

FLOTEK INDUSTRIES INC/CN/

Form 10-K

March 19, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

For the fiscal year ended December 31, 2007

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)

<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>90-0023731</b> (I.R.S. Employer Identification No.)
<b>2930 W. Sam Houston Parkway N. #300</b> (Address of principal executive offices)	<b>77043</b> (Zip Code)
<b>Registrant's telephone number, including area code (713) 849-9911</b>	

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

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

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

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

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  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 of information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately \$355,381,000 as of the last business day of the Registrant's recently completed second fiscal quarter June 30, 2007. As of March 10, 2008, the Registrant had 22,949,650 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

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Portions of the Registrant's Proxy Statement for its 2008 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 statements are 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 below and 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.

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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 energy and mining industries. 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>. 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 use of these terms is not intended to connote any particular corporate status or relationships.

**Historical Development**

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 entered into the following acquisitions that were outside the ordinary course of our business:

acquired IBS 2000, Inc., a Denver-based company engaged in the development and manufacturing of environmentally neutral chemicals for the oil industry, on February 19, 2002,

acquired manufacturing assets, inventory and intellectual property rights to produce oilfield shale shaker screens from Phoenix E&P Technology, LLC on January 28, 2005,

acquired Spidle Sales and Services, Inc. ( Spidle ), a downhole tool company with rental, sales and manufacturing operations throughout the Rocky Mountains, on February 14, 2005,

acquired the assets of Harmon s Machine Works, Inc. ( Harmon ), a downhole oilfield and mining tool company with manufacturing and sales operations located in Midland, Texas, on August 19, 2005,

acquired the assets of Precision-LOR, Ltd. ( LOR ), a drilling tool rental and inspection service provider in South Texas, on August 31, 2005,

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 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,

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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,

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 rentals and international sales operations,

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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,

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 measurement while drilling, or MWD, tools, on February 14, 2008.

## **Description of Operations**

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

### *Chemicals and Logistics*

We offer a full spectrum of oilfield specialty chemicals used for drilling, cementing, stimulation, and production. Our specialty chemical division provides chemical technology solutions to maximize recovery from both new and mature fields. Our development of specialty chemicals with enhanced performance characteristics to withstand a wide range of downhole pressures, temperatures and other well-specific conditions is key to the success of this business segment. We operate two laboratories, a technical services laboratory and a research and development laboratory that focus on design, development and testing of new chemical formulations and enhancement of existing products, often in cooperation with our customers. One of these laboratories is a new state-of-the-art chemical research and development facility in the Houston, Texas area.

Our logistics segment 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.

### *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 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.

### *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. 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. The majority of our products are manufactured in China, assembled domestically and distributed globally.



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### **Product Demand and Marketing**

The demand for our products and services is generally correlated to the level of oil and gas drilling activity, workover activity and gas production levels, both in the United States and internationally. We market our products primarily through direct sales to our customers through Company managers and sales employees. We have established customer relationships which provide for repeat sales. 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 the major integrated oil and natural gas companies, independent oil and natural gas companies, pressure pumping service companies and state-owned national oil companies. Although we are not dependent on one or a few major customers, five customers accounted for approximately 34% of consolidated revenue for the year ended December 31, 2007, 30% of consolidated revenue for the year ended December 31, 2006 and 32% of consolidated revenue for the year ended December 31, 2005. The majority of these sales were in the Chemicals and Logistics segment and collectively accounted for approximately 52% of revenue for this segment for the year ended December 31, 2007, 47% of revenue for this segment for the year ended December 31, 2006 and 49% of revenue for this segment for the year ended December 31, 2005. One customer of the five accounted for approximately 12% of consolidated revenue for the year ended December 31, 2007. The same customer accounted for approximately 21% of revenue of our Chemicals and Logistics segment for the year ended December 31, 2007.

### **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 \$0.8 million, \$0.7 million and \$0.6 million in research and development expenses for the years ended December 31, 2007, 2006 and 2005, respectively.

