

# **TEXCOM, INC. AND SUBSIDIARIES**

## **UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**As of June 30, 2014 and December 31, 2013  
and for the Three and Six Months Ended June 30, 2014 and 2013**

**TEXCOM, INC. AND SUBSIDIARIES**  
**UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
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**TEXCOM, INC. AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED BALANCE SHEETS**

	<u>June 30, 2014</u>	<u>December 31, 2013</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,785,101	\$ 791,716
Restricted cash	100,000	-
Accounts receivable, net	1,718,339	2,887,004
Prepaid expenses and other current assets	107,920	235,121
Prepaid income taxes	590,000	-
Current portion of deferred income tax asset	40,000	50,000
Total current assets	<u>7,341,360</u>	<u>3,963,841</u>
Property and equipment, net	4,902,571	6,039,908
Equity in net assets of affiliate	704,065	705,152
Intangible assets, net	848,000	1,107,991
Goodwill	519,172	533,894
Deferred income tax asset, net of current portion	-	2,590,000
Other assets	<u>158,913</u>	<u>234,054</u>
Total assets	<u><u>\$ 14,474,081</u></u>	<u><u>\$ 15,174,840</u></u>
<b>Liabilities and Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 801,953	\$ 1,908,422
Derivative liability	26,719	157,035
Line of credit	-	529,843
Current portion of long-term debt	-	1,800,012
Total current liabilities	<u>828,672</u>	<u>4,395,312</u>
Other long-term liabilities	865,265	457,956
Deferred income tax liability, net of current portion	380,000	-
Long-term debt, net of current portion	<u>-</u>	<u>4,796,644</u>
Total liabilities	<u><u>2,073,937</u></u>	<u><u>9,649,912</u></u>
Commitment and contingencies		
Equity:		
Series A convertible preferred stock, \$0.001 par value, 5,000,000 shares authorized, 2,028,750 shares issued and outstanding	2,029	2,029
Non-designated preferred stock, \$1.00 par value, 15,000,000 shares authorized, no shares issued.	-	-
Common stock, \$0.001 par value, 100,000,000 shares authorized, 67,946,101 and 64,453,389 shares issued and outstanding, respectively	67,946	64,453
Additional paid-in capital	13,855,652	13,037,481
Accumulated deficit	<u>(1,580,149)</u>	<u>(8,677,129)</u>
Total TexCom equity	<u>12,345,478</u>	<u>4,426,834</u>
Noncontrolling interest	<u>54,666</u>	<u>1,098,094</u>
Total equity	<u><u>12,400,144</u></u>	<u><u>5,524,928</u></u>
Total liabilities and equity	<u><u>\$ 14,474,081</u></u>	<u><u>\$ 15,174,840</u></u>

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

**TEXCOM, INC. AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS**

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Revenues	\$ 2,179,739	\$ 4,080,233	\$ 7,209,805	\$ 7,643,534
Cost of revenues, excluding royalties, depreciation and amortization	893,502	818,699	2,319,060	1,596,486
Royalties	391,928	965,743	1,328,464	1,808,747
Depreciation and amortization	186,236	103,524	363,297	204,189
Total cost of revenues	1,471,666	1,887,966	4,010,821	3,609,422
Gross profit	708,073	2,192,267	3,198,984	4,034,112
Selling, general, and administrative expenses	1,647,658	374,403	2,232,293	819,190
Loss on disposition of equipment	-	-	21,868	-
Operating income (loss)	(939,585)	1,817,864	944,823	3,214,922
Other income (expense)				
Interest expense	(400,255)	(180,594)	(574,664)	(374,379)
Gain on sale of subsidiary operations	11,242,147	-	11,242,147	-
Equity in loss of affiliate	(828)	(431)	(1,087)	(1,011)
Loss on derivative liability	(3,024)	(1,002)	(31,348)	(38,777)
Income before income taxes	9,898,455	1,635,837	11,579,871	2,800,755
Income tax expense	(3,340,000)	(560,000)	(3,890,000)	(970,000)
Net income	6,558,455	1,075,837	7,689,871	1,830,755
Income attributable to noncontrolling interest	(485,089)	(141,100)	(592,891)	(263,238)
Net income attributable to TexCom shareholders	\$ 6,073,366	\$ 934,737	\$ 7,096,980	\$ 1,567,517
Income per common share – basic	\$ 0.09	\$ 0.01	\$ 0.11	\$ 0.02
Income per common share – diluted	\$ 0.09	\$ 0.01	\$ 0.10	\$ 0.02
Weighted average common shares outstanding – basic	66,495,552	63,878,839	65,527,325	63,878,389
Weighted average common shares outstanding – diluted	70,905,274	64,031,221	70,242,405	63,990,113

