FLOTEK INDUSTRIES INC/CN/
Form 10KSB
March 29, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-KSB

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

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

Commission File Number 1-13270

FLOTEK INDUSTRIES, INC.

Incorporated pursuant to the Laws of the State of Delaware

Internal Revenue Service Employer Indentification No. 90-0023731

7030 Empire Central Drive, Houston, Texas 77040

(713) 849-9911

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

(none)

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

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

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

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

Revenues for the Company s 2003 fiscal year were $14,844,431.

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately $4,991,253 on March 30, 2004 based upon the closing sale price of common stock on such date of $0.75 per share on the OTC Bulletin Board. As of March 30, 2004, the Registrant had 6,655,004 shares of common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

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

Transitional Small Business Disclosure Format: Yes [_] No [x]

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CERTIFICATIONS

PART I

Item 1. ***Description of Business***

Business

Flotek Industries, Inc. and subsidiaries (the Company or Flotek) was originally incorporated under the laws of the Province of British Columbia on May 17, 1985. On October 23, 2001, the shareholders of the Company approved a change in its corporate domicile to Delaware and a reverse stock split of 120 to 1. On October 31, 2001, the Company completed a reverse merger (the Merger) with Chemical & Equipment Specialties, Inc. (CESI). CESI is treated as the acquirer for accounting purposes. In connection with the Merger, the Company adopted a calendar year end, which had been the prior reporting basis of CESI. The business of Flotek prior to the Merger consisted of the Downhole Equipment segment, as described below. CESI s business was comprised of the Specialty Chemical and Facility Construction and Management segments.

Flotek is headquartered in Houston, Texas and its common shares are traded on the OTC Bulletin Board market. Effective November 5, 2001, in connection with the Merger, the Company began trading with a new stock ticker symbol, FLTK , to reflect its change in status from a foreign-domiciled corporation to a Delaware corporation.

On June 27, 2003, we announced our intentions to divest the Equipment Specialties business unit located in Duncan Oklahoma. The sale of various assets of this business unit was finalized during the third quarter of 2003 to Special Equipment Manufacturing, Inc. (SEM). The proceeds from the sale were approximately $225,000 and the estimated loss on disposal was $1,157,000. The loss on disposal is recorded separately on the Consolidated Statement of Operations. The Equipment Specialties business unit is accounted for as a discontinued operation and therefore, the results of operations have been removed from results of continuing operations for all periods presented in this document.

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

The Specialty Chemicals segment develops, manufactures, packages and sells chemicals used by other oilfield service companies in oil and gas well cementing, stimulation and production.

The Facility Construction and Management segment designs, constructs and manages automated bulk material handling and loading facilities for other oilfield service companies.

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

Specialty Chemicals

Stimulation of oil and gas wells is comprised of hydraulic fracturing of sandstone reservoirs and acidizing of carbonate reservoirs. In the Specialty Chemicals segment, we offer a full spectrum of cementing, acidizing and fracturing chemicals and fracturing additives and also market certain specialty production chemicals. We have a laboratory facility in Oklahoma which is used to design and test new chemical formulations and enhance existing products, often in partnership with our customers. The laboratory also provides quality assurance to our manufacturing operations and expert technical support to our customers on existing product lines. The customer base for this business unit is primarily oil and gas well pumping service companies, including both major and independent oilfield service companies. The segment manufactures, packages and warehouses its products in Oklahoma. Product distribution, outside of its main warehouse facility in Oklahoma, is outsourced to a third party. Sales are conducted from Oklahoma, Colorado and Texas. We also work through sales representatives and agents in Canada, Mexico, South America, the Middle East and Far East. Business in this segment is highly competitive. We distinguish ourselves through the strength of our innovative and proprietary products, dedication to product quality and superior customer service.

Facility Construction and Management

In this segment, we design, construct and manage automated bulk material handling and loading facilities for other oilfield service companies, either as the general contractor on projects or as consulting engineers. The customer base for this segment consists of one major independent oilfield service company which specializes in pressure pumping, cementing and stimulation services. Our client s bulk facilities handle such oilfield products as sand and other proppant materials for well fracturing operations, as well as dry cement and additives for oil and gas well cementing and other supplies and materials used in oilfield operations.

Downhole Equipment

The Downhole Equipment segment manufactures and sells two primary product lines, the Petrovalve line of downhole pump valves, used in oil and gas production, and the Turbeco line of rigid body and integral joint centralizers used in cementing operations. Both product lines use patented and/or proprietary product designs to achieve greater efficiency and effectiveness than competing products.

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

Our Turbeco line of fixed rigid and integral joint centralizers is used in oil and gas well cementing programs to increase the effectiveness of such operations. Its primary products include the *Cementing Turbulator*, which Flotek acquired and began distributing in 1994. The main purpose of this tool is to assure the pipe is properly centered in the well bore and to improve placement of cement to obtain an effective bond with the formation. We were one of the first companies to distribute spiral-vane cementing turbulators. The *Turbulator* has gained widespread acceptance through its ability to improve oil and gas well cementing programs and is effective in deep, directional and horizontal well applications.

New products that have been introduced in this segment are the *Integral Pup Centralizer*, the *Integral Joint Bow Spring Centralizer*, the *Eccentric Turbulator* (jointly patented with Marathon Oil), and the recently patented *Turbo-lok Centralizer*.

