. Actual events and the results of operations may vary materially.

While it is not possible to identify all factors, we continue to face many risks and uncertainties that could cause actual results to differ from our forward-looking statements including:

- o The Company is dependent on the oil and gas industry, and activity levels in the industry are volatile.
- o Oil and gas prices are volatile and have a direct impact on the spending levels of our customers.
- o Severe weather conditions, for example, hurricanes, can have a direct impact on activity levels in the affected areas, and oil and gas prices.
- o The oilfield service industry is highly competitive and we must compete with many companies possessing greater financial resources and better established market positions.
- o The introduction of new products and technologies by competitors may adversely affect the demand for our products and services.
- o The Company's debt service obligations may limit our ability to fund operations and capital spending or provide for future growth.
- o Changes in political conditions, governmental regulations, economic and financial market conditions, unexpected litigation and other uncertainties may have an adverse effect on our operations.

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The Company's Chief Executive Officer and Chief Financial Officer (collectively, the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures for the Company. Such officers have concluded (based upon their evaluation of these controls and procedures as of a date within 90 days of the filing of this report) that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in this report is accumulated and communicated to the Company's management, including its principal executive officers as appropriate, to allow timely decisions regarding required disclosure.

The Certifying Officers also have indicated that there were no significant changes in the Company's internal controls or other factors that could significantly affect such controls subsequent to the date of their evaluation, however, there are corrective actions required with respect to significant deficiencies and material weaknesses in internal controls as follows:

| Weakness | Solution |
|--|--|
| 1. A contingency plan has not been developed for alternative processing of data in the event of loss or interruption of the IT server(s) | Develop a backup plan by March 2003 |
| 2. Off premises storage is not maintained for applications and related documentation | Identify applications and related documentation that need to be secured on-site and move to off-site storage by March 31, 2003 |
| 3. Annual property plant and equipment (PP&E) inventories have not been taken | Complete annual physical inventory of PP&E by December 31, 2002 |
| 4. Physical controls of Equipment Specialties inventory need improvement | Move inventory to a secure site by December 31, 2002 |

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

On May 1, 2002, Milam Tool Company and the Estate of Jack J. Milam filed a complaint against Flotek Industries, Inc., Turbeco, Inc., and Jerry D. Dumas, Sr., individually, in the United States District Court for the Southern District of Texas, Houston Division. The complaint asserts that the sale of TURBO-LOK turbulators, which are part of the Company's Downhole Equipment segment, violates an agreement among the parties and infringes a United States patent controlled by the plaintiffs. Plaintiffs seek injunctive relief and unspecified damages. The Company has answered the complaint. At a Scheduling Conference on July 3, the court deferred discovery on issues related to damage allegations and entered a scheduling order governing the consideration of liability issues. The court did not set a trial date, but did schedule a hearing on May 16, 2003 to consider construction of the claims of the Milam patent. The Company strongly

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denies the assertions in the complaint and intends to vigorously contest this matter.

Item 5 - Other Information

We intend to hold an annual meeting of shareholders during the month of May 2003. Proposals of shareholders intended for presentation at that annual meeting and intended to be included in our Proxy Statement and Form of Proxy for that meeting must be received at our executive offices by February 1, 2003.

Item 6 - Exhibits

(a) Exhibits

Exhibit

Number Description of Exhibit

- | | |
|------|--|
| 10.1 | Change in Terms Agreement dated September 16, 2002 by and between Legacy Bank and Flotek Industries, Inc. |
| 99.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

SIGNATURE

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

FLOTEK INDUSTRIES, INC.

Date: November 12, 2002

/s/ Mark D. Kehnemund

Mark D. Kehnemund
Sr. Vice President & Chief Financial Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Flotek Industries, Inc. on Form 10-QSB for the quarter ended September 30, 2002, as filed with the Securities and Exchange Commission on the date hereof, I, Jerry D. Dumas, Sr., the Chief Executive Officer of the Company, certify, pursuant to and for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, that:

1. I have reviewed this quarterly report on Form 10-QSB of Flotek Industries, Inc.;

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2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

/s/ Jerry D. Dumas, Sr.

Jerry D. Dumas, Sr.
Chief Executive Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Flotek Industries, Inc. on Form 10-QSB for the quarter ended September 30, 2002, as filed with the Securities and Exchange Commission on the date hereof, I, Mark D. Kehnemund, the Chief Financial Officer of the Company, certify, pursuant to and for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, that:

1. I have reviewed this quarterly report on Form 10-QSB of Flotek Industries, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

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- a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

/s/ Mark D. Kehnemund

Mark D. Kehnemund
Sr. Vice President & Chief Financial Officer