FLOTEK INDUSTRIES INC/CN/
Form 10-K
March 16, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2008

or

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

For the transition period from to

Commission file number 1-13270

FLOTEK INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**90-0023731**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
2930 W. Sam Houston Parkway N. #300	**77043**
(Address of principal executive offices)	**(Zip Code)**

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

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

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer x

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

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

The aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2008 (based on the closing market price on the Composite Tape on June 30, 2008) was approximately $377,900,000 (determined by subtracting the number of shares held by affiliates of Flotek Industries, Inc. on that date from the total number of shares outstanding on that date). At February 11, 2009, there were 23,179,894 outstanding shares of Flotek Industries, Inc. Common Stock, $0.0001 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s Proxy Statement for its 2009 annual meeting of shareholders have been incorporated by reference into Part III of this Form 10-K.

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FORWARD-LOOKING STATEMENTS

We have included or incorporated by reference in this Annual Report on Form 10-K, and from time to time our management may make statements that may constitute forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts but instead represent only our current belief regarding future events, many of which, by their nature, are inherently uncertain and outside our control. The forward-looking statements contained in this Annual Report are based on information as of the date of this Annual Report. Many of these forward looking statements relate to future industry trends, actions, future performance or results of current and anticipated initiatives and the outcome of contingencies and other uncertainties that may have a significant impact on our business, future operating results and liquidity. We try, whenever possible, to identify these statements by using words such as anticipate, believe, should, estimate, expect, plan, project and similar expressions. We caution you that these statemen predictions and are not guarantees of future performance. These forward-looking statements and our actual results, developments and business are subject to certain risks and uncertainties that could cause actual results and events to differ materially from those anticipated by these statements. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results may differ, possibly materially, from the anticipated results indicated in these forward-looking statements. Important factors that could cause actual results to differ from those in the forward-looking statements include, among others, those discussed under Risk Factors in Part I, Item 1A and Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 and elsewhere in this Annual Report on Form 10-K.

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PART I

Item 1. Business.
General

Flotek Industries, Inc. is a diversified global supplier of drilling and production related products and services to the oil and gas industry. In 2008, we sold $226.1 million of products and services to customers through our three business segments: Chemicals and Logistics, Drilling Products and Artificial Lift. Our core focus is oilfield specialty chemicals and logistics, downhole drilling tools and downhole production tools. Flotek offers its products primarily through its sales organizations, as well as through independent distributors and agents. Flotek was founded in 1985 and is headquartered in Houston, Texas. On December 27, 2007, our common stock began trading on the New York Stock Exchange (NYSE) under the stock ticker symbol FTK . Prior to this date and since July 27, 2005, our common stock was traded on the American Stock Exchange (AMEX) under the stock ticker symbol FTK . Prior to this date, our common stock was traded on the OTC Bulletin Board under the stock ticker symbol FLTK or FLTK.OB . Our website is located at *http://www.flotekind.com.* We make available free of charge on or through our internet website our Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after electronically filing such material with, or furnishing it to, the Securities and Exchange Commission (SEC). Information contained in our website or links contained on our website are not part of this filing. As used herein, Flotek, Company, we, our and us may refer to Flotek Industries, Inc. and/or its subsidiaries. The u these terms is not intended to connote any particular corporate status or relationships. Additional information regarding our business segments is presented below and in Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 (MD&A) and in Note 17 of the Notes to our Consolidated Financial Statements in Item 8 (Note 17). We sold approximately $208 million, $150 million and $94 million of products and services in the United States for the years ended December 31, 2008, 2007 and 2006, respectively. The remainder of our sales are generated internationally in approximately 20 countries and accounted for approximately 8%, 5% and 7% of our consolidated revenues for each of the last three years, respectively. No single country outside of the United States accounted for more than 10% of our total revenues in any of the past three years.

Historical Developments

Flotek 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 the state of Delaware and a reverse stock split of 120 to 1. On October 31, 2001, we completed a reverse merger with CESI Chemical, Inc. (CESI). Since that date, we have grown through a series of acquisitions.

Description of Operations

Our business is organized into three strategic business units or segments: Chemicals and Logistics, Drilling Products and Artificial Lift. Each segment is managed independently, offers various products and services and requires different technology and marketing strategies. All three segments market products domestically and internationally.

Chemicals and Logistics

The chemical business offers a full spectrum of oil gas field specialty chemicals used for drilling, cementing, stimulation, and production designed to maximize recovery from both new and mature fields. Our specialty chemicals, with enhanced performance characteristics are manufactured to withstand a wide range of downhole pressures, temperatures and other well-specific conditions, are key to the success of this business segment. We operate two laboratories, a technical services laboratory and a research and development laboratory, which focus

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on design, development and testing of new chemical formulations and enhancement of existing products, often in cooperation with our customers.

Our logistics business designs, project manages and operates automated bulk material handling and loading facilities for oilfield service companies. These bulk facilities handle oilfield products, including sand and other materials for well-fracturing operations, dry cement and additives for oil and gas well cementing, and supplies and materials used in oilfield operations, which we blend to customer specification.