Our competition, in the Petrovalve product line, is comprised of rod pump manufacturers and pump maintenance and service shops using the industry standard API ball and seat product, as well as other proprietary valve products. In the cementing centralizer market we compete with both large, diversified oilfield service companies and smaller independent competitors. The market is very competitive and is expected to remain as such for the foreseeable future.

Our customers in the Downhole Equipment segment are primarily oil and gas exploration and production companies, including major oil companies, which own producing oil and gas wells and are involved in the drilling and cementing of oil wells. Our active customer base is distributed among major oil companies and smaller independent operators. Marketing of our products is primarily focused in the Gulf of Mexico and Mid-Continent regions of the US. However, we do have one major customer in Venezuela for our Petrovalve products and we are continuing to expand our sales both internationally and domestically.

Product Demand and Marketing

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

We market our products primarily through direct sales to our customers by company managers and sales employees. We generally have established customer relationships which provide for repeat sales. As a result of the significant consolidation which has occurred in the industry over the past 16 years, our sales have tended to be concentrated in larger customer relationships. Five customers accounted for 53.8% of our consolidated revenues for the year ended December 31, 2003. All of these customers were also in the Specialty Chemicals segment of our business and they collectively accounted for 62.4% of the revenues in this segment.

Government Regulation, Operating Risks and Insurance

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

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

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

We have a legal action pending. Reference is made to Item 3, Legal Proceedings, contained in this filing. No significant losses have been recognized as a result of this pending litigation.

Research and Development and Intellectual Property

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

International Operations

Substantially all of our revenues and operations are currently derived and conducted, respectively, within the United States. However, we have been expanding our international sales efforts and we expect international sales to continue to increase. We have approximately $350,000 of consigned Petrovalve inventory warehoused in Miami, Florida, in anticipation of increased South American sales. We are utilizing a third party in Canada to blend and distribute Chemical products for customers in Canada. Otherwise, there are no current plans to locate any additional production operations or maintain any significant amounts of inventory outside the U.S. However, these plans are subject to change in the future based on management s assessment of business opportunities in certain global markets.

One of our product lines, Petrovalve downhole pumps, is currently sold in markets in South America, particularly Venezuela. During 2003 we experienced difficulties in collecting accounts receivable from sales to Venezuela, via our agent, on a timely basis due to political instability and a work disruption by the national oil company -- PDVSA. At December 31, 2003, we reversed $1,227,000 of accounts receivable and the associated reserve for doubtful accounts of $878,000 and recorded the inventory as finished goods with a carrying value of $350,000. Based on forecasts by the end user, we anticipate the resale of this inventory beginning in the first half of 2004.

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

Employees

As of December 31, 2003, we employed approximately 70 full-time employees. None of our employees are covered by collective bargaining agreements, and we believe that our relationship with our employees is satisfactory.

Risk Factors

We face various business risks specific to our industry, product lines, financial resources and competitive position, as well as general economic and financial risks. The following risk factors, among others, may cause our operating results and/or financial position to be adversely affected:

We are heavily dependent on the oil and gas industry, and activity levels in the industry are volatile.

Oil and gas prices are volatile and have a direct impact on the spending levels of our customers.

Severe weather conditions, for example, hurricanes, can have a direct impact on activity levels in the affected areas and oil and gas prices.

The oilfield service industry is highly competitive, and we must compete with many companies possessing greater financial resources and better established market positions.

The introduction of new products and technologies by competitors may adversely affect the demand for our products and services.

Our debt service obligations and cash required by operations may limit our ability to fund capital spending or provide for future growth.

Changes in political conditions, governmental regulations, economic and financial market conditions, unexpected litigation and other uncertainties may have an adverse effect on our operations.

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

The following table sets forth certain information with respect to the Company s principal properties:

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

We consider our facilities to be in good condition and suitable for the conduct of our business. All of our owned facilities are subject to mortgages or security agreements as described in Note 10 of the Notes to Consolidated Financial Statements.

Item 3. ***Legal Proceedings***

Milam Tool Company and the Estate of Jack J. Milam vs. Flotek Industries, Inc., Turbeco, Inc. and Jerry D. Dumas, Sr., individually, C.A. No. H-02-1647 (Jury Demanded), in the United States District Court, Southern District of Texas, Houston Division.

On May 1, 2002, Milam Tool Company and the Estate of Jack J. Milam filed a complaint against Flotek Industries, Inc., Turbeco, Inc. and Jerry D. Dumas, Sr., individually, in the United States District Court for the Southern District of Texas, Houston Division. The Complaint asserts that the sale of TURBO-LOK turbulators, which are part of the Company s Downhole Equipment segment, violates an agreement among parties and infringes a United States patent controlled by the Plaintiffs. Plaintiffs seek injunctive relief and unspecified damages. The Company has answered the complaint. On October 14, 2003, the Court entered a Memorandum and Order interpreting the claims of the patent and the settlement agreement. The Court adopted many of Flotek s positions and ordered mediation within 45 days. Plaintiffs moved for reconsideration or leave to file an appeal and the Court then postponed the mediation deadline. While the Company strongly denies the assertions in the complaint and intends to continue to vigorously contest this matter. We believe the results of these legal actions will not have a material adverse effect on the Company s consolidated financial position

On August 22, 2003 Dixie Iron Works, LTD. (Dixie), a supplier to Equipment Specialties, Inc. (ESI) a wholly owned subsidiary of CESI, a Flotek Industries, Inc. affiliate, filed suit against Flotek Industries, Inc. seeking payment for goods and services delivered to ESI totaling $127,200. A portion of this liability, $53,000, has been assumed by SEM, in their purchase of the assets of ESI. ESI does not deny responsibility for the goods and services provided and has made a settlement offer to the plaintiff in an effort to end the suit. A counter offer was received by the Plaintiff s attorney and ESI accepted the terms of the settlement offer on January 16, 2003. The terms require ESI to pay Dixie six installments of $13,109, or a total of $78,652, beginning February 15, 2004.