### **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 considers whether such protection can be obtained on a cost-effective basis and is likely to be effective in protecting our commercial interests. We believe our patents and trademarks, together with our trade secrets and proprietary design, manufacturing and operational expertise, are reasonably adequate to protect our intellectual property and provide for the continued operation of our business. We maintain patents on our production valve design and 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. Many other oil and gas service companies are larger than we are and have greater resources than we have. These competitors are 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 will continue to be intense in the foreseeable future.

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### **Raw Materials**

The Chemical and Logistics segment's operations purchase their principal raw material and chemical feed stocks on the open market. Collection and transportation of these raw materials to the Company's facilities can be adversely affected by extreme weather conditions. Prices for the chemical feed stocks also vary in relation to the general business cycle and global demand. 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. We use multiple suppliers, both domestically and internationally, for our key raw materials purchases.

### **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 strive to comply fully with these requirements and are not aware of any material instances of noncompliance. 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.

### **Employees**

As of March 10, 2008, we employed 460 employees, of which 448 were full-time and 12 were part-time. None of our employees are covered by collective bargaining agreements.

### **Item 1A. Risk Factors.**

This document and our other filings with the Securities and Exchange Commission (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**

*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. Acquisitions 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

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refrain from making additional acquisitions. We also must meet certain financial covenants in order to borrow money under our senior credit facility to fund future acquisitions and to borrow for other purposes which, if not met, could prevent us from making future acquisitions.

### ***Difficulties in integrating acquired businesses may result in reduced revenues and income.***

We may not be able to successfully integrate the businesses of our operating subsidiaries or any business we may acquire in the future. The integration of the businesses are complex and time consuming, place a significant strain on management and our information systems, and this strain could disrupt our businesses. Furthermore, if our combined businesses continue to grow rapidly, we may be required to replace our current information and accounting systems with systems designed for companies that are larger than ours. We may be adversely impacted by unknown liabilities of acquired businesses. We may encounter substantial difficulties, costs and delays involved in integrating common accounting, information and communication systems, operating procedures, internal controls and human resources practices, including incompatibility of business cultures and the loss of key employees and customers. These difficulties may reduce our ability to gain customers or retain existing customers, and may increase operating expenses, resulting in reduced revenues and income and a failure to realize the anticipated benefits of 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; and

increased 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 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 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. This reduction 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 and 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.

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***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 microemulsion 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. Specifically, the patent for our line of biodegradable non-toxic chemicals is still pending, may be subject to reverse engineering and requires specific feedstocks to produce, which may not be available. 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.

***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 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;

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 could elect to declare all the amounts borrowed, 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.

***We may not be able to generate sufficient cash flows to meet our debt service obligations and other liquidity needs.***

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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, increased the borrowing limits and redefined the covenant limits based on an expanded capital expenditures program. On February 4, 2008, we amended the terms of our senior credit facility to permit us to issue \$150 million in convertible senior notes and incur additional capital

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expenditures and to include 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, required us to reduce the amount of our term loan borrowings to \$40.0 million, 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. Our ability to generate sufficient cash flows from operations to make scheduled payments on these debt obligations and other future debt obligations we may incur, will depend on our future financial performance, which will be affected by a range of economic, competitive, regulatory and industry factors, many of which are beyond our control. If we 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 undertake alternative financing plans, such as refinancing or restructuring our debt, selling assets, reducing or delaying capital investments or seeking to raise additional capital through the issuance of debt securities or other securities. We cannot assure you that any refinancing, sale of assets or issuance of securities would be made on terms that are acceptable or otherwise meet our debt obligations. Our inability 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.

Our principal source of liquidity, other than cash flows from operations, is a revolving line of credit under our amended senior credit facility. While we believe that our cash flows from operations and amounts available under our revolving line of credit will be 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.

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

As part of our growth strategy, we have recently completed several acquisitions of privately-held businesses, and in the future, we may make additional strategic acquisitions of privately-held businesses. Prior to becoming part of our consolidated company, these acquired businesses have not been required to implement or maintain the disclosure controls and procedures or internal controls over financial reporting that federal law requires of publicly-held companies such as ours. Similarly, it is likely that our future acquired businesses will not have been required to maintain such disclosure controls and procedures or internal controls prior to their acquisition. Likewise, upon the completion of any future acquisition, we will be required to integrate the acquired business into our consolidated company's system of disclosure controls and procedures and internal controls over financial reporting, but we cannot assure you as to how long the integration process may take for any business that we may acquire. Furthermore, during the integration process, we may not be able to fully implement our consolidated disclosure controls and internal controls over financial reporting.