During the periods covered by this report, we consummated the following transactions related to this business segment and have included it in the results of this segment from the date of acquisition:

- acquired Sooner Energy Services, Inc. (Sooner) which develops, produces and distributes specialty chemical products and services for drilling and production of natural gas, on August 31, 2007.

Annual revenues for this segment totaled approximately $109 million, $86 million and $51 million in 2008, 2007 and 2006, respectively. Our proprietary biodegradable green chemicals sales amounted to $77 million, $56 million and $26 million for the years ended December 31, 2008, 2007 and 2006, respectively. These sales increased 37% in 2008 from the 2007 period and 115% in 2007 from the 2006 period.

Drilling Products

We are a leading provider of downhole drilling tools used in the oilfield, mining, water-well and industrial drilling sectors. We manufacture, sell, rent and inspect specialized equipment for use in drilling, completion, production and workover activities. Through internal growth and acquisitions, we have increased the size and breadth of our rental tool inventory and geographic scope of operations so that we now conduct tool rental operations throughout the United States and in select international markets. Our rental tools include stabilizers, drill collars, reamers, wipers, jars, shock subs, wireless survey, measurement while drilling (MWD) tools and mud-motors, while equipment sold includes centralizers and drill bits. We focus our product marketing efforts primarily in the Gulf of Mexico, Mid-Continent and Rocky Mountain regions of the United States, with international sales currently conducted through third party agents and employees.

During the periods covered by this report, we consummated the following transactions related to this business segment and have included them in the results of this segment from their respective dates of acquisition:

- acquired the assets of Can-Ok Oil Field Services, Inc. and Stabilizer Technology, Inc. (collectively Can-Ok), a downhole oilfield tool company located in Chickasha, Oklahoma on January 2, 2006,

- acquired the assets of Triumph Drilling Tools (Triumph), a downhole tool company with rental, inspection and manufacturing operations throughout the Gulf Coast and Mid-Continent regions, on January 4, 2007,

- acquired a 50% partnership interest in CAVO Drilling Motors Ltd Co. (CAVO) on January 31, 2007, a downhole mud-motor company with domestic rental and international sales operations and acquired the remaining 50% partnership interest in CAVO on November 15, 2007, and

- acquired the assets of Teledrift Inc. (Teledrift), which designs and manufactures wireless survey and MWD tools, on February 14, 2008.

Annual revenues for this segment totaled approximately $98 million, $57 million and $37 million in 2008, 2007 and 2006, respectively.

In 2008, we introduced the Teleshot, an all electronic wire-line drift indicator, that is capable of taking multiple surveys per run and incorporates the ability to download quickly the information. We provide the Teleshot to our

customers through direct sales or on a rental basis. The TelePulse fully steerable MWD system, featuring proprietary state-of-the-art surface software, is expected to be completed with all field-testing and released for production in the second half of 2009. The Telepulse will offer a positive pulse system with a gamma sensor module that will allow directional drilling companies to maintain integrity of their technical requirements. Additionally, we intend to combine our rental efforts with the CAVO downhole motor in order to provide us with an opportunity to increase our presence in the offshore market both domestically and internationally.

Artificial Lift

We provide pumping system components, including electric submersible pumps, or ESPs, gas separators, production valves and services. Our products address the needs of coal bed methane and traditional oil and gas production to efficiently move gas, oil and other fluids from the producing horizon to the surface. Several of our artificial lift products employ unique technologies to improve well performance. Our patented Petrovalve product optimizes pumping efficiency in horizontal completions, heavy oil and wells with high gas to liquids ratios. This unique valve can be placed horizontally, results in increased flow per stroke, and eliminates gas locking by replacing the traditional ball and seat valve that requires more maintenance. Furthermore, our patented gas separation technology is particularly applicable for coal bed methane production as it efficiently separates gas and water downhole, ensuring solution gas is not lost in water production. Because gas is separated downhole, it reduces the environmental impact of escaped gas at the surface. The majority of our products for Artificial Lift are manufactured in China, assembled domestically and distributed globally.

During the periods covered by this report, we consummated the following transactions related to this business segment and have included them in the results of this segment from their respective dates of acquisition:

- acquired the tangible assets and licensed the rights to exercise the exclusive worldwide rights to a patented gas separator used in coal bed methane production in the Powder River Basin from Total Well Solutions, LLC. (TWS) on April 3, 2006 and

- acquired the assets of LifTech, LLC (LifTech) which markets and services electric submersible pumps and downhole gas/water separators primarily to coal bed methane gas producers in the Powder River Basin on June 6, 2006.

Annual revenues for this segment totaled approximately $18 million, $15 million and $13 million in 2008, 2007 and 2006, respectively.

Seasonality

On an overall basis, our operations are not generally affected by seasonality. Certain working capital components may build and recede during the year reflecting established selling cycles and business cycles can impact our operations and financial position when compared to other periods, but we do not consider our operations to be highly-seasonal. Additionally, weather and natural phenomena can temporarily affect the performance of our services. Examples of how such phenomena can impact our business include:

- the severity and duration of the winter in North America can have a significant impact on gas storage levels and drilling activity for natural gas;

- the timing and duration of the spring thaw in Canada directly affects activity levels due to road restrictions;

- hurricanes can disrupt coastal and offshore operations.