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

None.

PART II

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

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

	High	Low
2003		
Fourth quarter ended December 31, 2003	$ 1.30	$ .55
Third quarter ended September 30, 2003	$ 1.30	$ .60
Second quarter ended June 30, 2003	$ 1.30	$ .55
First quarter ended March 31, 2003	$ 1.25	$ .60
2002		
Fourth quarter ended December 31, 2002	$ 3.00	$ .51
Third quarter ended September 30, 2002	$ 2.75	$ 1.10
Second quarter ended June 30, 2002	$ 4.94	$ 1.92
First quarter ended March 31, 2002	$ 3.75	$ 1.35

As of March 30, 2004, the closing stock price, as quoted on the OTC Bulletin Board, was $0.75. As of March 30, 2004, there were 6,655,004 common shares outstanding held by approximately 141 holders of record and an estimated 4 beneficial holders.

Dividend Policy

The Company has never paid cash dividends on its common stock. The Company intends to retain future earnings, if any, to meet its working capital requirements and to finance the future operations of its business. Therefore, the Company does not plan to declare or pay cash dividends to holders of its common stock in the foreseeable future. In addition, certain of the Company s credit agreements contain provisions that limit the Company s ability to pay cash dividends on its common stock.

Recent Issuance of Unregistered Securities

During 2003, the Company issued 578,500 stock options with a market value of $349,600 at the date of grant. On April 3, 2003, a stock grant of 125,000 shares was awarded to Mr. Jerry D. Dumas, Sr., Chairman and CEO of the Company which resulted in $75,000 of compensation expense.

Also, during 2003, the Company issued 875,000 shares of its common stock in a private offering to accredited investors in exchange for $525,000 of subscription proceeds, which was paid by the tender to the Company of $525,000 of cash. Proceeds of $150,000 of the total $525,000 subscription proceeds were provided from two directors of the company, one of which is considered to be a principal shareholder of the company.

In January, 2004, the Company issued 133,334 of its common stock in a private offering to accredited investors in exchange for $100,000 of subscription proceeds, which was paid by the tender to the Company of $100,000 of cash.

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

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Securities Authorized for Issuance Under Equity Compensation Plans

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

Equity Compensation Agreement Information

Plan category	Number of securities to be issued upon exercise of outstanding options and warrants (a)	Weighted-average exercise price of outstanding options and warrants (b)	Number of securities remaining available for future issuance under equity compensation agreements (excluding securities reflected in column (a)) (c)
Equity compensation agreements not approved by security holders:			
Individual stock compensation agreements	657,843	$ 1.54	--
Warrants	56,030	$ 13.13	--
Total	713,873	$ 2.45	--

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

Business Overview

Flotek was established in 1985 and is currently traded on the OTC Bulletin Board market. On October 31, 2001, the Company completed the Merger with CESI. The Merger has been accounted for as a reverse acquisition using the purchase method of accounting. In the Merger, the shareholders of the acquired company, CESI, received the majority of the voting interests in the surviving consolidated company. Accordingly, CESI was deemed to be the acquiring company for financial reporting purposes. All of the assets and liabilities of Flotek were recorded at fair value on October 31, 2001, the date of the Merger.

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

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

The Specialty Chemicals segment develops, manufactures, packages and sells chemicals used by other oilfield service companies in oil and gas well cementing, stimulation, and production.

The Facility Construction and Management segment designs, constructs and manages automated bulk material handling and loading facilities for other oilfield service companies.

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

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

The oil and gas industry has continued to improve in 2003. Oil and gas commodity prices have remained strong and the U.S. rig count, as measured by Baker Hughes Incorporated, has continued to strengthen throughout the year. Having begun the year at 862 rigs, the count steadily increased to 1,126 active rigs by the end of 2003. This is a 31% year over year increase in rig count. This activity has been underpinned by demand for natural gas and record levels of injection required to refill storage. Natural gas and crude oil prices have remained strong throughout the year. The current 12-month strip for natural gas is $5.40/MCF, up from $4.95/MCF in the third quarter. Wellhead and futures prices are still strong with the 12-month strip at $32.31 compared to $28.67 in the third quarter. Our business will continue to benefit from these oil and gas commodity prices and the increase in drilling activity as we have experienced throughout 2003.

The following is a discussion of our results of operations for the last two years. This discussion should be read in conjunction with our consolidated financial statements and notes thereto that are included in Item 7, Financial Statements, of this filing.

The Company is also subject to various Risk Factors as discussed in Part 1, Item 1, description of business, of this filing, and the following discussion should be read in light of those factors, which could have a material effect on our business in the future.