Likewise, during the course of our integration of any acquired business, we may identify needed improvements to our or such acquired business internal controls and may be required to design enhanced processes and controls in order to make such improvements. This could result in significant delays and costs to us and could require us to divert substantial resources, including management time, from other activities.

If we fail to achieve and maintain the adequacy of our disclosure controls and procedures and/or our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to conclude that we have effective disclosure controls and procedures and/or effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. If:

we are not successful in improving our financial reporting process, our disclosure controls and procedures and/or our internal controls over financial reporting;

we identify deficiencies and/or one or more material weaknesses in our internal controls over financial reporting; or

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we are not successful in integrating acquired businesses into our consolidated company's system of disclosure controls and procedures and internal controls over financial reporting, then our independent registered public accounting firm may be unable to attest that our internal control over financial reporting is fairly stated, or on the effectiveness of, our internal controls.

If it is determined that our disclosure controls and procedures and/or our internal controls over financial reporting are not effective and/or we fail to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act on a timely basis, we may not be able to provide reliable financial and other reports, which, in turn, could harm our business and operating results, cause investors to lose confidence in the accuracy and completeness of our financial reports, have a material adverse effect on the trading price of our common stock and/or adversely affect our ability to timely file our periodic reports with the SEC.

***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 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 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.

***If we lose the services of key members of our management, we may not be able to manage our operations and implement our growth strategy effectively.***

We will depend on the continued service of Jerry D. Dumas, age 72, our Chairman and Chief Executive Officer, who possesses significant expertise and knowledge of our business and industry. We do not have an employment agreement with Mr. Dumas, nor do we carry key man life insurance on him. Any loss or interruption of the services of Mr. Dumas or other key members of our management could significantly reduce our ability to manage our operations effectively and implement our growth strategy, and we cannot assure you that we would be able to find appropriate replacements should the need arise.

***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, 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.

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***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. Specifically, the patent for our line of green chemicals, which was filed in 2003, is still pending and has been the subject of several amendments and preliminary rejections during the course of its examination. Some of these rejections have been based on prior patents owned by third parties that were cited by the patent examiner as describing similar technology in certain respects. This patent application, as well as all of our other patent applications, may not result in an issued patent or may result in a patent that does not provide us with a competitive advantage. Furthermore, 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.



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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, foreign exchange and other uncertainties.***

During the years ended December 31, 2007, 2006 and 2005, approximately 5%, 7% and 16%, respectively, of our consolidated revenue was 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, 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. 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. In addition, from time to time the United States has passed laws and imposed regulations prohibiting or restricting trade with certain nations.

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.***

Although we are not dependent on one or a few major customers, five customers accounted for approximately 34%, 30% and 32% of our consolidated revenue for the years ended December 31, 2007, 2006 and 2005, respectively. One of these customers accounted for approximately 12% of our consolidated revenue and 21% of our sales in the Chemicals and Logistics segment for the year ended December 31, 2007. One of these customers accounted for approximately 8% of our consolidated revenue and 15% of our sales in the Chemicals and Logistics segment for the year ended December 31, 2006. One of these customers accounted for approximately 12% of our consolidated revenue and 22% of our sales in the Chemicals and Logistics segment for the year ended December 31, 2005. 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 as a result of competition, creditworthiness or otherwise could have a material adverse effect on our results of operations and could result in a decline in our revenue.

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### **Risks Related to Our Industry**

***Volatility or decline in oil and natural gas prices may result in reduced demand for our products and services which may adversely affect our business, financial condition and results of operation.***

The markets for oil and natural gas have historically been extremely volatile. We anticipate that these markets will continue to be volatile in the future. Although oil and gas prices have increased significantly in recent years, there can be no guarantees that these prices will remain at current levels. Such volatility in oil and gas prices, or the perception by our customers of unpredictability in oil and natural gas prices, adversely affects the spending patterns in our industry. The demand for our products and services is, in large part, driven by current and anticipated oil and gas prices and the related general levels of production spending and drilling activity. In particular, volatility or a decline in oil and gas prices may cause a decline in exploration and drilling activities. This, in turn, could result in lower demand for our products and services and may cause lower prices for our products and services. As a result, volatility or a prolonged decline in oil or natural gas prices may adversely affect our business, financial condition and results of operations.