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

**TEXCOM, INC. AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	For the six months ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net income	\$ 7,689,871	\$ 1,830,755
Adjustments to reconcile net income to cash from operating activities:		
Depreciation and amortization	363,297	204,189
Bad debt recovery	(43,065)	(42,039)
Stock-based compensation	660,000	-
Loss on disposition of equipment	21,868	-
Amortization of deferred financing costs	332,879	143,965
Gain on sale of subsidiary operations	(11,242,147)	-
Equity in loss of affiliate	1,087	1,011
Loss on derivative liabilities	31,348	38,777
Deferred income tax expense	2,980,000	970,000
Changes in operating assets and liabilities:		
Accounts receivable	1,211,730	(396,611)
Prepaid expenses and other current assets	(130,537)	(39,831)
Prepaid income tax	(590,000)	-
Accounts payable and accrued liabilities	(1,116,485)	(473,912)
Other long-term liabilities	458	(22,012)
Net cash provided by operating activities	170,304	2,214,292
Cash flows from investing activities:		
Net proceeds from restricted cash	(100,000)	1,086,477
Proceeds from sale of subsidiary operations	12,839,149	-
Purchases of property and equipment	(153,250)	(1,643,000)
Net cash provided by (used in) investing activities	12,585,899	(556,523)
Cash flows from financing activities:		
Net change in line of credit	(529,843)	(882,378)
Principal repayments on long-term debt	(6,596,656)	(851,854)
Payment of dividends to noncontrolling interest	(1,636,319)	(233,520)
Net cash used in financing activities	(8,762,818)	(1,967,752)
Net change in cash and cash equivalents	3,993,385	(309,983)
Cash and cash equivalents, beginning of period	791,716	807,022
Cash and cash equivalents, end of period	\$ 4,785,101	\$ 497,039

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

**TEXCOM, INC. AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)**

Supplemental cash flows information:

Cash paid for interest	\$ <u>135,942</u>	\$ <u>120,877</u>
Cash paid for income taxes	\$ <u>1,500,000</u>	\$ <u>-</u>
Non-cash investing and financing activities:		
Net change of payable recorded for purchase of equipment	\$ <u>-</u>	\$ <u>40,794</u>
Transfer of warrant derivative from liability to equity classification	\$ <u>161,664</u>	\$ <u>-</u>

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

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 – DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Business and Basis of Presentation**

TexCom, Inc. (“TexCom” or the “Company”) was incorporated under the laws of the State of Texas on December 9, 2003. In 2012, the Company converted from a Texas corporation to a Nevada corporation.

The Company was organized to pursue investment opportunities in certain energy related businesses and develop them to their logical and full commercial potential. The Company is a provider of environmental services to the oil and gas industry, currently engaged in the business of disposing of waste generated by exploration and production operations. Among these wastes are non-hazardous oilfield wastes (“NOW”) and naturally occurring radioactive materials (“NORM”). The Company’s controlled subsidiaries, M.B. Environmental Services, LLC (“MBES”) and Eagle Ford Environmental Services, LLC (“EFES”), operate two wells for disposal of NOW and NORM and two for disposal of NOW, all located in Texas. See Note 2 concerning the sale of MBES. The Company’s wholly owned subsidiary TexCom Environmental Services, LLC (“TES”) provides NORM consulting and remediation services. TES was formed with the assets and ongoing business that were purchased from ALMAC Environmental Services, Inc. (“ALMAC”), in July 2013. See Notes 2, 5 and 8.

The consolidated financial statements include the accounts of the Company and its wholly owned and majority-owned subsidiaries. All material intercompany transactions and balances have been eliminated. The Company owns 83.2% of M.B. Energy Services (“MBSI”) who fully owns MBES. The Company’s twenty percent (20%) interest in TexCom Gulf Disposal, LLC (“TGD”) is accounted for under the equity method.

**Use of Estimates and Assumptions**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could materially differ from those estimates.

**Summary of Significant Accounting Policies**

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission and should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2013 posted on the website of OTC Markets. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the financial statements which substantially duplicate the disclosure contained in the audited financial statements for the year ended December 31, 2013 have been omitted.

**Cash and Cash Equivalents** – The Company considers any highly liquid financial instruments purchased with an original maturity of three months or less to be cash equivalents.

**Restricted Cash** – During the six months ended June 30, 2014, the Company deposited \$100,000 into an escrow account related to a possible acquisition of an oilfield waste disposal business that had not been completed as of June 30, 2014. At June 30, 2014 and December 31, 2013, there was \$100,000 and \$0 in restricted cash, respectively.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Accounts Receivable and Allowance for Doubtful Accounts*** – Accounts receivable are stated at the amount the Company expects to collect. Accounts receivable represents receivables, net of allowances for doubtful accounts. The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on historical experience and other currently available information. When a specific account is deemed uncollectible, the account is written off against the allowance. As of June 30, 2014 and December 31, 2013, the allowance for doubtful accounts was \$112,645 and \$155,710, respectively.

***Equity Method of Accounting*** – Investments in corporate entities over which the Company can exert significant influence (but not control) are accounted for using the equity method. Under the equity method, the investment is recorded initially at cost. Subsequent adjustments are made through recognition in the income statement for the Company's share of post-acquisition profits and losses and through recognition in stockholders' equity for other post-acquisition changes in the investee's net assets. Dividends received reduce the investment account. The equity method requires the Company to record its investment in the investee as a one-line asset and to reflect its proportionate share of the investee's net income/loss on one line in the statement of operations.