Results of Operations

	For the Years Ended December 31, 2003	2002
Revenues	$ 14,844,431	$ 11,341,012
Cost of revenues	9,264,091	7,128,680
Gross margin	5,580,340	4,212,332
Gross margin %	37.6%	37.1%

	For the Years Ended December 31,	
Selling, general and administrative	4,788,749	5,595,600
Goodwill impairment	5,120,633	600,000
Depreciation and amortization	713,531	518,003
Research and development	46,654	111,674
Total expenses	10,669,567	6,825,277
Operating loss	(5,089,227)	(2,612,945)
Operating loss %	(34.3)%	(23.0)%
Interest expense	(618,438)	(504,200)
Interest income	--	245
Other, net	26,985	(566)
Other income (expense), net	(591,453)	(504,521)
Loss from continuing operations	$ (5,680,680)	$ (3,117,466)
Loss %	(38.3)%	(27.5)%

Total revenues increased $3,503,418 or 31.0% in 2003 compared to 2002. As discussed under Results by Segment, the Specialty Chemicals segment produced the majority of this revenue increase between years. The Facility Construction and Management segment, which now excludes the discontinued operating results for ESI reported slightly lower revenues in 2003, while the Downhole Equipment segment had an increase in revenues for 2003 compared to 2002 due to the Turbeco line of casing centralizers. The increase in revenues for Specialty Chemicals and Turbeco is attributable to the increased exploration and production activity for oil and gas as evidenced by a 31% increase in the average daily rig count in the U.S. in 2003 compared to 2002. All three segments are heavily dependent on the global oil and gas market, except the Petrovalve line of downhole pump components, which is primarily dependent on international oil and gas production activity.

On an aggregate basis, the gross margin as a percentage of revenues increased 0.5% from 37.1% in 2002 to 37.6% in 2003. The majority of the gross margin percentage increase is attributable to improved margins for our Downhole Equipment Segment, specifically Turbeco. See Results by Segment for a discussion of the gross margin on a segment by segment basis, as the margin varies significantly between operating segments and can vary significantly from period to period.

Goodwill impairment costs were $5,120,633 in 2003 compared to $600,000 in 2002. These impairment costs are attributable to the Petrovalve reporting unit which fully offsets all goodwill for this reporting unit as of December 31, 2003.

SG&A represents the costs of selling and general and administrative expenses not directly attributable to products sold or services rendered. SG&A costs decreased between years on significantly higher revenue. This decrease was primarily due to the allowance for doubtful accounts of $31,102 in 2003 compared to $900,067 in 2002. In the fourth quarter of 2002 the Company recorded an $878,000 allowance for doubtful accounts associated with a $1,227,000 accounts receivable from a customer in Venezuela. SG&A costs were 32.3% of revenues in 2003 and 49.3% of revenues in 2002, resulting in a 17.0% reduction from 2002 to 2003. Significant emphasis and effort has been placed on reducing SG&A costs across the organization. Further reduction of SG&A is possible with respect to legal fees, once the patent litigation suit, as described in Part I, Item 3, is settled. Depreciation and amortization expense increased $195,528 or 37.7% in 2003 compared to 2002. The majority of this increase is due to a full year of depreciation in 2003 on the approximate $1,200,000 of capital improvement at the MTI Raceland transload facility versus only four months of depreciation in 2002. Our other business units also experienced increases in depreciation associated with capital expenditures placed in service in 2003.

Interest expense increased $114,238 or 22.7% in 2003 compared to 2002 due to higher average debt balances and higher interest rates. The average amount of outstanding debt under the Company s credit agreements and related party debt was higher in 2003 due to the refinancing of the construction loan for the bulk material transload facility in Raceland, Louisiana, the financing of capital expenditures and the Company s increased working capital needs during 2003. In addition, the revolving line of credit with our primary bank was reduced, with $753,000 converted into long-term debt. Both the revolving line and the term loan interest rates were increased 3.0%, from prime plus 1.25% to prime plus

4.25%. The majority of the Company s indebtedness carries a variable interest rate tied to the prime rate and is adjusted on a quarterly basis.

Results by Segment

Specialty Chemicals

	For the Years Ended December 31, 2003		2002	
Revenues	$	10,249,738	$	6,845,403
Gross margin	$	3,376,848	$	2,260,472
Gross margin %		33.0%		33.0%
Operating income	$	1,716,431	$	854,165
Operating margin %		16.7%		12.5%

Specialty Chemical revenues increased $3,404,335 or 49.7% in 2003 compared to 2002. Sales in this segment are significantly influenced by drilling and well stimulation activity, and this increase is primarily attributable to a 31% increase in drilling activity in 2003 compared to 2002, as well as market penetration in the U.S., Canada and Mexico. This segment has increased its customer base 44% in 2003. Revenues related to our environmental friendly chemicals in the U.S. have grown from $303,302 in 2002 to $1,197,551 in 2003, a 295% increase.

The gross margin in this segment was 33.0% for both 2003 and 2002. Increased sales of higher margin products and selected product price increases in 2003 offset higher product costs from product purchase premiums associated with a related party procurement arrangement. Due to cash constraints, CESI entered into an agreement with a related company for the purchase of raw materials of $500,000 under deferred payment terms and a percentage markup over the suppliers cost. This added cost impacted gross margins 1.0% for 2003. This purchase arrangement was terminated in the third quarter of 2003, thus eliminating any future impact on gross margins.

Operating income increased $862,266 or 100.9%, in 2003 compared to 2002, primarily as a result of a significant increase in revenues and gross margins year over year. In addition, operating income margin percentage increased from 12.5% of revenues in 2002 to 16.7% in 2003. This is a significant increase and reflects this segment s operating margin leverage from revenue growth. SG&A and other costs of operations decreased to 12.9% of revenue for 2003 as compared to 15.1% for 2002.

