

BOOTS & COOTS INTERNATIONAL WELL CONTROL INC
Form 10-Q
August 19, 2002

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

FORM 10-Q

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

FOR THE QUARTER ENDED JUNE 30, 2002

COMMISSION FILE NUMBER 1-13817

BOOTS & COOTS INTERNATIONAL
WELL CONTROL, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

11-2908692
(I.R.S. Employer
Identification No.)

777 POST OAK BOULEVARD, SUITE 800
HOUSTON, TEXAS
(Address of principal executive offices)

77056
(Zip Code)

(713) 621-7911
Registrant's telephone number, including area code

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 ☐

The number of shares of the Registrant's Common Stock, par value \$.00001 per share, outstanding at August 16, 2002, was 44,816,723.

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BOOTS & COOTS INTERNATIONAL WELL CONTROL, INC.

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(UNAUDITED)

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BOOTS & COOTS INTERNATIONAL WELL CONTROL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS		DECEMBER 31, 2001	
		-----	-----
CURRENT ASSETS:			
Cash.	\$	303,000	\$
Receivables - net		3,557,000	
Restricted assets		1,353,000	
Inventories		138,000	
Assets of discontinued operations		6,756,000	
Prepaid expenses and other current assets		843,000	
		-----	-----
Total current assets.		12,950,000	
		-----	-----
PROPERTY AND EQUIPMENT - net.		4,613,000	
OTHER ASSETS:			
Deposits and other - net.		191,000	
		-----	-----
Total assets.	\$	17,754,000	\$
		=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)			
CURRENT LIABILITIES:			
Short term debt and current maturities of long-term debt and notes payable.	\$	1,025,000	\$
Accounts payable.		1,155,000	

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Accrued liabilities	4,481,000	
Liabilities of discontinued operations.	3,004,000	
	-----	----
Total current liabilities	9,665,000	
	-----	----
LONG-TERM DEBT AND NOTES PAYABLE - net of current maturities.	12,520,000	
Total liabilities	22,185,000	
	-----	----
COMMITMENTS AND CONTINGENCIES		-
STOCKHOLDERS' EQUITY (DEFICIT):		
Preferred stock (\$.00001 par, 5,000,000 shares authorized, 327,123 and 319,563 shares issued and outstanding at December 31, 2001 and June 30, 2002, respectively).		-
Common stock (\$.00001 par, 125,000,000 shares authorized, 41,442,285 and 44,245,256 shares issued and outstanding at December 31, 2001 and June 30, 2002, respectively).		-
Additional paid-in capital.	56,659,000	
Accumulated deficit	(61,090,000)	
	-----	----
Total stockholders' equity (deficit).	(4,431,000)	
	-----	----
Total liabilities and stockholders' equity (deficit). . . .	\$ 17,754,000	\$
	=====	=====

See accompanying notes to condensed consolidated financial statements.

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BOOTS & COOTS INTERNATIONAL WELL CONTROL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	THREE MONTHS ENDED JUNE 30,		
	2001	2002	
	-----	-----	----
REVENUES.	\$ 5,087,000	\$ 3,984,000	\$ 9,
COSTS AND EXPENSES:			
Cost of sales	809,000	1,890,000	1,
Operating expenses.	1,177,000	1,747,000	2,
Selling, general and administrative	748,000	734,000	1,
Depreciation and amortization	397,000	288,000	
	-----	-----	----
	3,131,000	4,659,000	5,
	-----	-----	----
OPERATING INCOME (LOSS)	1,956,000	(675,000)	3,
INTEREST EXPENSE (INCOME) AND OTHER	531,000	905,000	

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INCOME (LOSS) FROM CONTINUED OPERATIONS, before income taxes.	1,425,000	(1,580,000)	2,
INCOME TAX EXPENSE.	-	158,000	
INCOME (LOSS) FROM CONTINUING OPERATIONS.	1,425,000	(1,738,000)	2,
Loss from discontinued operations net of income taxes of zero.	(449,000)	(5,422,000)	(1,
NET INCOME (LOSS)	976,000	(7,160,000)	1,
PREFERRED DIVIDEND REQUIREMENTS AND ACCRETIONS.	694,000	762,000	1,
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ 282,000	\$ (7,922,000)	\$
Basic Earnings (Loss) per Common Share:			
Continuing Operations	\$ 0.02	\$ (0.06)	\$
Discontinued Operations	\$ (0.01)	\$ (0.13)	\$
Net Income (Loss)	\$ 0.01	\$ (0.19)	\$
Weighted Average Common Shares Outstanding - Basic.	40,522,000	42,180,000	39,
Diluted Earnings (Loss) per Common Share:			
Continuing Operations	\$ 0.02	\$ (0.06)	\$
Discontinued Operations	\$ (0.01)	\$ (0.13)	\$
Net Income (Loss)	\$ 0.01	\$ (0.19)	\$
Weighted Average Common Shares Outstanding - Diluted.	41,344,000	42,180,000	40,