In addition, historically due to higher spending near the end of the year by our customers, the results of operations of the Chemical and Logistics segment are generally stronger in the fourth quarter of the year than at

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the beginning of the year. Also, historically the results of operations of our Artificial Lift segment are generally weaker in the second quarter due to restrictions on drilling on federal lands because of the breeding season of certain bird species.

Product Demand and Marketing

The demand for our products and services is generally correlated to the level of oil and gas drilling activity, work-over activity and gas production levels, both in the United States and internationally. We market our products primarily through direct sales to our customers through sales employees with the assistance of operations and Company management. We have established customer relationships which provide for repeat sales in all of our segments. The majority of our marketing is currently conducted within the United States. Internationally, we operate primarily through agents in Canada, Mexico, Central and South America, the Middle East, Asia and Russia.

Customers

The customers for our products and services include major integrated oil and natural gas companies, independent oil and natural gas companies, pressure pumping service companies and state-owned national oil companies. One of our customers accounted for 12% of our consolidated revenues for each of the years ended December 31, 2008 and 2007. No single customer accounted for more than 10% of our consolidated revenues in the year ended December 31, 2006. Our top five customers accounted for 34% of our consolidated revenues for each of the years ended December 31, 2008 and 2007 and 30% of consolidated revenue for the year ended December 31, 2006.

The majority of the sales to our top five customers were in the Chemicals and Logistics segment and collectively accounted for approximately 63%, 52% and 47% of revenue for this segment for the years ended December 31, 2008, 2007 and 2006, respectively. Our top three customers accounted for 25%, 15% and 12% of the segment s revenue for the year ended December 31, 2008, respectively. In 2007, these companies accounted for 21%, 14% and 10% of segment revenue, respectively, while in fiscal 2006 these companies accounted for 11%, 15% and 14% of segment revenue, respectively.

Two of our top customers also make purchases for another one of our top customers as part of their normal business operations. We cannot quantify the magnitude of purchases made by one of our customers on behalf of another entity. While these three customers are not under common control nor are they affiliates of each other or Flotek, combined they accounted for 40%, 38% and 28% of segment revenue for the years ended December 31, 2008, 2007 and 2006 respectively. A loss of this combined customer group would negatively impact the Company s operating results.

One customer, accounted for 56%, 53% and 43% of the Artificial Lift segment revenue for the years ended December 31, 2008, 2007 and 2006, respectively.

None of these customers were a related party or affiliate of Flotek during any of the years ended December 31, 2008, 2007 or 2006.

Research and Development

We are engaged in research and development activities directed primarily toward the improvement of existing products and services, the design of specialized products to meet customer needs and the development of new products, processes and services. We incurred $1.9 million, $0.8 million and $0.7 million in research and development expenses for the years ended December 31, 2008, 2007 and 2006, respectively. In 2008, our research and development spending was approximately 1% of consolidated revenues. It is our intention to maintain Flotek s future research and development investment at approximately 1% of consolidated revenues.

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Backlog

Due to the nature of our business and contracts with our customers, we do not experience any significant amount of backlog orders.

Intellectual Property

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 depends on 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. We maintain patents on our production valve design, casing centralizer design, and trade secrets and pending patents on certain specialty chemicals.

Competition

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. The regions in which we operate are highly competitive. The competitive environment has intensified as recent mergers among oil and gas companies have reduced the number of available customers. Additionally, the recent downturn in the economy and commodity prices have caused the market for our services and that of our competitors, which may vary significantly by geographical region, to contract. Many other oil and gas service companies are larger than we are and have greater resources than we have. These competitors may be better able to withstand industry downturns, compete on the basis of price and acquire new equipment and technologies, all of which could affect our revenue and profitability. These competitors compete with us both for customers and for acquisitions of other businesses. This competition may cause our business to suffer. We believe that competition for contracts and margins will continue to be intense in the foreseeable future.

Raw Materials

The Company believes that materials and components used in its servicing and manufacturing operations and purchased for sales are generally available on the open market and from multiple sources, although collection and transportation of these raw materials to the Company s facilities can be adversely affected by extreme weather conditions. However, certain raw materials used by the Chemical and Logistics segment in the manufacture of our proprietary, green chemical sales are available from limited sources and disruptions to our suppliers could materially impact our sales. The prices paid by the Company for its raw materials may be affected by, among other things, energy, steel and other commodity prices; tariffs and duties on imported materials; foreign currency exchange rates; the general business cycle and global demand. The Company experienced greater difficulty in securing the necessary supplies of certain chemicals in 2008 than it experienced during the preceding several years. During 2008, the prices of many raw materials rose considerably above our forecast, but we began to see prices decline towards the end of 2008. Higher prices and lower availability of chemicals, steel and other raw materials the Company uses in its business may adversely impact future period sales and margins. The Drilling Products and Artificial Lift segments purchase their principal raw material and steel on the open market. Except for a few chemical additives, the raw materials are available in most cases from several suppliers at market prices. Where we can, we use multiple suppliers, both domestically and internationally, for our key raw materials purchases.

We also maintain a three to six month supply of key mud-motor inventory parts that are primarily sourced from China as well as an equivalent amount of stock of parts within our Artificial Lift segment. This inventory stock position approximates the lead time required to secure these parts in order to avoid disruption of service to our customers.