Facility Construction and Management

	For the Years Ended December 31, 2003		2002	
Revenues	$	1,669,612	$	1,801,439
Gross margin	$	754,759	$	763,960
Gross margin %		45.2%		42.4%
Operating income	$	106,095	$	14,851
Operating margin %		6.4%		0.1%

The Equipment Specialties reporting unit, which designed, manufactured and rebuilt specialized cementing and stimulation equipment, including heavy vehicles used for pressure pumping, blending and bulk material transport was discontinued and the assets were sold in the third quarter of 2003. The remaining operations in this segment consist of the Material Translogistics, Inc. (MTI) reporting unit which designs, constructs and manages automated bulk material handling and loading facilities for oilfield service companies. Our business in this segment has principally revolved around one customer with plans to diversify the customer base for the segment in the 2004. The segment comparative financial information above relates only to the MTI reporting unit.

Facility Construction and Management revenues decreased 7.3% between reporting periods due to a decrease in bulk material handling facility construction revenues. Contract awards for bulk material handling facilities have declined significantly over the past eighteen months due to a lack of customer capital spending and working capital limitations at Flotek Industries, Inc. Working capital limitations shifted some customer projects to a project management basis versus lump sum contract which reduced revenue and gross margins. Revenues for the material transload facility at Raceland, Louisiana were $409,827 or 69.1% higher in 2003 compared to 2002. The facility operated the entire year in 2003 compared to only six months of operation in 2002.

Gross margin percentage increased from 42.4% of revenues in 2002 to 45.2% in 2003. This improvement was essentially due to product mix. Gross margin contributed by the material transload facility at Raceland, Louisiana was 53.8% higher than margins contributed by the bulk material facility design and construction portion of this segment. Gross margin for the bulk material design and construction portion actually declined between 2003 compared to 2002 due to a $541,654 decrease in revenues related to lower margin construction projects due to cash flow constraints.

Operating income increased $91,244 in 2003 compared to 2002. This significant improvement came from the bulk material facility design and construction operation which increased its operating income between reporting periods $113,594. This increase was due to reduction of SG&A costs as a result of reduced business.

The Raceland transload facility operating income was essentially flat between years even though the facility operated six more months in 2003 compared to 2002 due to higher SG&A costs and a full year of facility depreciation offsetting a higher gross margin.

__Downhole Equipment__

	For the Years Ended December 31, 2003		2002	
Revenues	$	2,925,081	$	2,694,171
Gross margin	$	1,448,733	$	1,187,901
Gross margin %		49.5%		44.1%
Operating income (loss)	$	(5,153,253)	$	(1,687,606)
Operating margin %		(176.2)%		(62.6)%

Downhole Equipment revenues increased $230,910 or 8.6% in 2003 compared to 2002. This increase is due to increased sales for the Turbeco line of casing centralizers. The Petrovalve line of downhole pump component sales decreased $1,300,000 in 2003 compared to 2002. We had insignificant sales to our customer in Venezuela in 2003 compared to sales of $1,227,000 in 2002. Sales to our Venezuela customer, PDVSA, ceased after April 2002 due to political unrest in that country. In addition, the customer did not take delivery of these products sold in 2002 from our agent. At December 31, 2003, we reversed the $1,227,000 of accounts receivable and the associated reserve for doubtful accounts, for $878,000, and recorded the inventory as finished goods with a carrying value of $350,000. The purchase liability of $1,227,000 to our agent associated with the reversed sale has not been canceled. Based on forecasts by the end user we anticipate the resale of this inventory beginning in the first half of 2004.

Turbeco s revenues have increased dramatically due to the 31% increase in drilling activity in the US during 2003 compared to 2002. Turbeco has also penetrated the market by expanding its customer base 59%.

Gross margin percentage increased from 44.1% of revenues in 2002 to 49.5% in 2003. This increase is due to the Turbeco line of casing centralizers. This reporting unit has contributed 98.0% of the gross margin for this reporting segment in 2003 compared to 31.7% in 2002 at significantly improved margins over 2002. This margin improvement is due to better pricing for the product, increased volume and the sale of previously reserved excess and obsolete inventory. The Petrovalve line of downhole pump components did not contribute significantly to the operating results for this segment in 2003 due to a lack of large sales to international customers. We anticipate that international and U.S. sales activity for Petrovalve will increase and gross margins will improve for 2004.

Operating loss increased to ($5,153,253) in 2003 compared to a loss of ($1,687,606) in 2002. This was primarily due to the goodwill impairment loss for Petrovalve of $5,120,633 recorded in 2003 compared to $600,000 of impairment recorded for Petrovalve in 2002. As of December 31, 2003 all Petrovalve goodwill has been impaired and fully offset from the balance sheet. The Turbeco reporting unit does not have any recorded goodwill.

SG&A expenses decreased $830,791 or 38.1% for this segment, between periods, due to the non repeating allowance for doubtful accounts for $878,000 recorded in 2002 as a result of the inability to collect the $1,227,000 receivable from our agent in Venezuela..