***Property and Equipment*** – Property and equipment are stated at cost. Depreciation is computed over the estimated useful lives of the related assets using the straight-line method for financial reporting purposes. Assets held for sale are not depreciated.

Expenditures for normal repairs and maintenance are charged to expense as incurred. Significant renewals and improvements are capitalized. The costs and related accumulated depreciation of assets retired or otherwise disposed of are eliminated from the accounts, and any resulting gain or loss is recognized in the year of disposal.

***Impairment of Long-Lived Assets*** – Management reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be realizable or at a minimum annually during the fourth quarter of the year. If an evaluation is required, the estimated future undiscounted cash flows associated with the asset are compared to the asset's carrying value to determine if an impairment of such asset is necessary. The effect of any impairment would be to expense the difference between the fair value of such asset and its carrying value.

***Goodwill and Other Intangible Assets*** – We apply a fair value-based impairment test to the net book value of goodwill and indefinite-lived intangible assets on an annual basis and, if certain events or circumstances indicate that an impairment loss may have been incurred, on an interim basis.

***Key Assumptions*** - The key assumptions in our impairment tests include (1) our projected revenues, expenses and cash flows, (2) an estimated weighted average cost of capital, (3) assumed discount rates depending on the asset and (4) a tax rate. These assumptions are consistent with those hypothetical market participants would use. Since we are required to make estimates and assumptions when evaluating goodwill and indefinite-lived intangible assets for impairment, the actual amounts may differ materially from these estimates.

Changes in assumptions or circumstances could result in impairment. Factors which could cause impairment include, but are not limited to, (1) negative trends in our market capitalization, (2) a decline in prices for oil and natural gas, (3) a decrease in drilling activity, (4) interruption to our operations, (5) changes to the regulatory environment and (6) consolidation of competitors in the disposal industry.

***Goodwill*** – In evaluating goodwill for impairment, we estimate the fair value of our reporting unit by considering market capitalization and other factors if it is more likely than not that the fair value of our reporting unit is less than its carrying value. If the reporting unit's fair value exceeds its carrying value, no further testing is required. If, however, the reporting unit's carrying value exceeds its fair value, we then determine the amount of the impairment charge, if any. We recognize an impairment charge if the carrying value of the reporting unit's goodwill exceeds its estimated fair value.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

***Intangible Assets*** – Intangible assets with definite useful lives are recorded on the basis of cost and are amortized on a straight-line basis over their estimated useful lives. The Company uses a useful life of 20 years for permits and 5 years for customer relationships and workforce. The Company evaluates the remaining useful life of intangible assets annually to determine whether events and circumstances warrant a revision to the remaining amortization period. If the estimate of the intangible asset's remaining useful life is changed, the remaining carrying amount of the intangible asset will be amortized prospectively over that revised remaining useful life. At June 30, 2014, the assets related to the acquisition of ALMAC were revalued. See Note 2.

***Asset Retirement Obligations*** – The Company recognizes the fair value of all liabilities where the Company has an obligation to close or remediate property upon its abandonment or the end of its useful life. The amount recognized as a liability is capitalized as part of the cost of the asset to which it relates and amortized to expense ratably over its useful life. The Company's asset retirement obligations are associated with its oil and gas and industrial wastewater disposal wells.

***Derivatives*** – All derivatives are recorded at fair value and recorded on the balance sheet. Fair values for securities traded in the open market and derivatives are based on quoted market prices. Where market prices are not readily available, fair values are determined using market based pricing models incorporating readily observable market data and requiring judgment and estimates.

***Income Taxes*** – The Company uses the asset and liability method in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and income tax carrying amounts of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company reviews deferred tax assets for a valuation allowance based upon whether it is more likely than not that the deferred tax asset will be fully realized. A valuation allowance, if necessary, is provided against deferred tax assets, based upon management's assessment as to their realization.

***Fair Value of Financial Instruments*** – Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. A fair value hierarchy has been established for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- Level 1 Inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2 Inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
- Level 3 Inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Financial instruments consist of cash and cash equivalents, accounts receivable, collateralized receivables, accounts payable and secured borrowings.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Earnings Per Common Share** – The Company provides basic and diluted earnings per common share information for each period presented. The basic earnings per common share is computed by dividing the net income available to common stockholders by the weighted average number of common shares outstanding during the reporting period. Diluted earnings per common share is computed by dividing the net income available to common stockholders by the weighted average number of common shares outstanding plus dilutive securities. The dilutive effect of outstanding stock options and warrants is reflected in diluted earnings per share by application of the treasury stock method. The dilutive effect of Series A Preferred Stock is reflected in diluted earnings per share by application of the if-converted method.

**Revenue Recognition** – Revenues from waste disposal activities are recognized when the Company takes delivery of the waste product at its disposal well location, the price is fixed or determinable, and collection is reasonably assured.