Government Regulations

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 are subject to numerous environmental, legal, and regulatory requirements related to our operations worldwide. We strive to comply fully with these requirements and are not aware of any material instances of noncompliance. In the United States, these laws and regulations include, among others:

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

In addition to the federal laws and regulations, states and other countries where we do business may have numerous environmental, legal, and regulatory requirements by which we must abide. We evaluate and address the environmental impact of our operations by assessing and remediating contaminated properties in order to avoid future liabilities and comply with environmental, legal, and regulatory requirements. Many of the products within our Chemicals and Logistics segment are considered hazardous or flammable. If a leak or spill occurs in connection with our operations, we could incur material costs, net of insurance, to remediate any resulting contamination. On occasion, we are involved in specific environmental litigation and claims, including the remediation of properties we own or have operated, as well as efforts to meet or correct compliance-related matters. We do not expect costs related to these remediation requirements to have a material adverse effect on our consolidated financial position or our results of operations.

Employees

As of January 30, 2009, we had approximately 500 employees worldwide, with approximately 15 employed as part-time workers. None of our employees are covered by collective bargaining agreements and our labor relations are generally good. In certain international locations, changes in staffing or work arrangements may need approval of local works councils or other bodies.

Available Information

We maintain a web site at www.flotekind.com. We make available, free of charge, on the Investor Relations section of our web site, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file or furnish such materials to the SEC. Additionally, our corporate governance materials, including governance guidelines; the charters of the Audit, Compensation, and Governance and Nominating Committees; and the code of conduct may also be found under the Investor Relations section of our web site at www.flotekind.com. A copy of the foregoing corporate governance materials is available upon written request.

You may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street NE, Washington, DC 20549. You may obtain information regarding the Public Reference Room by calling the

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SEC at 1-800-SEC-0330. In addition, the SEC maintains an internet website at www.sec.gov that contains reports and other information regarding registrants that file electronically with the SEC, including us.

We submitted our 2008 annual Section 12(a) CEO certification with the New York Stock Exchange (NYSE) on March 16, 2009. The certification was not qualified in any respect. Additionally, we filed with this Form 10-K the CEO and CFO certifications required under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002.

Information with respect to our executive officers and directors is incorporated herein by reference to information included in the Proxy Statement for our 2008 Annual Meeting of Shareholders.

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Item 1A. Risk Factors.

This document, our other filings with the SEC, and other materials released to the public contain forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements may discuss our prospects, expected revenue, expenses and profits, strategies for our operations and other subjects, including conditions in the oilfield service and oil and natural gas industries and in the United States and international economy in general.

Our forward-looking statements are based on assumptions that we believe to be reasonable but that may not prove to be accurate. All of our forward-looking information is, therefore, subject to risks and uncertainties that could cause actual results to differ materially from the results expected. Although it is not possible to identify all factors, these risks and uncertainties include the risk factors discussed below.

Risks Related to Our Business

Demand for the majority of our services is substantially dependent on the levels of expenditures by the oil and gas industry. Current global economic conditions have resulted in a significant decline and volatility in oil and gas prices. If current global economic conditions and the availability of credit worsen or continue for an extended period, this could reduce our customers levels of expenditures and have a significant adverse effect on our revenue, margins and overall operating results.

The current global credit and economic environment has reduced worldwide demand for energy and resulted in significantly lower crude oil and natural gas prices. A substantial or extended decline in oil and natural gas prices can reduce our customers activities and their spending on our services and products. Demand for the majority of our services substantially depends on the level of expenditures by the oil and gas industry for the exploration, development and production of crude oil and natural gas reserves. These expenditures are sensitive to oil and natural gas prices and generally dependent on the industry s view of future oil and gas prices. As the worldwide deterioration in the financial and credit markets has deepened in recent months, demand for oil and gas has reduced dramatically and oil and gas prices have fallen sharply, causing some of our customers to start to reduce or delay their oil and gas exploration and production spending. This has started to reduce the demand for our services and has begun to exert downward pressure on the prices that we charge. If economic conditions continue to deteriorate or do not improve, it could result in further reductions of exploration and production expenditures by our customers, causing further declines in the demand for our services and products. This could result in a significant adverse effect on our operating results. Furthermore, it is difficult to predict how long the economic downturn will continue, to what extent it will worsen, and to what extent this will continue to affect us.

The reduction in cash flows being experienced by our customers resulting from declines in commodity prices, together with the reduced availability of credit and increased costs of borrowing due to the tightening of the credit markets, could have significant adverse effects on the financial condition of some of our customers. This could result in project modifications, delays or cancellations, general business disruptions, and delay in, or nonpayment of, amounts that are owed to us, which could have a significant adverse effect on our results of operations and cash flows. Additionally, our suppliers could be negatively impacted by current global economic conditions. If certain of our suppliers were to experience significant cash flow issues or become insolvent as a result of such conditions, it could result in a reduction or interruption in supplies or a significant increase in the price of supplies, and adversely impact our results of operations and cash flows.