Capital Resources and Liquidity

During 2003, the Company produced a loss from continuing operations of ($5,680,680) and had positive cash flow from continuing operations of $1,048,924. The loss from continuing operations is the result of goodwill impairment, higher depreciation, an operating loss for the Petrovalve line of downhole pump valves and higher interest costs during 2003 compared to 2002. All segments showed improvements in operating income this year versus 2002, excluding the goodwill impairment of $5,120,633 for the Petrovalve reporting unit. The positive cash flow from continuing operations is a result of minimal working capital requirements to grow operations in 2003 primarily for the Specialty Chemical segment and the Turbeco reporting unit which is part of the Downhole Equipment segment.

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As of December 31, 2003, net working capital was a negative ($5,248,186) resulting in a current ratio of .43 to 1. Accounts receivable have decreased slightly due to the net $350,000 reversal of Petrovalve accounts receivable associated with prior sales to Venezuela, which was almost entirely offset by higher sales activity for the Turbeco reporting unit. In addition, amounts due to related parties have increased $480,259 during 2003 primarily due to an agreement between CESI Chemical (CESI), a Flotek Industries, Inc. company, and Stimulation Chemicals, LLC (SCL), owned by two directors as well as principal stockholders of the Company, for the purchase of various raw materials from CESI chemical suppliers under deferred payment terms.

Cash and cash equivalents are $0.00 at December 31, 2003, an amount considered insufficient for continuing operations. As discussed in Notes 10, 11 and 14 of the Notes to Consolidated Financial Statements, several short-term financing arrangements have been made to fund the Company s working capital requirements.

The Company completed the sale of assets of its Equipment Specialties (ESI) business unit to SEM for approximately $225,000 in 2003. The proceeds from the ESI sale were cash of $60,000, assumption of various liabilities totaling $88,425 associated with work-in-process inventory assumed by SEM and three installment payments totaling $76,575 payable monthly beginning September 30, 2003. ESI owed Oklahoma Facilities, LLC (Facilities) $74,500 of past due rent. This amount plus the $10,000 of rent due for August 2003 was settled by ESI to Facilities by assigning the three installments mentioned above to Facilities and paying the balance in cash. The $60,000 cash was used to pay down a note payable to the bank to secure release of lien for assets sold to SEM.

In addition, as a result of this asset sale and business transfer to SEM, effective August 1, 2003, ESI assigned its remaining lease obligation with Facilities to SEM, thus eliminating any future liability for the capital lease obligation. To effect this assignment, the Company agreed to pay Facilities an additional $91,000 of rent for the 17 month rental period beginning March 1, 2002 and ending July 31, 2003 in 6 equal installments beginning November 15, 2003. As of December 31, 2003, Facilities is owed $30,333 in delinquent payments for this obligation which has not been paid as of this filing. In addition, ESI assigned its U.S. and foreign rights to the pending Mobile Blending Apparatus patent to SEM.

Sales to PDVSA virtually ceased after April 2002, due to political unrest in that country. In addition, the customer did not take delivery of Petrovalve downhole pump products from our agent. At December 31, 2003, we reversed the $1,227,000 of accounts receivable, associated with sales recorded in the first half of 2002, and the associated reserve for doubtful accounts, for $878,000, and recorded the inventory as finished goods. Based on forecasts by the end user we anticipate the resale of this inventory beginning in the first half of 2004.

Accounts payable and accrued expenses increased $1,028,340 during 2003. This increase is primarily due to increased payables associated with litigation, increased trade payables from a higher level of business activity and accrued liabilities associated with the discontinued operations of the ESI business unit.

A 125,000 share stock grant was awarded to Mr. Jerry D. Dumas, Sr., Chairman and CEO of the Company on April 3, 2003, resulting in $75,000 of compensation expense.

During 2003, the Company issued 875,000 shares of its common stock in a private offering to accredited investors in exchange for $525,000 of subscription proceeds, which was paid by the tender to the Company of $525,000 in cash. Proceeds of $150,000 of the total $525,000 subscription proceeds were provided from two directors of the company, one of which is considered to be a principal shareholder of the company.

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In January, 2004, the Company issued 133,334 of its common stock in a private offering to accredited investors in exchange for $100,000 of subscription proceeds, which was paid by the tender to the Company of $100,000 of cash.

The Company borrowed $359,001 in 2003 under its line of credit arrangements, including an approximate $200,000 refinance of the construction loan for the MTI transload facility in Raceland, Louisiana. As of December 31, 2003, the Company had not paid principal and interest payments associated with the construction loan in the amount of $16,369 but was subsequently paid in January 2004.

On February 24, 2003, the Company entered into a forbearance agreement with two stockholders of acquired businesses extending $100,000 each of principal payments due, under the original promissory notes, on January 22, 2003 until June 30, 2003 and September 30, 2003. On February 24, 2003 and again on July 28, 2003, the forbearance agreements were modified to defer the $100,000 payment due June 30, 2003 to on or before December 31, 2003 and the $100,000 payment due September 30, 2003 to January 22, 2004, with no interest penalty. The interest at 9% under the terms of the original note continues to be payable quarterly. In the event that principal payments are not made when due, a penalty of 5.25% of the outstanding unpaid principal will be assessed and in addition, interest will default to a rate of 12% per annum, until past due amounts are paid.

On December 31, 2003, the July 28, 2003 forbearance agreements were modified to defer the $100,000 payment due on or before December 31, 2003, and the $100,000 payment due January 22, 2004, to June 30, 2004, with no interest penalty. All other due dates for payments set forth in the Promissory Notes are extended one (1) year from the original due date specified in the Promissory Notes.