**Stock-Based Compensation** – The cost of employee services received in exchange for stock is measured based on the grant-date fair value (with limited exceptions). That cost is to be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The fair value of immediately vested shares is determined by reference to quoted prices for similar shares, and the fair value of shares issued subject to a service period is estimated using an option-pricing model. Excess tax benefits, for which no valuation allowance is required, are recognized as additions to paid-in-capital.

The Company also makes stock awards to non-employees for goods and services acquired by the Company. These awards are generally recorded at the market price of the shares issued on the date the shares are issued.

For the six months ended June 30, 2014, the Company issued 3,000,000 shares, valued at \$660,000 to the Board of Directors and two employees. There were no issuances in the six months ended June 30, 2013.

**Concentration of Credit Risk** – Financial instruments which subject the Company to concentrations of credit risk include cash and cash equivalents, accounts receivable, and notes payable to third parties. The Company maintains its cash and cash equivalents with major financial institutions selected based upon management's assessment of the institutions' financial stability. Balances periodically exceed the federally insured limits. The Company has not experienced any losses on deposits. Accounts receivable generally arise from sales of services to customers operating in the United States of America. Collateral is generally not required for credit granted. The Company provides allowances for potential credit losses when necessary.

**Recent Accounting Pronouncements** – Management does not expect the adoption of any other recently issued accounting pronouncements to have a significant effect on the Company's financial position or results of operation.

**Reclassifications** – Certain prior period amounts have been reclassified to conform to current period presentation.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 2 – BUSINESS COMBINATION**

**Sale of MBES**

On April 16, 2014, the Company sold the tangible assets of MBES, retaining the cash, accounts receivable and accounts payable. The details of the sale were:

Gross sales price	\$ 15,724,087
Payments to royalty holder	(2,492,836)
Payments to financial advisors	(392,102)
Net proceeds from sale	<u>12,839,149</u>
Net book value of assets sold	<u>(1,597,002)</u>
Gain on sale of subsidiary operations	<u><u>\$ 11,242,147</u></u>

The previous land owner elected to receive a 6% royalty on the sale of the assets in lieu of exercising its right of first refusal, as described in Note 11. This payment amounted to \$943,445. Additionally, this party received a payment of \$1,549,391 to settle a dispute regarding the financing transactions that took place in 2009. The party filed suit in Chambers County, Texas in February 2014, claiming that MBES had breached its contract with the party in 2009 by conveying a property interest (the royalty conveyance to the financing party) without providing notice to the party. While confident that it had properly notified the party of the royalty conveyance in 2009, MBES settled the suit in April 2014 so it could proceed with the sale of the assets.

Upon closing the sale, the Company immediately extinguished all long-term debt and paid out a portion of the proceeds to the 16.8% owners in MBSI. The Company intends to use the rest of the proceeds to cover related tax expense and fund future acquisitions of disposal properties. MBES will provide future cash flow from the collection of accounts receivable to be offset by payment of related royalties and of accounts payable.

Total assets sold in this transaction were as follows:

Property and equipment, net	\$ 1,019,289
Intangible assets, net	180,991
Goodwill	<u>396,722</u>
Total assets sold	<u><u>\$ 1,597,002</u></u>

Depreciation and amortization were recorded on the assets through December 31, 2013.

Pro forma results of operations for the six months ended June 30, 2014 as though this disposal had taken place at the beginning of the period are as follows. The pro forma results are not necessarily indicative of what would have actually occurred had the disposal been in effect for the entire period presented.

	<u>June 30, 2014</u>
Gross revenue	\$ 4,977,079
Gross profit	2,121,096
Operating income	84,424
Net income attributable to TexCom shareholders	\$ 9,810

Earnings per share, basic and fully diluted, would have been \$0.00 for the six-months ended June 30, 2014.

The April sale of the property freed TexCom of the royalties associated with MBES, which are described further at Note 11.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 2 – BUSINESS COMBINATION (CONTINUED)**

**Acquisition of Arkansas Saltwater Disposal Wells**

On July 31, 2014, the Company completed the acquisition of two saltwater disposal wells in Arkansas. The Company accounted for the assets and ownership interests in accordance with the provisions of *ASC 805, Business Combinations*. Pursuant to the purchase agreement, the Company issued 43,192,089 shares of common stock and paid \$9,756,404 in cash. The shares were valued at \$10,150,141 on the date of the transaction.

The acquisition price was allocated to the assets acquired based upon their estimated fair values. The following table summarizes the estimated fair values of the assets acquired at the date of acquisition. The Company did not assume any liabilities. The estimated fair values of assets acquired were determined based on management's best estimates. Estimates and assumptions are subject to change upon management's final review.