The prices for oil and natural gas are subject to a variety of additional factors, including:

- demand for energy, which is affected by worldwide population growth, economic development and general economic and business conditions;

the ability of the Organization of Petroleum Exporting Countries (OPEC) to set and maintain production levels for oil;

oil and gas production by non-OPEC countries;

availability and quantity of natural gas storage;

LNG import volume and pricing;

pipeline capacity to key markets;

political and economic uncertainty and socio-political unrest;

the level of worldwide oil exploration and production activity;

the cost of exploring for, producing and delivering oil and gas;

technological advances affecting energy consumption; and

weather conditions.

Our business depends primarily on domestic spending by the oil and gas industry, and this spending and our business may be adversely affected by industry conditions or by new or increased government regulations that are beyond our control.

We depend primarily on our customers willingness to make operating and capital expenditures to explore for, develop and produce oil and gas in the United States. Customers expectations for lower market prices for oil and gas may curtail spending thereby reducing demand for our products and services. Industry conditions in the United States are influenced by numerous factors over which we have no control, such as the supply of and demand for oil and gas, domestic and international economic conditions, political instability in oil and gas producing countries and merger and divestiture activity among oil and gas producers. The volatility of the oil and gas industry and the consequent effect on exploration and production activity could adversely affect the level of drilling and production activity by some of our customers. One indication of drilling and production activity and spending is rig count, which the company monitors to gauge market conditions. This reduction in exploration may cause a decline in the demand for, or adversely affect the price of, our products and services. Reduced discovery rates of new oil and gas reserves in our market areas could also have a negative long-term impact on our business, even in an environment of stronger oil and gas prices, to the extent existing production is not replaced or the number of drilling and producing wells declines because of substantial depletion of existing domestic reserves or the availability of cheaper reserves outside the United States. In addition, domestic demand for oil and gas may be uniquely affected by public attitudes regarding drilling in environmentally sensitive areas, vehicle emissions and other environmental standards, alternative fuels, taxation of oil and gas and excess profits of oil and gas companies, and the potential changes in governmental regulation and policy that may result from such public attitudes.

We may not be able to generate sufficient cash flows, to meet our debt service obligations or other liquidity needs, and we may not be able to successfully negotiate waivers or a new credit agreement to cure any covenant violations under our current credit agreements.

Due to an extensive capital expenditure program in 2006, we exceeded the indebtedness covenant, fixed charge coverage ratio and capital expenditures limit set forth in our senior credit facility. In 2006, we obtained waivers of those covenants from our principal lender. In February 2008, we amended the terms of our senior credit facility to permit us to issue up to $150 million in convertible senior notes and incur additional capital expenditures. The amended facility includes new financial covenants requiring us to maintain a minimum net worth and not to exceed a maximum senior leverage ratio. These amendments also increased the interest rates under the facility, increased our quarterly principal payments pursuant to our term loan and will require us to make mandatory prepayments of our term loan facility in specified circumstances, including if the appraised value of our fixed assets falls below specified levels.

The Company evaluated its goodwill and other intangibles assets in the fourth quarter of 2008, and recorded an impairment of $67.7 million. As a result, we did not meet the Minimum Net Worth covenant contained within our credit agreement as of December 31, 2008. On February 25, 2009, we entered into a First Amendment and Temporary Waiver Agreement (the "Amendment") with our lenders, which amended the terms of our credit agreement dated as of March 31, 2008 (the "New Credit Agreement"). The Amendment, among other things, increased the interest rate margins applicable to advances under the New Credit Agreement, decreased the aggregate revolving commitment under the New Credit Agreement to $15.0 million, and provides a temporary waiver of any breach by Flotek of the Minimum Net Worth covenant in the New Credit Agreement through the earlier of May 15, 2009 or the occurrence of certain other specified events. The Amendment also permits the Company to exchange shares of its common stock for up to $40.0 million of our Convertible Senior Notes.

Our financial projections for 2009 indicated that we could potentially be in non-compliance with the Leverage Ratio, Minimum Net Worth and Fixed Charge Coverage Ratio Covenants contained within our New Credit Agreement during 2009. Due to all of these factors, we negotiated a Second Amendment, dated March 13, 2009 (the Second Amendment) to our New Credit Agreement with our lenders. The Second Amendment changes the manner in which our borrowing base is computed increases our interest rate and fees associated with borrowings under the New Credit Agreement, limits our permitted maximum capital expenditures to $8.0 million and $11.0 million for 2009 and 2010, respectively and established new covenants related to the Minimum Net Worth, Leverage and Fixed Charge Coverage Ratios.

Our ability to generate sufficient cash flows from operations to make scheduled payments or mandatory prepayments on our current debt obligations and other future debt obligations we may incur will depend on our future financial performance, which may be affected by a range of economic, competitive, regulatory and industry factors, many of which are beyond our control. In addition, we may be required under generally accepted accounting principles to record further impairment charges in the future relating to the carrying value of our goodwill and intangible assets. If as a result of our financial performance or future impairment charges we exceed the amended maximum leverage ratio, fail to meet the required amended minimum net worth, exceed the amended maximum senior leverage ratio or are unable to generate sufficient cash flows or otherwise obtain the funds required to make principal and interest payments on our indebtedness, we may have to seek waivers of these covenants from our lenders or undertake alternative financing plans, such as refinancing or restructuring our debt, selling assets, reducing or delaying capital expenditures or seeking to raise additional capital through the issuance of debt securities or other securities. We cannot assure you that we will be able to obtain any required waivers from our lenders or that we will be able to accomplish any necessary refinancing, sale of assets or issuance of securities on terms that are acceptable. Our inability to obtain any required waivers, to generate sufficient cash flows to satisfy such obligations, or to refinance our obligations on commercially reasonable terms, would have an adverse effect on our business, financial condition and results of operations.