On September 30, 2003, the Company s primary lending institution restructured the revolving lines of credit secured by accounts receivable and inventory (the borrowing base). The revolving lines were reduced from a maximum borrowing of $3,023,201 to $2,250,948 to align this debt with the Company s reduced borrowing base. The borrowing base has declined during 2003 due to the sale of assets associated with the discontinued operations of ESI. In addition, the term of the revolving line was extended 11 months to August 30, 2004. As of December 31, 2003, the company had not paid interest due on the revolving line of credit in the amount of $15,475. This interest was subsequently paid in January 2004.

On July 25, 2002, the Company borrowed $500,000 under a promissory note from Facilities. An officer, who is also a director and principal shareholder of the Company, has a minority investment interest in and is an officer of Facilities. The note was amended as of July 31, 2003. The majority of the note is secured by an account receivable from our agent in Venezuela. This invoice has been reversed from trade accounts receivable as of December 31, 2003; however, the purchase liability of $1,277,000 to our agent associated with the reversed sale has not been cancelled. The note requires that interest in arrears of $26,000 as of July 31, 2003, be paid as of September 1, 2003, and that interest only payments be made monthly thereafter. The note is due upon the earlier of collection of the account receivable or August 1, 2004. As of December 31, 2003, the Company was delinquent in interest payments to Facilities in the amount of $10,222. Delinquent payments now total $17,040 as of this filing. The Company has not been notified of default by Facilities. The unpaid balance at December 31, 2003 is recorded in trade payables.

The Company made principal payments of $745,937 during 2003. The Company has estimated minimum debt service payments in 2004 of $5,659,696. This includes minimum principal payments on Related Party indebtedness, Notes Payable and Long-Term Debt as discussed in Notes 10, 11 and 14 of the Notes to Consolidated Financial Statements.

Capital expenditures in 2003 totaled $575,260 of which approximately $89,000 was financed through various capital lease arrangements. These expenditures were primarily for additional improvements at the MTI transload facility in Raceland, Louisiana, and the purchase of a new financial software package and related hardware at a cost of $357,000. Capital expenditures budgeted for 2004 are approximately $470,000.

The Company believes its continuing operations are capable of generating cash flow to meet most of its debt service obligations under current market conditions. However, if a market downturn occurred it would be very difficult to meet debt service obligations without increased sales. While the market we serve continues to steadily improve, as well as our overall cash flow position, sufficient cash flow to grow the business is not readily available without the sale of debt or equity securities. The Company has sustained accumulated operating losses since inception, has used substantial amounts of working capital and has a significant debt load; consequently, there is substantial doubt about the Company s ability to continue as a going concern. In addition, there can be no assurance that the Company can raise additional capital through the sale of debt or equity.

It is uncertain that we will be able to grow our business to the projected 2004 plan levels and/or obtain additional equity or debt financing. Accordingly, investors are advised that the Company faces significant financial risks in the near future as we attempt to meet these challenges.

Forward-Looking Statements

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

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Item 7. ***Financial Statements***

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying Consolidated Balance Sheets of Flotek Industries Inc. and Subsidiaries as of December 31, 2003 and 2002, and the related Consolidated Statements of Operations, Changes in Stockholders Equity and Cash Flows for the years then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Flotek Industries Inc. and Subsidiaries as of December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that Flotek Industries Inc. and Subsidiaries will continue as a going concern. As more fully described in Note 2, the Company has incurred accumulated operating losses and has a working capital deficit from operations. These conditions raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

WEINSTEIN SPIRA & COMPANY, P.C.
Houston, Texas

March 18, 2004

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FLOTEK INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS

	For the Years Ended December 31, 2003	2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ --	$ --
Accounts receivable, less allowance of $31,102 and $900,067 as of December 31, 2003 and 2002, respectively	1,977,926	2,034,381
Inventories, net	1,905,070	1,553,230
Other current assets	113,326	198,055
Assets held for sale from discontinued operations	--	1,958,610
Total current assets	3,996,322	5,744,276
Property, plant and equipment, net	2,644,860	2,692,059
Goodwill, net	7,145,713	12,266,346
Patents and other intangible assets, net	183,443	237,421
Total assets	$ 13,970,338	$ 20,940,102
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	$ 3,482,325	$ 3,532,924
Current portion of long-term debt	1,596,221	977,695
Accounts payable	2,961,805	2,464,499
Accrued liabilities	623,006	91,971
Amounts due to related parties	581,151	100,892
Liabilities associated with discontinued operations	--	1,388,261
Total current liabilities	9,244,508	8,556,242
Long-term debt	2,165,726	3,039,649
Stockholders' equity:		
Preferred stock, $.0001 par value, 100,000 shares authorized, no shares issued	--	--
Common stock, $.0001 par value, 20,000,000 shares authorized, 6,521,670 and 5,521,670 shares issued and outstanding for 2003 and 2002, respectively	652	552
Additional paid-in capital	16,973,056	16,373,156
Accumulated deficit	(14,413,604)	(7,029,497)
Total stockholders' equity	2,560,104	9,344,211
Total liabilities and stockholders' equity	$ 13,970,338	$ 20,940,102