See accompanying notes to condensed consolidated financial statements.

BOOTS & COOTS INTERNATIONAL WELL CONTROL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
SIX MONTHS ENDED JUNE 30, 2002
(UNAUDITED)

PREFERRED STOCK	COMMON STOCK	ADDITIONAL PAID-IN	ACCUMULATED DEFICIT
-----	-----		

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	SHARES	AMOUNT	SHARES	AMOUNT	CAPITAL	DE
	-----	-----	-----	-----	-----	-----
BALANCES, December 31, 2001	327,123	\$ -	41,442,285	\$ -	\$56,659,000	\$(61,
Warrant discount						
Accretion	-	-	-	-	26,000	
Preferred stock						
dividends accrued	13,024	-	-	-	1,566,000	(1,
Preferred stock converted to						
common.	(20,022)	-	2,669,637	-	-	
Preferred stock cancelled	(750)	-	-	-	-	
Preferred stock issued for						
settlements	188	-	-	-	19,000	
Common stock issued	-	-	133,334	-	49,000	
Net loss.	-	-	-	-	-	(8,
	-----	-----	-----	-----	-----	-----
BALANCES, June 30, 2002.	319,563	\$ -	44,245,256	\$ -	\$58,319,000	\$(71,
	=====	=====	=====	=====	=====	=====

See accompanying notes to condensed consolidated financial statements.

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BOOTS & COOTS INTERNATIONAL WELL CONTROL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	SIX MONTHS ENDED JUNE 30,	
	-----	-----
	2001	2002
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,743,000	\$(8,990,000)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization.	661,000	574,000
Bad debt expense	286,000	-
Loss on sale of assets	-	45,000
Equity issued for services and settlements	54,000	-
Loss on reserve for discontinued operations.	-	3,495,000
	-----	-----
Net cash provided by (used in) operating activities before changes in operating assets and liabilities:.	2,744,000	(4,876,000)
Receivables.	(3,825,000)	234,000
Restricted Assets.	-	448,000
Inventories.	-	138,000
Prepaid expenses and other current assets.	118,000	554,000
Net assets/liabilities of discontinued operations.	2,000	1,255,000
Deferred financing costs and other assets.	-	124,000
Accounts payable and accrued liabilities	503,000	1,170,000
	-----	-----
Net cash used in operating activities.	(458,000)	(953,000)
	-----	-----

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CASH FLOWS FROM INVESTING ACTIVITIES:

Property and equipment additions	(4,000)	(99,000)
Proceeds from sale of property and equipment	1,000	42,000
	-----	-----
Net cash used in investing activities.	(3,000)	(57,000)
	-----	-----

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from pledging arrangement	-	969,000
	-----	-----
Net cash provided by financing activities.	-	969,000
	-----	-----
Net decrease in cash and cash equivalents.	(461,000)	(41,000)

CASH AND CASH EQUIVALENTS, Beginning of Period.	1,409,000	303,000
	-----	-----
CASH AND CASH EQUIVALENTS, End of Period.	\$ 948,000	\$ 262,000
	=====	=====

SUPPLEMENTAL CASH FLOW DISCLOSURES:

Cash paid for interest	\$ 6,000	\$ 21,000
Cash paid for income taxes	-	-

NON-CASH INVESTING AND FINANCING ACTIVITIES:

Transaction costs of convertible debt financing.	101,000	-
Common stock issued for services and settlements	575,000	49,000
Stock and warrant accretions	27,000	26,000
Preferred stock dividends accrued	1,401,000	1,566,000

See accompanying notes to condensed consolidated financial statements.