The tightening of the credit markets or a downgrade in our credit ratings could increase our borrowing costs and make it more difficult for us to access funds, to refinance our existing indebtedness, to enter into agreements for new indebtedness or to obtain funding through the issuance of securities. If such conditions were to persist, we would seek alternative sources of liquidity but may not be able to meet our obligations as they become due.

Our principal source of liquidity, other than cash flows from operations, is the revolving line of credit under our amended senior credit facility. The borrowing base under our revolving line of credit is based on our accounts receivable and inventory. If our revenues and inventory decrease as a result of the current economic environment or otherwise, our borrowing capacity under our revolving line of credit could decrease, and such decreases could require us to repay excess borrowings under the revolving line. Any such decreases could also outpace any offsetting reductions in our working capital requirements, which could lead to reduced liquidity. While we believe that our cash flows from operations and amounts available under our new revolving line of credit are

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sufficient to meet our obligations in the near term, our needs for cash may exceed the levels generated from operations and available to us under our revolving line of credit due to factors which are beyond our control.

Our New Credit Agreement, as amended by the Second Amendment also contains representations, warranties, fees, affirmative and negative covenants, and default provisions. A breach of any of these covenants could result in a default under our credit agreement. Upon the occurrence of an event of default under our credit agreement, the lenders could elect to declare all amounts outstanding to be immediately due and payable and terminate all commitments to extend further credit. If the lenders accelerate the repayment of borrowings, we may not have sufficient assets to repay our revolving credit agreement and our other indebtedness. Also, should there be an event of default, or need to obtain waivers following an event of default, we may be subject to higher borrowing costs and/or more restrictive covenants in future periods. Acceleration of any obligation under any of our material debt instruments will permit the holders of our other material debt to accelerate their obligations. See Liquidity and Capital Resources included in Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7.

Our senior credit facility contains certain covenants that could limit our flexibility and prevent us from taking certain actions, which could adversely affect our ability to execute our business strategy.

Our senior credit facility, as amended includes a number of significant restrictive covenants. These covenants could adversely affect us by limiting our ability to plan for or react to market conditions, meet our capital needs and execute our business strategy. The senior credit facility contains covenants that, among other things, limit our ability, without the consent of the lender, to:

- incur certain types and amounts of additional debt;
- consolidate, merge or sell our assets or materially change the nature of our business;
- pay dividends on capital stock and make restricted payments;
- make voluntary prepayments, or materially amend the terms, of subordinated debt;
- enter into certain types of transactions with affiliates;
- make certain investments;
- level of capital expenditures;
- make certain capital expenditures; and
- incur certain liens.

These covenants may restrict our operating and financial flexibility and limit our ability to respond to changes in our business or competitive activities. Our senior credit facility also requires us to maintain certain financial ratios and satisfy certain financial conditions, several of which may require us to reduce our debt or take some other action in order to comply with the covenants. If we fail to comply with these covenants, we could be in default. In the event of a default, our lender or the holders of our Convertible Senior Notes could elect to declare all the amounts borrowed and due to them, together with accrued and unpaid interest, to be due and payable. In addition, the lender could elect to terminate its commitment to us, and we or one or more of our subsidiaries could be forced into liquidation or bankruptcy. Any of the foregoing consequences could restrict our ability to execute our business strategy.

Our future success and profitability may be adversely affected if we or our suppliers fail to develop and introduce new and innovative products and services that appeal to our customers.

The oil and gas drilling industry is characterized by continual technological developments that have resulted in, and likely will continue to result in, substantial improvements in the scope and quality of oilfield chemicals, drilling and artificial lift products and services and product function and performance. As a result, our future success depends, in part, upon our and our suppliers continued ability to develop and introduce new and innovative products and services beyond our micro-emulsion surfactant line to address the increasingly sophisticated needs of our customers and anticipate and respond to technological and industry advances in the oil and gas drilling industry in a timely manner. If we or our suppliers fail to successfully develop and introduce new and innovative products and services that appeal to our customers, or if new market entrants or our competitors offer such products and services, our revenue and profitability may suffer.

We intend to pursue strategic acquisitions, which could have an adverse impact on our business.