Assets acquired:		
Current assets	\$	-
Plant, property and equipment		13,150,000
Customer relationships		6,160,000
Permits		500,000
Workforce		30,000
Goodwill		116,545
Asset retirement obligations		<u>(50,000)</u>
Net assets acquired	\$	<u>19,906,545</u>
Consideration:		
Common stock	\$	10,150,141
Cash		<u>9,756,404</u>
Total consideration	\$	<u>19,906,545</u>

The estimated useful lives for assets acquired are 15 years for customer relationships, 30 years for permits and 5 years for the workforce.

The following table presents pro forma results of operations information that reflect the acquisition of the Arkansas saltwater disposal wells and the disposition of MBES as if the acquisition had already occurred as of January 1, 2014, adjusted for items that are directly attributable to the acquisition. This information has been compiled from historical financial statements, and is not necessarily indicative of the results that actually would have been achieved had the transaction already occurred at the beginning of 2014 or that may be achieved in the future.

	June 30, 2014
Gross revenue	\$ 7,724,207
Gross profit	3,578,140
Operating income	<u>1,475,172</u>
Net income attributable to TexCom shareholders	<u>\$ 1,148,630</u>

Pro forma results include non-recurring pro forma adjustments that were directly attributable to the business combination, as follows:

- Pre-tax charge to selling, general and administrative expenses of \$216,408 in the six months ended June 30, 2014, for acquisition-related transaction costs incurred by the Company.

Earnings per share, basic and fully diluted, would have \$0.01 for the six months ended June 30, 2014.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 2 – BUSINESS COMBINATION (CONTINUED)**

**Acquisition of ALMAC**

On July 1, 2013, the Company completed the acquisition of certain assets of ALMAC. The Company accounted for the assets and ownership interests in accordance with the provisions of *ASC 805, Business Combinations*. Pursuant to the purchase agreement, the Company paid \$1,200,000, consisting of \$1,000,000 cash at closing and \$200,000 recorded as a payable to the sellers, which was paid during 2013. In addition, the Company agreed to pay up to \$1,600,000 as contingent consideration, based on the subsidiary's cumulative earnings for the first 16 quarters. The Company has calculated an estimated present value of the contingent consideration of \$743,235 at June 30, 2014, which includes accretion of \$93,235 since the acquisition date.

The acquisition price was allocated to the assets acquired based upon their estimated fair values. The following table summarizes the estimated fair values of the assets acquired at the date of acquisition. The Company did not assume any liabilities. The estimated fair values of assets acquired were determined based on management's best estimates. The Company originally valued the acquisition at \$1,438,000 and has since increased the value of the contingent consideration, goodwill and customer relationships due to measurement period adjustments. Measurement period adjustments represent updates made to the preliminary purchase price allocation based on revisions to valuation estimates in the interim period subsequent to the acquisition and initial accounting date up until the purchase price allocation is finalized which cannot be any later than one year from the acquisition date.

Assets acquired:	
Current assets	\$ -
Fixed assets	270,828
Customer relationships	790,000
Workforce	270,000
Goodwill	<u>519,172</u>
Total assets acquired	<u>\$ 1,850,000</u>
Consideration:	
Cash	\$ 1,200,000
Contingent liability	<u>650,000</u>
Total consideration	<u>\$ 1,850,000</u>

**NOTE 3 – INVESTMENTS IN AFFILIATES**

In 2005, the Company created a wholly owned subsidiary, TexCom Gulf Disposal, LLC ("TGD") to develop an injection well it owned in Texas. In various transactions in 2008 and 2009, the Company transferred 80% of its interest in TGD to Montgomery County Environmental Solutions, LLC ("MCES"), an unrelated third party, that agreed to provide the working capital necessary to complete the application for a Class I Industrial Wastewater Disposal Permit, from the Texas Commission on Environmental Quality, (the "TCEQ"), and construct the surface facilities needed to place the disposal business in commercial operation. MCES together with its shareholders is now a 30% owner of the Company.

The Company does not guarantee any obligations of TGD, but may be obligated to partially fund the operations of TGD in order to maintain its 20% interest. When the controlling interest was transferred to MCES, TexCom began to account for TGD using the equity method rather than consolidating the entity. At that time, TexCom's investment in the net assets of TGD exceeded its share of the net assets recorded in the financial statements of TGD by approximately \$612,000.

For the six months ended June 30, 2014 and 2013, the Company recorded equity losses of affiliates of \$1,087 and \$1,011, respectively, related to its investment in TGD.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 4 – PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following at June 30, 2014 and December 31, 2013.

	<u>Lives</u>	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Building & improvements	10 – 30 years	\$ -	\$ 308,117
Equipment, furniture & fixtures	5 – 10 years	142,459	651,802
Disposal wells	10 years	-	581,501
Transportation equipment	7 years	238,619	358,829
Leasehold improvements	10 years	5,370,119	5,320,427
Land		<u>1,358</u>	<u>47,484</u>
Subtotal		5,752,555	7,268,160
Less: accumulated depreciation		<u>(849,984)</u>	<u>(1,228,252)</u>
Property and equipment, net		<u>\$ 4,902,571</u>	<u>\$ 6,039,908</u>

All of the leasehold improvements are related to our location in the Eagle Ford shale area. The value of leasehold improvements includes \$192,675 of capitalized interest at June 30, 2014 and December 31, 2013.