BOOTS & COOTS INTERNATIONAL WELL CONTROL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS SIX MONTHS ENDED JUNE 30, 2002 (UNAUDITED)

A. GOING CONCERN

During the first half of 2002, demand for the Company's services declined as overall industry conditions weakened. In response, the Company discontinued certain of its operations resulting in a loss from discontinued operations of \$7.2 million. The Company's continuing operations incurred a \$1.8 million loss for the six months ended June 30, 2002. These losses further impair the Company's liquidity position and hamper the Company's capacity to pay vendors on a timely basis, obtain materials and supplies, and otherwise conduct effective or efficient operations. To date, however, the Company has not been limited in its ability to respond to critical well events.

The Company continues to experience severe working capital constraints. As of June 30, 2002, the Company's current assets totaled approximately \$6,721,000 and current liabilities were \$11,617,000, resulting in a net working capital deficit of approximately \$4,896,000 (compared to a beginning year working capital of \$3,285,000). The Company's highly liquid current assets, represented by cash of \$262,000 and receivables and restricted assets of \$4,228,000 were collectively \$7,127,000 less than the amount of current liabilities at June 30, 2002 (compared to a beginning year deficit of \$4,452,000). The Company is actively exploring new sources of financing, including the establishment of new

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credit facilities and the issuance of debt and/or equity securities. During April and May 2002, the Company entered into loan participation agreements with certain parties under which it borrowed an additional \$1,000,000 under the Senior Secured Loan Facility. The participation agreements have an initial maturity of 90 days, which have been extended for an additional 90 days at the Company's option.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. However, the uncertainties surrounding the sufficiency and timing of its future cash flows and the lack of firm commitments for additional capital raise substantial doubt about the ability of the Company to continue as a going concern. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

B. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. They do not include all information and notes required by generally accepted accounting principles for complete annual financial statements. The accompanying consolidated financial statements include all adjustments, including normal recurring accruals, which, in the opinion of management, are necessary in order to make the consolidated financial statements not be misleading. The unaudited consolidated financial statements and notes thereto and the other financial information contained in this report should be read in conjunction with the audited financial statements and notes in the Company's annual report on Form 10-K for the year ended December 31, 2001, and those reports filed previously with the Securities and Exchange Commission ("SEC"). The results of operations for the three month and six month periods ended June 30, 2001 and 2002 are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made to the prior periods to conform to the current presentation.

C. RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." Under SFAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Separable intangible assets that are not deemed to have indefinite lives will continue to be amortized over their useful lives (with no maximum life). The amortization provisions of SFAS No. 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible assets attributable to acquisitions prior to July 1, 2001, the amortization provisions of SFAS No. 142 were effective January 1, 2002. The Company adopted SFAS No. 142, on January 1, 2002 and applied this accounting method in determining the losses from operations at June 30, 2002.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" which covers all legally enforceable obligations associated with the retirement of tangible long-lived assets and provides the accounting and reporting requirements for such obligations. SFAS No. 143 is effective for the Company beginning January 1, 2003. Management has yet to determine the impact that the adoption of SFAS No. 143 will have on the

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Company's consolidated financial statements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". SFAS No. 144 establishes a single accounting method for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and extends the presentation of discontinued operations to include more disposal transactions. SFAS No. 144 also requires that an impairment loss be recognized for assets held-for-use when the carrying amount of an asset is not recoverable. The carrying amount of an asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset, excluding interest charges. Estimates of future cash flows used to test the recoverability of a long-lived asset must incorporate the entity's own assumptions about its use of the asset and must factor in all available evidence. The Company adopted SFAS No. 144, on January 1, 2002 and applied this accounting method in determining the losses from operations at June 30, 2002.

In April 2002, the FASB issued SFAS No. 145, "Rescission of SFAS No. 4, 44 and 64, Amendment of SFAS Statement No. 13, and Technical Corrections." This statement rescinds the following statement of SFAS 4, "Reporting Gains and Losses from Extinguishment of Debt," and its amendment SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking Fund Requirements," as well as, SFAS No. 44, "Accounting for Intangible Assets of Motor Carriers". The statement also amends SFAS No. 13, "Accounting for Leases", by eliminating an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. Management does not believe that this statement will have a material impact on the results of operations or financial conditions of the Company.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", which nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)." Under the terms of SFAS No. 146, the statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than at the date an entity commits to an exit plan. The effective date of the statement is for exit or disposal activities initiated after December 31, 2002 with early application encouraged. The Company elected early adoption for its current period disposal activities and the adoption had no significant impact on the results of operation and financial position of the Company.