	For the Years Ended December 31,	

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

FLOTEK INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31, 2003	2002
Revenues	$ 14,844,431	$ 11,341,012
Cost of sales	9,264,091	7,128,680
Gross margin	5,580,340	4,212,332
Expenses:		
Selling, general and administrative	4,788,749	5,595,600
Goodwill impairment	5,120,633	600,000
Depreciation and amortization	713,531	518,003
Research and development	46,654	111,674
Total expenses	10,669,567	6,825,277
Loss from operations	(5,089,227)	(2,612,945)
Other income (expense):		
Interest expense	(618,438)	(504,200)
Other income (expense), net	26,985	(321)
Total other income (expense)	(591,453)	(504,521)
Loss from continuing operations	(5,680,680)	(3,117,466)
Loss from discontinued operations	(545,592)	(1,892,621)
Loss on disposal of discontinued operations	(1,157,835)	--
Cumulative effect of change in accounting principle -- discontinued operations	--	(452,745)
Net loss	$ (7,384,107)	$ (5,462,832)
Basic and diluted loss per common share from:		
Continuing operations	$ (0.95)	$ (0.63)
Discontinued operations	(0.09)	(0.38)
Disposal of discontinued operations	(0.19)	--
Cumulative effect of change in accounting principle -- discontinued operations	--	(0.09)
Basic and diluted loss per common share	$ (1.23)	$ (1.10)

	For the Years Ended December 31,	
Weighted average common shares outstanding	5,976,237	4,967,658

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

FLOTEK INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulatd Deficit	Total
Balance at December 31, 2001	4,850,696	485	15,572,886	(1,566,665)	14,006,706
Common stock issued in acquisitions	60,116	6	189,460	--	189,466
Common stock issued for cash	610,858	61	610,810	--	610,871
Net loss	--	--	--	(5,462,832)	(5,462,832)
Balance at December 31, 2002	5,521,670	552	16,373,156	(7,029,497)	9,344,211
Common stock issued for compensation	125,000	12	74,988	--	75,000
Common stock issued for cash	875,000	88	524,912	--	525,000
Net loss	--	--	--	(7,384,107)	(7,384,107)
Balance at December 31, 2003	6,521,670	652	16,973,056	(14,413,604)	2,560,104

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

FLOTEK INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31, 2003	2002
Cash flows from operating activities:		
Loss from continuing operations	$ (5,680,680)	$ (3,117,466)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	713,531	518,003
Goodwill impairment	5,120,633	600,000
Stock compensation expense	75,000	--
Bad debt expense	12,943	878,000
Loss on sale of fixed assets	2,756	15,579
(Increase) decrease in working capital:		
Accounts receivable	43,512	(691,563)
Inventories and work in progress	(351,840)	578,533

	For the Years Ended December 31,	
Other current assets	84,729	(98,773)
Accounts payable and accrued liabilities	1,028,340	(363,382)
Net cash provided by (used in) continuing operations	1,048,924	(1,681,069)
Net cash used in discontinued operations	(1,086,181)	(444,813)
Net cash used in operating activities	(37,257)	(2,125,882)
Cash flows from investing activities:		
Acquisition of subsidiaries, net	--	(122,250)
Proceeds from sale of assets	8,924	111,312
Capital expenditures	(575,260)	(1,313,709)
Net cash used in investing activities from continuing operations	(566,337)	(1,324,647)
Net cash used in investing activities from discontinued operations	--	(159,812)
Net cash used in investing activities	(566,337)	(1,484,459)
Cash flows from financing activities:		
Issuance of stock for cash	525,000	610,871
Proceeds from borrowings	359,001	3,035,055
Repayments of indebtedness	(664,997)	(902,433)
Payments to related parties	(80,940)	(88,060)
Proceeds from related parties	561,199	144,808
Net cash provided by financing activities from continuing operations	699,263	2,800,241
Net cash provided by (used in) financing activities from discontinued operations	(95,670)	569,662
Net cash provided by financing activities	603,593	3,369,903
Net decrease in cash and cash equivalents	--	(240,438)
Cash and cash equivalents at beginning of period	--	240,438
Cash and cash equivalents at end of period	$ --	$ --

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FLOTEK INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

	For the Years Ended December 31, 2003	2002
Supplemental schedule of noncash investing and financing activities:		
Capital expenditures incurred but not paid at year end	$ 38,118	$ 32,000
Acquisition of subsidiaries:		
Assets (liabilities) acquired:		
Patents and other intangibles	$ --	$ 104,466
Goodwill	--	207,250
	--	311,716
Common stock issued	--	(189,466)
Net cash paid to sellers	$ --	$ 122,250

Supplemental disclosures of cash flow information:

	For the Years Ended December 31,	
Cash paid for interest	$ 564,165	$ 639,918

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

FLOTEK INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Organization and Summary of Significant Accounting Policies

Flotek Industries, Inc. and subsidiaries (the Company or Flotek) was originally incorporated under the laws of the Province of British Columbia on May 17, 1985. On October 23, 2001, the Company moved its corporate domicile to Delaware and completed a reverse stock split of 120 to 1. On October 31, 2001, the Company completed a merger (the Merger) with Chemical & Equipment Specialties, Inc. (CESI). The Merger has been accounted for as a reverse acquisition using the purchase method of accounting. In the Merger, the shareholders of the acquired company, CESI, received the majority of the voting interests in the surviving consolidated company. Accordingly, CESI was deemed to be the acquiring company for financial reporting purposes.

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

The Specialty Chemicals segment develops, manufactures, packages and sells chemicals used by other oilfield service companies in oil and gas well cementing, stimulation and production.

The Facility Construction and Management segment designs, constructs and manages automated bulk material handling and loading facilities for other o