Depreciation expense was \$254,297 and \$194,799 for the six-month ended June 30, 2014 and 2013, respectively.

In April 2014, the Company sold \$1,019,289 of the property and equipment related to MBES. See Note 2.

**NOTE 5 – GOODWILL AND OTHER INTANGIBLE ASSETS**

As of June 30, 2014 and December 31, 2013, our goodwill balance was \$519,172 and \$533,894, respectively.

Intangible assets consisted of the following at June 30, 2014 and December 31, 2013:

	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Disposal permit	\$ -	\$ 1,257,901
Customer relationships	790,000	760,000
Workforce	270,000	270,000
Less: accumulated amortization	<u>(212,000)</u>	<u>(1,179,910)</u>
Intangible assets, net	<u>\$ 848,000</u>	<u>\$ 1,107,991</u>

Amortization expense was \$109,000 and \$9,390 for the six-month periods ended June 30, 2014 and 2013, respectively.

In April 2014, the Company sold the \$180,991 of net amortized disposal permits related to MBES and reduced the related goodwill of \$396,722 to zero. See Note 2.

The Company originally valued the goodwill associated with the acquisition of ALMAC at \$137,172 and the related customer relationships at \$760,000. As explained at Note 2, the Company has revalued the goodwill at \$519,172 and the customer relationships at \$790,000.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 6 – NOTES PAYABLE**

Notes payable consisted of payables to financial institutions and other third parties of the following at June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
\$7,400,000 note payable, bearing interest at Prime + 3% (6.25% at December 31, 2013), subject to a maximum rate of 18% and minimum of 6.25%, payable in 60 monthly installments of \$123,334 plus interest, secured by a first-position lien on all assets of the Company. Paid in full on April 16, 2014.	\$ -	\$ 5,796,658
\$960,000 note payable, bearing interest at Prime + 3% (6.25% at December 31, 2013), subject to a maximum rate of 18% and minimum of 6.25%, payable in 36 monthly installments of \$26,667 plus interest, secured by a first-position lien on all assets of the Company. Paid in full on April 16, 2014.	-	799,998
Total notes payable	-	6,596,656
Less: amounts due within one year	-	(1,800,012)
Long-term portion of notes payable	\$ -	\$ 4,796,644

In November 2012, the Company refinanced the majority of its debt and augmented its working capital through a relationship with a new bank. The Company obtained \$7,400,000 in a term loan and a separate revolving line of credit equal to 80% of eligible trade accounts receivable, subject to a maximum of \$2,000,000. The Company incurred \$590,517 of financing costs associated with the financing. The \$464,875 related to the term loan was to be amortized using the effective-interest-rate method over the life of the five-year term loan. The entire balance was paid off in April 2014 and the deferred financing costs were written down to zero. The \$125,642 related to the line of credit was amortized equally over twelve months. The line of credit was renewed in November 2013 and cancelled in April 2014 when it was paid off.

On July 1, 2013, the Company issued a note to borrow \$960,000 for the acquisition of the assets of ALMAC Environmental Services, Inc. The note bears interest at the Prime Rate plus 3% with a minimum rate of 6.25% and is secured by all the assets purchased and all assets of the Company. Principal on the note was payable in 36 monthly installments of \$26,667 plus interest. The Company incurred \$53,080 of financing costs associated with the financing, which was to be amortized using the effective interest rate method over the life of the three-year term loan. The loan was paid off in April 2014 and the deferred financing costs were written down to zero.

Revolving line of credit payable to third party consisted of the following at June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
\$2,000,000 revolving line of credit, bearing interest at Prime + 2% (5.25% at December 31, 2013), subject to a maximum rate of 18% and minimum of 5.25%, secured by a first-position lien on all assets of the Company. Paid in full on April 16, 2014.	\$ -	\$ 529,843

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 6 – NOTES PAYABLE (CONTINUED)**

For the six months ended June 30, 2014 and 2013, the Company recognized \$332,879 and \$143,965 of expense related to the amortization of the two term loans and the line of credit, respectively. The higher expense in 2014 came from the payoff of the related debt.

**NOTE 7 – DERIVATIVE INSTRUMENTS**

The Company determined that the warrants associated with the purchase of the Eagle Ford share area disposal well qualified for accounting treatment as a financial derivative, because the warrant agreement requires that the exercise price and number of shares be adjusted if the Company sells or issues stock or common-stock equivalents at a price that is less than the warrant's strike price. The fair value of \$112,020 on these warrants valued in August 2011, the date of issuance, was classified as a derivative liability. At December 31, 2012, the Company revalued the derivative at \$89,786. At June 30, 2013, the Company again revalued the derivative at \$128,563 and recorded a \$38,777 loss for the six months then ended. At December 31, 2013, the Company again revalued the derivative at \$157,035. On February 18, 2014, the warrant holder partially exercised its warrants in a cashless exercise, receiving 90,789 shares with a derivative value of \$23,547, the equivalent of purchasing 500,000 shares in a for-cash exercise. On March 19, the warrant holder partially exercised its warrants in a separate cashless exercise, receiving 401,923 shares with a derivative value of \$138,117, the equivalent of 1,000,000 shares in a for-cash exercise. On June 30, 2014, the Company again revalued the derivative at \$26,719. Including the effect of the conversion, the Company recorded a loss of \$31,348 during the six months ended June 30, 2014.