D. DISCONTINUED OPERATIONS

On September 28, 2000, the Company announced that it closed the sale of the assets of the Baylor Company and its subsidiaries to National Oilwell, Inc. The proceeds from the sale were approximately \$29,000,000 in cash. Comerica Bank-Texas, the Company's primary senior secured lender at the time, was paid in full as a component of the transaction. For the six months ended June 30, 2001, the Company recorded \$300,000 of gain due to the subsequent collection of receivables that were over 90 days old at the time of the sale.

On June 30, 2002, the Company made the decision and formalized a plan to sell the assets of its Special Services and Abasco operations. The anticipated sales proceeds will be approximately \$700,000. The operations of these two companies are reflected as discontinued operations on the condensed consolidated statements of operations and as assets and liabilities of discontinued operations on the condensed consolidated balance sheets. A non-cash charge of

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\$3,495,000 is included in the condensed consolidated financial statements to write down the net assets of these operations to their estimated fair market value less cost of sale.

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The following represents a condensed detail of assets and liabilities adjusted for write downs:

	DECEMBER 31, 2001	JU (UNA
	-----	----
Cash	\$ 6,000	\$
Receivables - net.	1,637,000	
Restricted assets.	1,386,000	
Inventories.	283,000	
Property, plant and equipment - net.	1,599,000	
Goodwill - net	1,845,000	
	-----	----
Total assets	\$ 6,756,000	\$ 1
	=====	=====
Short term debt and current maturities of long-term debt and notes payable	\$ 1,178,000	\$
Accounts payable	1,708,000	1
Accrued liabilities.	118,000	
	-----	----
Total liabilities.	\$ 3,004,000	\$ 2
	=====	=====

Charges to income related to the six month period ended June 30, 2002:

Goodwill write down	\$1,845,000
Property, plant and equipment write down to fair value	836,000
Inventory write down to fair value	65,000
Future lease costs, net of estimated sublease proceeds	486,000
Severance costs	143,000
Other accruals	120,000

Six months loss from operations	3,495,000
	3,692,000

Total charge to discontinued operations	\$7,187,000
	=====

E. LONG-TERM DEBT AND NOTES PAYABLE AND OTHER FINANCINGS

The Subordinated Note Restructuring Agreement between the Company and The Prudential Insurance Company of America contains customary affirmative and negative covenants, including that the Company not permit the ratio of its total

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debt to earnings before interest, taxes, depreciation and amortization (EBITDA) for the trailing twelve months to be greater than 3.25 to 1 or the ratio of its EBITDA to consolidated interest expense to be less than 2.9 to 1. On March 29, 2002 and on June 29, 2002, Prudential agreed to waive compliance with the ratio tests for the twelve months ended March 31, 2002 and June 30 2002, respectively. Significant improvements in the Company's operating performance during the current quarter, or a modification or waiver of the ratio tests, will be required for the Company to regain compliance for the twelve months ended September 30, 2002. The Company does not have a commitment from Prudential that it will modify or waive compliance with these tests in the future.

Prudential also agreed to modifications to the Subordinated Note Restructuring Agreement to accommodate up to \$5 million in borrowings under the KBK facility and an aggregate of \$6 million under the Company's existing senior credit facility or a new senior credit facility. The Company has agreed to pay Prudential a fee of \$100,000 in connection with the waiver of financial covenants required with the recent participations in the existing credit facility (as discussed below and in Note I). This amount has been charged to interest expense for the six months ended June 30, 2002.

On April 9, 2002, the Company entered into a loan participation agreement with certain parties under which it borrowed an additional \$750,000 under its existing Senior Secured Loan Facility with Specialty Finance Fund I, LLC. The effective interest rate of the participation is 11% after taking into account rate adjustment fees. The Company also paid 3% of the borrowed amount in origination fees, paid closing expenses and issued 100,000 shares of common stock to the participation lender at closing. The participation has an initial maturity of 90 days, which may be extended for an additional 90 days at the Company's option. On July 9, 2002, the Company exercised its option to extend the participation 90 days and issued an additional 100,000 shares of common stock to the participation lender.