***Competition from new and existing competitors within our industry could have an adverse effect on our results of operations.***

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

***Our industry has experienced a high rate of employee turnover. Any difficulty we experience attracting or retaining personnel could adversely affect our business.***

We operate in a highly competitive industry for securing qualified personnel with the required technical skills and experience. Our services require skilled personnel who can perform physically demanding work. Due to industry volatility and the demanding nature of the work, workers may choose to pursue employment in fields that offer a more desirable work environment at wages that are competitive with ours. As a result, we may not be able to find enough labor to meet our needs, which could limit our growth. In addition, the cost of attracting and retaining qualified personnel has increased over the past several years due to competition, and we expect it will continue to increase in the future. In order to attract and retain qualified personnel we may be required to offer increased wages and benefits. If we are not able to increase the prices of our products and services to compensate for increases in compensation, or if we are unable to attract and retain qualified personnel, our operating results could be adversely affected.

***Severe weather could have a material adverse impact on our business.***

Our business could be materially and adversely affected by severe weather. Hurricanes, tropical storms, blizzards and cold weather and other weather hazards may cause the curtailment of services, damages to our equipment and facilities, interruptions in the transportation of our products and materials in accordance with contract schedules and loss of productivity. If our customers are unable to operate or are required to reduce their operations due to severe weather, and as a result curtail the purchases of our products and services, our business could be materially adversely affected.

***A terrorist attack or armed conflict could harm our business.***

Terrorist activities, anti-terrorist efforts and other armed conflict involving the United States may adversely affect the United States and global economies and could prevent us from meeting our financial and other

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obligations. We may experience loss of business, delays or defaults in payments from payers, or disruptions of fuel supplies and markets if pipelines, production facilities, processing plants and refineries are direct targets or indirect casualties of an act of terror or war. In addition, such activities could reduce the overall demand for oil and natural gas which, in turn, could reduce the demand for our products and services. We have implemented certain security measures in response to the threat of terrorist activities. Terrorist activities and the threat of potential terrorist activities and any resulting economic downturn could adversely affect our results of operations, impair our ability to raise capital or otherwise adversely impact our ability to execute our business strategy.

### **Risks Related to Our Common Stock**

*The market price of our common stock has been and may continue to be volatile.*

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

variations in our quarterly results of operations;

changes in market valuations of companies in our industry;

fluctuation in stock market prices and volume;

fluctuation in oil and natural gas prices;

issuance of common stock or other securities in the future;

the addition or departure of key personnel; and

announcements by us or our competitors of new business, acquisitions or joint ventures.

The stock market has experienced extreme price and volume fluctuations in recent years that have significantly affected the prices of the common stock of many companies, including companies in our industry. The changes often occur without regard to specific operating performance. The price of our common stock could continue to fluctuate based upon factors that have little to do with our Company, and these fluctuations could materially reduce our stock price. Class action lawsuits have frequently been brought against companies following periods of volatility in the market price of their common stock. If we become involved in this type of litigation it could be expensive and divert management's attention and Company resources, which could have a material adverse effect on our business, financial condition and results of operation.

*An active market for our common stock may not continue to exist or may not continue to exist at current trading levels.*

Our common stock was quoted on the American Stock Exchange until December 27, 2007 when it began trading on the New York Stock Exchange. While there is currently one specialist in our common stock, this specialist is not obligated to continue to make a market in our common stock. In the event it does not continue to make a market in our common stock, the liquidity of our common stock could be adversely impacted and a stockholder could have difficulty obtaining accurate stock quotes. Trading volume for our common stock has historically been low. We cannot assure you that an active trading market for our common stock will develop or be sustained. Sales of significant amounts of shares of our common stock in the public market could lower the market price of our stock.