After adjustments for price resets, the warrant provides for the purchase of 300,643 shares at an exercise price of \$0.16 per share, expiring in August 2015.

The Company developed a lattice model that values the derivative based on a probability weighted discounted cash flow model. This model is based on future projections of the various potential outcomes. The following assumptions were made in valuing the derivative at June 30, 2014 and 2013:

- The stock price will fluctuate with an annual volatility ranging from 82% to 99% at June 30, 2014 and 116% to 624% at June 30, 2013.
- The holder will exercise the warrant at a target price equal to 2.0 times the reset price or stock price.
- The holder will exercise at maturity if the market value exceeds the exercise price.
- The Company will raise capital through sales of common stock quarterly during the next twelve months at prices equal to the market value.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 8 – OTHER LONG-TERM LIABILITIES**

	June 30, 2014	December 31, 2013
Asset retirement obligations	\$ 50,000	\$ 100,000
Production payment of Eagle Ford well	132,276	158,595
Contingent consideration related to the acquisition of ALMAC	743,235	254,456
Subtotal	925,511	513,051
Current portion of production payment of Eagle Ford well	(60,246)	(55,095)
Long-term portion of other long-term liabilities	<u>\$ 865,265</u>	<u>\$ 457,956</u>

The Company's asset retirement obligations, totaling \$50,000 at June 30, 2014 and \$100,000 at December 31, 2013, are related to its expected costs for the plugging of its oil and gas waste disposal injection wells. The balances are included in other long-term liabilities on the consolidated balance sheets.

As part of the August 2011 acquisition of the disposal well in the Eagle Ford shale area, the Company agreed to pay \$0.03 for every barrel of disposed liquid, up to a maximum of \$350,000. Accordingly, the Company calculated the present value of the future payments at \$240,265 and recorded a liability. For the six months June 30, 2014 and 2013, the Company paid \$51,342 and \$18,162, respectively, for disposed liquid. The present value of the estimated remaining payments is \$132,276.

As part of the July 2013 acquisition of the assets of ALMAC Environmental Services, Inc., the Company agreed to pay the sellers contingent consideration based on TES pre-tax net income ("PNI") for the first 16 quarters. The payments will equal 75% of the amount by which cumulative PNI exceeds \$1.2 million. The Company estimated the present value of the payments to be \$650,000. The balances are included in other long-term liabilities on the consolidated balance sheets. As of June 30, 2014, total TES PNI has not exceeded \$1.2 million, and nothing has been paid to the sellers. The sellers are now Company employees.

**NOTE 9 – INCOME TAXES**

The difference between the income tax expense and the amount that would result if the U.S. Federal statutory rate of 34% were applied to pre-tax income for the six months ended June 30, 2014 and 2013 is as follows:

	June 30, 2014			June 30, 2013		
	Amount	%		Amount	%	
Income tax at federal statutory rate	\$ 3,930,000	34.0 %		\$ 960,000	34.0 %	
Other adjustments	(40,000)	(1.2) %		10,000	0.4 %	
Effective tax expense	<u>\$ 3,890,000</u>	<u>32.8 %</u>		<u>\$ 970,000</u>	<u>34.4 %</u>	

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 10 – EQUITY TRANSACTIONS**

**Preferred Stock**

The Company's Articles of Incorporation authorize the issuance of 20,000,000 shares of preferred stock with a par value of \$0.001 per share. In 2006, the Board of Directors adopted a Statement of Designations Establishing Series A Convertible Preferred Stock. Initially, 5,000,000 of the 20,000,000 shares authorized have been designated Series A Convertible Preferred Stock, par value \$0.001 per share. The shares are entitled to a dividend of \$0.20 per share payable on October 1 of each year commencing October 1, 2006, when and if declared by the Board of Directors. If not paid, the dividends accumulate and no dividends, whether in cash, stock or other property, and no distributions may be made on any class of stock of the Company ranking junior to the Series A Convertible Preferred Stock until dividends are no longer in arrears. Furthermore, the Company may not redeem, purchase or otherwise acquire any stock ranking junior to the Series A Convertible Preferred until dividends are no longer in arrears. The Company is in arrears to the extent of \$3,144,563 (\$1.55 per share) and \$2,941,688 (\$1.45 per share) in dividends on the Series A Convertible Preferred Stock as of June 30, 2014 and December 31, 2013, respectively.