On May 2, 2002, the Company borrowed \$250,000 under the Senior Secured Loan Facility upon similar terms, and issued 33,334 shares of common stock to the participation lenders at closing. The Company has amended the Senior Secured Loan Facility to reflect these additional participations in the facility. On August 2, 2002, the Company exercised its option to extend the participation 90 days and issued an additional 33,334 shares of common stock to the participation lenders.

F. COMMITMENTS AND CONTINGENCIES

The Company's subsidiary ITS Supply Corporation ("ITS") filed in Corpus Christi, Texas on May 18, 2000, for protection under Chapter 11 of the U.S. Bankruptcy Code. ITS is now proceeding to liquidate its assets and liabilities pursuant to Chapter 7 of Title 11. At the time of the filing, ITS had total liabilities of approximately \$6,900,000 and tangible assets of approximately \$950,000. The Company had an outstanding guaranty on ITS debt upon which a judgment against the Company was entered by a state district court in the amount of approximately \$1,833,000. The judgment was paid in full on August 31, 2001.

On April 27, 2001, in the United States Bankruptcy Court for the Southern District of Texas, the Chapter 7 Trustee in the bankruptcy proceeding of ITS Supply Corporation, the Company's subsidiary, filed a complaint against Comerica Bank-Texas, the Company and various subsidiaries of the Company for a formal accounting of all lockbox transfers that occurred between ITS and Comerica Bank, et al and all intercompany transfers between ITS and the Company and its subsidiaries to determine if any of the transfers are avoidable under Federal or state statutes and seeking repayment to ITS of all such amounts. The Trustee

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asserts that approximately \$400,000 of lockbox transfers and \$3,000,000 of intercompany transfers were made between the parties.

The Company does not believe it is likely that an accounting of the transactions between the parties will demonstrate there is a liability owing by the Company to the ITS Chapter 7 estate. However, there is no assurance that the Company will not be found liable. To provide security to Comerica Bank for any potential claims by the Chapter 7 trustee, the Company has pledged a \$350,000 certificate of deposit in favor of Comerica Bank. This amount has been classified as a restricted asset on the balance sheet as of December 31, 2001 and June 30, 2002.

In September 1999, a lawsuit styled Jerry Don Calicutt, Jr., et al., v. Larry H. Ramming, et al., was filed against the Company, certain of its subsidiaries, Larry H. Ramming, certain other employees of the Company, and several entities affiliated with Larry H. Ramming in the 269th Judicial District Court, Harris County, Texas. The plaintiffs allege various causes of action, including fraud, breach of contract, breach of fiduciary duty and mismanagement relating to the acquisition of stock of a corporation by the name of Emergency Resources International, Inc. ("ERI") by a corporation affiliated with Larry H. Ramming and the circumstances relating to the founding of the Company. In July 2002, the Company agreed to pay \$500,000 in cash in four installments, the last installment being due in January 2003, in partial settlement of the plaintiff's claims against all of the defendants. As to the remaining claims, the defendants have filed motions for summary judgment that have been set for oral argument on August 23, 2002. The Company intends to continue to vigorously defend against the remaining claims.

The Company is involved in or threatened with various other legal proceedings from time to time arising in the ordinary course of business. The Company does not believe that any liabilities resulting from any such proceedings will have a material adverse effect on its operations or financial position.

G. EARNINGS PER SHARE

The weighted average number of shares used to compute basic and diluted earnings per share for the three and six month periods ended June 30, 2001 and 2002, respectively, is illustrated below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2002	2001	2002
Numerator:				
For basic and diluted earnings per share-				
Net Income (Loss) Attributable to Common Shareholders	\$ 282,000	\$ (7,922,000)	\$ 315,000	\$ (10,582,000)
Denominator:				
For basic earnings per share-				
Weighted-average shares	40,522,000	42,180,000	39,051,000	41,811,000
Effect of dilutive securities:				
Preferred stock conversions, stock options and warrants	822,000	-	1,599,000	-
Denominator:				
For diluted earnings per share -				

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Weighted-average shares and
assumed conversions