*We have no plans to pay dividends on our common stock, and therefore, investors will have to look to stock appreciation for return on their investments.*

## Edgar Filing: FLOTEK INDUSTRIES INC/CN/ - Form 10-K

We do not anticipate paying any cash dividends on our common stock in the foreseeable future. We currently intend to retain all future earnings to fund the development and growth of our business. Any payment of

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future dividends will be at the discretion of our board of directors and will depend on, among other things, our earnings, financial condition, capital requirements, level of indebtedness, statutory and contractual restrictions applying to the payment of dividends and other considerations that the board of directors deems relevant. Certain covenants of our senior credit facility restrict the payment of dividends without the prior written consent of the lender. Investors must rely on sales of their common stock after price appreciation, which may never occur, in order to realize a return on their investment.

***Certain anti-takeover provisions of our charter documents under Delaware law could discourage or prevent others from acquiring our company, which may adversely affect the market price of our common stock.***

Our certificate of incorporation and bylaws contain provisions that:

permit us to issue, without stockholder approval, up to 100,000 shares of preferred stock, in one or more series and, with respect to each series, to fix the designation, powers, preferences and rights of the shares of the series;

prohibit stockholders from calling a special meeting;

limit the ability of shareholders to act by written consent;

prohibit cumulative voting; and

require advance notice for stockholder proposals and nominations for election to the board of directors to be acted upon at meetings of stockholders.

In addition, Section 203 of the Delaware General Corporation Law limits business combinations with owners of more than 15% of our stock that have not been approved by the board of directors. These provisions and other similar provisions make it more difficult for a third party to acquire us without negotiation. Our board of directors could choose not to negotiate with an acquirer that it did not feel was in our strategic interest. If the acquirer were discouraged from offering to acquire us or prevented from successfully completing a hostile acquisition by the anti-takeover measures, you could lose the opportunity to sell your shares at a favorable price.

***Future issuance of additional shares of our common stock could cause dilution of ownership interests and adversely affect our stock price.***

The Company may in the future issue its previously authorized and unissued securities, resulting in the dilution of the ownership interests of its current stockholders. We are currently authorized to issue 40,000,000 shares of common stock, of which 18,731,491 were issued and 18,394,730 were outstanding as of December 31, 2007 and 1,335,634 were subject to future issuance through the exercise of options previously granted under our equity compensation plans and 336,761 of restricted stock awards that will be issued over the vesting period or based on achievement of performance goals. The potential issuance of such additional shares of common stock, whether directly or pursuant to any conversion right of our convertible senior notes or other convertible securities we may issue in the future, may create downward pressure on the trading price of our common stock. We may also issue additional shares of our common stock or other securities that are convertible into or exercisable for common stock for capital raising or other business purposes. Future sales of substantial amounts of common stock, or the perception that sales could occur, could have a material adverse effect on the price of our common stock.

***We may issue shares of preferred stock or debt securities with greater rights than our common stock.***

Subject to the rules of the New York Stock Exchange, our certificate of incorporation authorizes our board of directors to issue one or more series of preferred stock and set the terms of the preferred stock without seeking any further approval from holders of our common stock. Currently, there are 100,000 preferred shares authorized but none issued. Any preferred stock that is issued may rank ahead of our common stock in terms of dividends, priority and liquidation premiums and may have greater voting rights than holders of our common stock.



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**Item 1B. Unresolved Staff Comments.**

The Company has no unresolved staff comments as of the date of this report.

**Item 2. Properties.**

The following table describes the location and general character of the principal physical properties used in each of our company's businesses as of December 31, 2007.

<b>Segment</b>	<b>Owned/Leased</b>	<b>Location</b>
Chemicals and Logistics	Owned	Marlow, Oklahoma
	Leased	Raceland, Louisiana
	Owned	Raceland, Louisiana
	Owned	Carthage, Texas
	Owned	Norman, Oklahoma
	Owned	Wheeler, Texas
	Leased	Wilburton, Oklahoma
	Drilling Products	Owned
Owned		Robstown, Texas
Owned		Vernal, Utah
Owned		Evanston, Wyoming
Owned		Mason, Texas
Leased		