The Series A Convertible Preferred shares are convertible into 2 shares of common stock, par value \$0.001. The conversion rate is subject to anti-dilution provisions in certain circumstances set out in the Statement of Designations. Holders of the Series A Convertible Preferred shares are entitled to vote on all matters subject to a vote of holders of Common Stock. Each share of Series A Convertible Preferred is entitled to two votes.

Series A Convertible Preferred shares have a liquidation preference of \$2.00 plus dividends in arrears in the event of a dissolution, liquidation or winding up of the Company. There are no preemptive rights attached to the Series A Convertible Preferred shares. Any shares of Series A Convertible Preferred stock reacquired by the Company will be returned to the status of authorized but unissued, undesignated as to series and subject to later issuance.

**Common Stock**

The Company is authorized to issue up to 100,000,000 shares of common stock. Each share of common stock has a par value of \$0.001.

As of June 30, 2014, the Board of Directors of the Company has reserved a total of 5,003,379 shares of common stock for the contingent issuances in connection with the following securities:

	Shares
Convertible preferred stock	4,057,500
Warrants issued to non-employees	945,879
	<hr/>
Total shares reserved for contingent issuances	5,003,379

See Note 7 for a description of the shares issued for the exercise of warrants.

During the six months ended June 30, 2014, 492,712 shares were issued to an investor in the cashless partial exercise of a warrant. See Note 7 for details. Also, the Company issued 3,000,000 shares, valued at \$660,000 to the Board of Directors and two employees.

During the six months ended June 30, 2013, no shares were issued by the Company.

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 11 – COMMITMENTS AND CONTINGENCIES**

As part of the land acquisition transaction which established the Company's MBES operations in 1998, the Company was required to pay the previous land owner a 7% royalty on all cash received from disposal operations at its location in Liberty County. The previous land owner was also entitled to a right of first refusal on any proposed sale of the land and business assets or in lieu of exercising its right of first refusal, might elect to receive a 6% royalty on the sales proceeds. See Note 2 concerning the sale of the majority of the assets of MBES. That sale released TexCom from all royalty requirements related to the previous land owners.

As part of the acquisition of additional interests in the MBES operations in 2009, the Company granted the financing party a 20% royalty on all of MBES' cash receipts. The Company was required to receive consent from the financing party to operate, invest in or otherwise take part in a competing business in the state of Texas or its bordering states. Without such consent, the Company would have been obligated to pay double the 20% royalty for as long as the competing operations continued. As part of the April 2014 sale of the majority of the MBES assets to an affiliate of the financing party, TexCom obtained a release from all royalty requirements. Further, the non-complete area was reduced to 150 miles from the MBES location. See Note 2.

Related to the Company's EFES location, the Company is required to pay a royalty of \$0.08 for every barrel of disposed fluid and a 20% royalty of all skim oil sold.

**NOTE 12 – EARNINGS PER COMMON SHARE**

The following table illustrates the computation of basic and diluted earnings per common share for the three and six months ended June 30, 2014 and 2013.

	For the three months ended		For the six months ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
<b>Basic earnings per share</b>				
Numerator:				
Net income attributable to TexCom shareholders	\$ 6,073,366	\$ 934,737	\$ 7,096,980	\$ 1,567,517
Less: preferred stock dividends	(101,438)	(101,437)	(202,875)	(202,875)
Income available to common shareholders	<u>\$ 5,971,928</u>	<u>\$ 833,300</u>	<u>\$ 6,894,105</u>	<u>\$ 1,364,642</u>
Denominator:				
Weighted-average common shares outstanding	<u>66,495,552</u>	<u>63,878,389</u>	<u>65,527,325</u>	<u>63,878,389</u>
Basic earnings per common share	<u>\$ 0.09</u>	<u>\$ 0.01</u>	<u>\$ 0.11</u>	<u>\$ 0.02</u>
<b>Dilutive earnings per share</b>				
Numerator:				
Income available to common shareholders	<u>\$ 6,073,366</u>	<u>\$ 833,300</u>	<u>\$ 7,096,980</u>	<u>\$ 1,364,642</u>
Denominator:				
Weighted-average common shares outstanding	66,495,552	63,878,389	65,527,325	63,878,389
Effect of dilutive securities:				
Preferred shares	4,057,500	-	4,057,500	-
Warrants	352,222	152,832	657,580	111,724
Adjusted weighted-average common shares	<u>70,905,274</u>	<u>64,031,221</u>	<u>70,242,405</u>	<u>63,990,113</u>
Dilutive earnings per common share	<u>\$ 0.09</u>	<u>\$ 0.01</u>	<u>\$ 0.10</u>	<u>\$ 0.02</u>

**TEXCOM, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 12 – EARNINGS PER COMMON SHARE (CONTINUED)**

There were no potentially dilutive securities excluded from the computation of dilutive earnings per share for the three and six months ended June 30, 2014 because their effects were all dilutive.

Potentially dilutive securities include stock options and warrants to purchase 2,795,879 shares of common stock and Series A Preferred Stock convertible to 4,057,500 common stock were excluded from the computation of dilutive earnings per share for the three and six months ended June 30, 2013 because their effect would have been antidilutive.