41,344,000	42,180,000	40,650,000	41,811
=====	=====	=====	=====

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For the three and six months ended June 30, 2002, the Company incurred a loss to common stockholders before consideration of the loss from discontinued operations. At June 30, 2002, the exercise price of the Company's stock options and stock warrants varied from \$0.43 to \$5.00 per share. The Company's convertible securities have conversion prices that range from \$0.75 to \$2.75, or, in certain cases, are based on a percentage of the market price for the Company's common stock. Assuming that the exercise and conversions were made at the lowest price provided under the terms of their agreements, the maximum number of potentially dilutive securities at June 30, 2002 would include: (1) 7,660,000 common shares issuable upon exercise of stock options, (2) 35,533,000 common shares issuable upon exercise of stock purchase warrants, (3) 1,333,000 common shares issuable upon conversion of senior convertible debt, and (4) 37,354,000 common shares issuable upon conversion of convertible preferred stock. The actual number may be substantially less depending on the market price of the Company's common stock at the time of conversion. These securities were not included in the calculation of diluted earnings per share, because to do so would have been antidilutive for the periods presented.

For the three and six months ended June 30, 2001, there were (1) 7,913,000 common shares issuable upon exercise of stock options, (2) 34,226,000 and 33,441,000, respectively, of common shares issuable upon exercise of stock purchase warrants, (3) 1,680,000 common shares issuable upon conversion of senior convertible debt, and (4) 25,508,000 common shares issuable upon conversion of convertible preferred stock that were not included in the computation of earnings per share because to do so would have been antidilutive for the periods presented.

H. BUSINESS SEGMENT INFORMATION

On January 1, 2001, the Company redefined the segments in which it operates as a result of the discontinued operations of ITS and Baylor business operations and further redefined the segments on June 30, 2002, as a result of the decision to discontinue its Abasco and Special Services business operations. The current segments are Prevention and Response. Intercompany transfers between segments were not material. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. For purposes of this presentation, general and corporate expenses have been allocated between segments on a pro rata basis based on revenue. ITS, Baylor, Abasco and Special Services are presented as discontinued operations in the condensed consolidated financial statements and are therefore excluded from the segment information for all periods presented.

The Prevention segment consists of "non-event" services that are designed to reduce the number and severity of critical well events to oil and gas operators. The scope of these services include training, contingency planning, well plan reviews, services associated with the Company's Safeguard programs and services in conjunction with the WELLSURE(R) risk management program. All of these services are designed to significantly reduce the risk of a well blowout or other critical response event.

The Response segment consists of personnel and equipment services provided during an emergency response such as a critical well event or a hazardous material response. These services are designed to minimize response time and damage while maximizing safety. Response revenues typically provide high gross

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profit margins.

Information concerning operations in the two business segments for the three and six months ended June 30, 2001 and 2002 is presented below. General and corporate are included in the calculation of identifiable assets and are included in the Prevention and Response segments.

	PREVENTION	RESPONSE	CONSOLIDATED
	-----	-----	-----
Three Months Ended June 30, 2001:			
Net Operating Revenues	\$ 481,000	\$ 4,606,000	\$ 5,087,000
Operating Income (Loss)	(75,000)	2,031,000	1,956,000
Identifiable Operating Assets	3,114,000	14,640,000	17,754,000
Capital Expenditures	-	2,000	2,000
Depreciation and Amortization	33,000	364,000	397,000
Interest Expense	16,000	93,000	109,000
Three Months Ended June 30, 2002:			
Net Operating Revenues	\$ 2,537,000	\$ 1,447,000	\$ 3,984,000
Operating Income (Loss)	(475,000)	(200,000)	(675,000)
Identifiable Operating Assets	5,775,000	5,029,000	10,784,000
Capital Expenditures	-	61,000	61,000
Depreciation and Amortization	182,000	106,000	288,000
Interest Expense	170,000	120,000	290,000

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	PREVENTION	RESPONSE	CONSOLIDATED
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Six Months Ended June 30, 2001:			
Net Operating Revenues	\$ 1,615,000	\$ 7,595,000	\$ 9,210,000
Operating Income	251,000	3,000,000	3,251,000
Identifiable Operating Assets	3,114,000	14,640,000	17,754,000
Capital Expenditures	-	4,000	4,000
Depreciation and Amortization	102,000	559,000	661,000
Interest Expense	24,000	115,000	139,000
Six Months Ended June 30, 2002:			
Net Operating Revenues	\$ 4,266,000	\$ 3,728,000	\$ 7,994,000
Operating Income (Loss)	(370,000)	(255,000)	(625,000)
Identifiable Operating Assets	5,775,000	5,029,000	10,784,000
Capital Expenditures	-	99,000	99,000
Depreciation and Amortization	291,000	283,000	574,000
Interest Expense	143,000	169,000	312,000

For the three month and six month periods ended June 30, 2001 the Company's revenue from foreign sources included 35% and 20% foreign sales respectively, while the three and six month periods ended June 30, 2002 included 41% and 34%, respectively.