Our business strategy includes growing our business through strategic acquisitions of complementary businesses as our capital structure permits. Acquisitions that we have made or that we may make in the future may entail a number of risks that could adversely affect our business and results of operations. The process of negotiating potential acquisitions or integrating newly acquired businesses into our business could divert our management s attention from other business concerns and could be expensive and time consuming. Acquisitions could expose our business to unforeseen liabilities or risks associated with entering new markets or businesses. Consequently, we might not be successful in integrating our acquisitions into our existing operations, which may result in unforeseen operational difficulties or diminished financial performance or require a disproportionate amount of our management s attention and resources. Even if we are successful in integrating our acquisitions into our existing operations, we may not derive the benefits, such as operational or administrative synergies, that we expect from such acquisitions, which may result in the commitment of capital resources without the anticipated returns on such capital. In addition, we may not be able to continue to identify attractive acquisition opportunities or successfully acquire identified targets. Competition for acquisition opportunities may escalate, increasing our cost of making further acquisitions or causing us to refrain from making additional acquisitions. We also must meet certain financial covenants in order to borrow money under our senior credit facility, as amended, to fund future acquisitions and to borrow for other purposes which, if not met, could prevent us from making future acquisitions. Recent changes in accounting literature that govern how companies account for acquisitions may make new acquisitions more costly and/or have an immediate adverse impact on our profitability, potentially resulting in our consummating few acquisitions.

If we do not manage the potential difficulties associated with expansion successfully, our operating results could be adversely affected.

We have grown over the last several years through internal growth and strategic acquisitions of other businesses and assets. We believe our future success depends in part on our ability to manage the growth we have experienced. The following factors could present difficulties to our business going forward:

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

If we do not manage these potential difficulties successfully, our operating results could be adversely affected. In addition, we may have difficulties managing the increased costs associated with our growth, which could adversely affect our operating margins.

Our ability to grow and compete in the future will be adversely affected if adequate capital is not available.

The ability of our business to grow and compete depends on the availability of adequate capital, which in turn depends in large part on our cash flow from operations and the availability of equity and debt financing. We

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cannot assure you that our cash flow from operations will be sufficient or that we will be able to obtain equity or debt financing on acceptable terms or at all to implement our growth strategy. For example, our senior credit facility, as amended, restricts our ability to incur additional indebtedness and requires us to meet certain financial covenants in order to borrow money, including borrowings to fund future acquisitions, a key component of our growth strategy. As a result, we cannot assure you that adequate capital will be available to finance our current growth plans, take advantage of business opportunities or respond to competitive pressures, any of which could harm our business.

Our current insurance policies may not be adequate to protect our business from all potential risks.

Our operations are subject to hazards inherent in the oil and gas industry, such as, but not limited to, accidents, blowouts, explosions, fires, severe weather, oil and chemical spills and other hazards. These conditions can cause personal injury or loss of life, damage to property, equipment and the environment, and suspension of oil and gas operations of our customers. Litigation arising from a catastrophic occurrence at a location where our equipment, products or services are being used may result in our being named as a defendant in lawsuits asserting large claims. We maintain insurance coverage that we believe to be customary in the industry against these hazards. However, we do not have insurance against all foreseeable risks, either because insurance is not available or because of the high premium costs. In addition, we may not be able to maintain adequate insurance in the future at rates we consider reasonable. As a result, losses and liabilities arising from uninsured or underinsured events could have a material adverse effect on our business, financial condition and results of operations.

We are subject to complex foreign, federal, state and local environmental, health and safety laws and regulations, which expose us to costs and liabilities that could have a material adverse effect on our business, financial condition and results of operations.

Our operations are subject to foreign, federal, state and local laws and regulations relating to, among other things, the protection of natural resources and the environment, health and safety, waste management and transportation of waste and other materials. Our operations, including our Chemicals and Logistics segment, which involves chemical manufacturing, packaging, handling and delivery operations, pose risks of environmental liability that could result in fines and penalties, expenditures for remediation, and liability for property damage and personal injuries. In order to conduct our operations in compliance with these laws and regulations, we must obtain and maintain permits, approvals and certificates from various foreign, federal, state and local governmental authorities. Sanctions for noncompliance with such laws and regulations may include assessment of administrative, civil and criminal penalties, revocation of permits and issuance of corrective action orders. We may incur substantial costs in order to maintain compliance with these existing laws and regulations. Laws protecting the environment generally have become more stringent over time and are expected to continue to do so, which could lead to material increases in costs for future environmental compliance and remediation. In addition, our costs of compliance may increase if existing laws and regulations are amended or reinterpreted. Such amendments or reinterpretations of existing laws or regulations or the adoption of new laws or regulations could curtail exploratory or developmental drilling for and production of oil and gas which, in turn, could limit demand for our products and services. Some environmental laws and regulations may also impose joint and strict liability, which means that in some situations we could be exposed to liability as a result of our conduct that was lawful at the time it occurred or conduct of, or conditions caused by, prior operators or other third parties. Clean-up costs and other damages arising as a result of such laws and regulations could be substantial and have a material adverse effect on our financial condition and results of operations.

If we are unable to adequately protect our intellectual property rights or are found to infringe intellectual property rights of others our business is likely to be adversely affected.

We rely on a combination of patents, trademarks, non-disclosure agreements and other security measures to establish and protect our intellectual property rights. Although we believe that those measures are reasonably adequate to protect our intellectual property and provide for the continued operation of our business, there can be no assurance that the measures we have taken or may take in the future will prevent misappropriation of our proprietary information or provide us with a competitive advantage, or that others will not independently develop similar products or services, design around our proprietary or patented technology or duplicate our products or services. Moreover, there can be no assurance that these protections will be available in all cases or will be adequate to prevent our competitors from copying, reverse engineering or otherwise obtaining and using our technology, proprietary rights or products. We have not sought foreign protection corresponding to all of our US intellectual property rights. Consequently, we may not be able to enforce all of our intellectual property rights outside of the United States. Furthermore, the laws of certain countries in which our products are manufactured or marketed may not protect our proprietary rights to the same extent as the laws of the United States. Third parties may seek to challenge, invalidate or circumvent our patents, trademarks, copyrights and trade secrets. In each case, our ability to compete could be significantly impaired.

In addition, some of our products are not protected by issued patents. The issuance of a patent does not guarantee that it is valid or enforceable, so even if we obtain patents, they may not be valid or enforceable against third parties. The issuance of a patent does not guarantee that we have the right to practice the patented invention. Third parties may have blocking patents that could be used to prevent us from marketing our own patented product and practicing our own patented technology.

We have from time to time received, and may in the future receive, communications alleging possible infringement of patents and other intellectual property rights of others. Furthermore, we have in the past, and may in the future, become involved in costly litigation or proceedings brought against us regarding patents or other intellectual property rights. If any such claims are asserted against us, we may seek to obtain a license under the third party s intellectual property rights. We cannot assure you that we will be able to obtain all of the necessary licenses on satisfactory terms, if at all. In the event that we cannot obtain a license, these parties may file lawsuits against us seeking damages (potentially including treble damages) or an injunction against the sale of our products that incorporate allegedly infringed intellectual property or against the operation of our business as presently conducted, which could result in our having to stop the sale of some of our products, increase the costs of selling some of our products, or cause damage to our reputation. The award of damages, including material royalty payments, or the entry of an injunction against the manufacture and sale of some or all of our products, could have a material adverse effect on our results of operations and ability to compete.

We and our customers are subject to risks associated with doing business outside of the United States which may expose us to political risk, foreign exchange risk and other uncertainties.

During the years ended December 31, 2008, 2007 and 2006, approximately 8%, 5% and 7%, respectively, of our consolidated revenues were derived from the sale of products for use outside of the United States. Accordingly, we and our customers are subject to certain risks inherent in doing business outside of the United States, including:

- governmental instability,
- war and other international conflicts,
- civil and labor disturbances,
- requirements of local ownership,
- partial or total expropriation or nationalization,
- currency devaluation, and

foreign exchange control and foreign laws and policies, each of which may limit the movement of assets or funds or result in the deprivation of contract rights or the taking of property without fair compensation.

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Collections and recovery of rental tools from international customers and agents may also prove more difficult due to the uncertainties of foreign law and judicial procedure. We may therefore experience significant difficulty resulting from the political or judicial climate in countries in which we operate or in which our products are used.

Our international operations must also comply with the Foreign Corrupt Practices Act and other applicable United States laws, and we could be liable under these laws for actions taken by our employees or agents. In addition, from time to time, the United States has passed laws and imposed regulations prohibiting or restricting trade with certain nations, and the United States government could change these laws or enact new laws that could restrict or prohibit us from doing business in certain foreign countries.

Although most of our international revenue is derived from transactions denominated in United States dollars, we have conducted and likely will continue to conduct some business in currencies other than the United States dollar. We currently do not hedge against foreign currency fluctuations. Accordingly, our profitability could be affected by fluctuations in foreign exchange rates. We have no assurance that future laws and regulations will not materially adversely affect our international business.

The loss of certain key customers could have a material adverse effect on our results of operation and could result in a decline in our revenue.

We are dependent on a few major customers. Five customers accounted for approximately 34%, 34% and 30% of our consolidated revenue for the years ended December 31, 2008, 2007 and 2006, respectively. Two of these customers accounted for approximately 18%, 18% and 13% of our consolidated revenue and 37%, 32% and 26% of our Chemicals and Logistics segment revenue for the years ended December 31, 2008, 2007 and 2006, respectively. Our customer relationships are typically governed by purchase orders or other short-term contracts rather than long-term contracts. The loss of one or more of our key customers could have a material adverse effect on our results of operations and could result in a decline in our revenue.

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

The Company believes that materials and components used in its servicing and manufacturing operations and purchased for sales are generally available on the open market and from multiple sources. Collection and transportation of these raw materials to the Company s facilities can be adversely affected by extreme weather conditions. However, certain raw materials used by the Chemical and Logistics segment in the manufacture of our proprietary, green chemical sales are available from limited sources and disruptions to our suppliers could materially impact our sales. The prices paid by the Company for its raw materials may be affected by, among other things, energy, steel and other commodity prices; tariffs and duties on imported materials; foreign currency exchange rates; the general business cycle and global demand. The Company experienced greater difficulty in securing the necessary supplies of certain chemicals in 2008 than it had experienced during the preceding several years due to the production capacity of our suppliers and weather related events. These specific events had minimal impact on prices of these supplies but did result in longer lead times. During 2008, the prices of many raw materials rose considerably, though towards the end of 2008, we began to see prices decline. Higher prices and lower availability of chemicals, steel and other raw material the Company uses in its business may adversely impact future periods. The Drilling Products and Artificial Lift segments purchase their principal raw material and steel on the open market and where we can, we use multiple suppliers, both domestically and internationally, for our key raw materials purchases.