I. SUBSEQUENT EVENTS

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On July 5, 2002, the Company entered into a loan participation agreement with certain parties under which it borrowed an additional \$100,000 under its existing Senior Secured Loan Facility with Specialty Finance Fund I, LLC. The effective interest rate of the participation is 25% after taking into account rate adjustment fees. The Company also paid 3% of the borrowed amount in origination fees, paid closing expenses and issued 130,000 shares of common stock to the participation lender at closing. The participation has a maturity of 90 days.

On July 8, 2002, the Company entered into a loan participation agreement with certain parties under which it borrowed an additional \$200,000 under its existing Senior Secured Loan Facility with Specialty Finance Fund I, LLC. The effective interest rate of the participation is 16% after taking into account rate adjustment fees. The Company also paid 4% of the borrowed amount in origination fees, paid closing expenses and issued 150,000 shares of common stock to the participation lender at closing. The participation has a maturity of 90 days.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Actual results could differ from those projected in any forward-looking statements for the reasons detailed in this report. The forward-looking statements contained herein are made as of the date of this report and the Company assumes no obligation to update such forward-looking statements, or to update the reasons why actual results could differ from those projected in such forward-looking statements. Investors should consult the information set forth from time to time in the Company's reports on Forms 10-K, 10-Q and 8-K, and its Annual Report to Stockholders.

OVERVIEW

On January 1, 2001, the Company redefined the segments that it operates in as a result of the discontinuation of ITS and Baylor, and on June 30, 2002, Abasco and Special Services business operations. All of these operations are presented as a discontinued operation in the consolidated financial statements and therefore are excluded from the segment information for all periods. The current segments are Prevention and Response. Intercompany transfers between segments were not material. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. For purposes of this presentation, selling, general and administrative and corporate expenses have been allocated between segments on a pro rata basis based on revenue. Business segment operating data from continuing operations is presented for purposes of discussion and analysis of operating results.

Most of the Company's operating expenses represent fixed costs for base labor charges, rent and utilities. Consequently, operating expenses increase only slightly as a result of responding to a critical event. In the past, during periods of few critical events, resources dedicated to emergency response were underutilized or, at times, idle, while the fixed costs of operations continued to be incurred, contributing to significant operating losses. To mitigate these consequences, the Company is actively expanding its non-event service capabilities. These services primarily utilize existing personnel resources to maximize utilization with only slight increases in fixed operating costs.

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The Prevention segment consists of "non-event" services that are designed to reduce the number and severity of critical well events to oil and gas operators. These services include training, contingency planning, well plan reviews, services associated with the Company's Safeguard programs and service fees in conjunction with the WELLSURE(R) risk management program. All of these services are designed to significantly reduce the risk of a well blowout or other critical response event.

The Response segment consists of personnel and equipment services provided during an emergency, such as a critical well event or a hazardous material response. The services provided are designed to minimize response time and damage while maximizing safety. Response revenues typically provide high gross profit margins.

AMERICAN STOCK EXCHANGE LISTING

The American Stock Exchange ("AMEX") by letter dated March 15, 2002, required the Company to submit a reasonable plan to regain compliance with AMEX's continued listing standards by December 31, 2002. On April 15, 2002, the Company submitted a plan that included interim milestones that the Company would be required to meet to remain listed. AMEX subsequently notified the Company that its plan had been accepted; however, the Company subsequently submitted an amendment to the plan to take into account, among other things, the Company's recently announced restructuring initiatives. The Company believes its amended plan, as submitted, meets AMEX requirements but has not yet been advised by AMEX whether or not it approves of the amended plan.

If AMEX does not accept the Company's plan or the Company fails to meet the milestones contained in the plan, AMEX has indicated that it may institute immediate delisting proceedings. Similarly, if the Company otherwise fails to achieve compliance with AMEX continued listing standards by December 31, 2002, as reflected in its audited financial statements for the year then ended, AMEX has indicated that it may institute immediate delisting proceedings.

AMEX continued listing standards require that listed companies maintain stockholders equity of \$2,000,000 or more if the Company has sustained operating losses from continuing operations or net losses in two of its three most recent fiscal years or stockholders equity of \$4,000,000 or more if it has sustained operating losses from continuing operations or net losses in three of its four most recent fiscal years. Further, the AMEX will normally consider delisting companies that have sustained losses from continuing operations or net losses in their five most recent fiscal years or that have sustained losses that are so substantial in relation to their operations or financial resources, or whose financial resources, or whose financial condition has become so impaired, that it appears questionable, in the opinion of AMEX, as to whether the company will be able to continue operations or meet its obligations as they mature.

CRITICAL ACCOUNTING POLICIES

In response to the SEC's Release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," the Company has identified the accounting principles which it believes are most critical to its reported financial status by considering accounting policies that involve the most complex or subjective decisions or assessment. The Company identified its most critical accounting policies to be those related to revenue recognition, allowance for doubtful accounts and income taxes.

Revenue Recognition - Revenue is recognized on the Company's service contracts primarily on the basis of contractual day rates as the work is completed. Revenue and cost from product and equipment sales is recognized upon customer acceptance and contract completion.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined.

The Company recognizes revenues under the WELLSURE(R) program as follows: (a) initial deposits for pre-event type services are recognized ratably over the life of the contract period, typically twelve months (b) revenues and billings for pre-event type services provided are recognized when the insurance carrier has billed the operator and the revenues become determinable and (c) revenues and billings for contracting and event services are recognized based upon predetermined day rates of the Company and sub-contracted work as incurred. When the Company responds to a critical event under the WELLSURE(R) program, the Company acts as a general contractor and engages third party service providers. The Company records revenue related to general contracting services net of the cost of third party service providers.

Allowance for Doubtful Accounts - The Company performs ongoing evaluations of its customers and generally does not require collateral. The Company assesses its credit risk and provides an allowance for doubtful accounts for any accounts which it deems doubtful of collection.

Income Taxes - The Company accounts for income taxes pursuant to SFAS No. 109, "Accounting For Income Taxes," which requires recognition of deferred income tax liabilities and assets for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Deferred income tax liabilities and assets are determined based on the temporary differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and available tax carry forwards.

RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and notes thereto and the other financial information included in this report and contained in the Company's periodic reports previously filed with the SEC.

Information concerning operations in different business segments for the three and six months ended June 30, 2001 and 2002 is presented below. Certain reclassifications have been made to the prior periods to conform to the current presentation.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2001	2002	2001	2002
REVENUES				
Prevention	\$ 481,000	\$2,537,000	\$1,615,000	\$4,266,000
Response	4,606,000	1,447,000	7,595,000	3,728,000
	<u>\$5,087,000</u>	<u>\$3,984,000</u>	<u>\$9,210,000</u>	<u>\$7,994,000</u>
COST OF SALES				

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Prevention	\$ 324,000	\$1,172,000	\$ 469,000	\$1,588,000
Response	485,000	718,000	979,000	1,671,000
	-----	-----	-----	-----
	\$ 809,000	\$1,890,000	\$1,448,000	\$3,259,000
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OPERATING EXPENSES (1)				
Prevention	\$ 148,000	\$1,197,000	\$ 521,000	\$2,003,000
Response	1,029,000	550,000	1,778,000	1,370,000
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	\$1,177,000	\$1,747,000	\$2,299,000	\$3,373,000
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SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (2)				
Prevention	\$ 51,000	\$ 461,000	\$ 272,000	\$ 754,000
Response	697,000	273,000	1,279,000	659,000
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	\$ 748,000	\$ 734,000	\$1,551,000	\$1,413,000
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DEPRECIATION AND AMORTIZATION (3)				
Prevention	\$ 33,000	\$ 182,000	\$ 102,000	\$ 291,000
Response	364,000	106,000	559,000	283,000
	-----	-----	-----	-----
	\$ 397,000	\$ 288,000	\$ 661,000	\$ 574,000
	-----	-----	-----	-----
OPERATING INCOME (LOSS)				
Prevention	\$ (75,000)	\$ (475,000)	\$ 251,000	\$ (370,000)
Response	2,031,000	(200,000)	3,000,000	(255,000)
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	\$1,956,000	\$ (675,000)	\$3,251,000	\$ (625,000)
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