

NATURAL GAS SERVICES GROUP INC
Form 10-Q
May 10, 2018

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

FORM 10-Q

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

For the quarterly period ended March 31, 2018

OR

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

For the transition period from to

Commission File Number 1-31398

NATURAL GAS SERVICES GROUP, INC.

(Exact name of registrant as specified in its charter)

Colorado 75-2811855

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

508 W. Wall St., Ste 550

Midland, Texas 79701

(Address of principal executive offices)

(432) 262-2700

(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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

(Do not check if smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class May 4, 2018

Common Stock, \$0.01 par value 13,085,607

Part I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Unaudited Condensed Consolidated Balance Sheets Page 1

Unaudited Condensed Consolidated Income Statements Page 2

Unaudited Condensed Consolidated Statements of Cash Flows Page 3

Notes to Unaudited Condensed Consolidated Financial Statements Page 4

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Page 12

Item 3. Quantitative and Qualitative Disclosures about Market Risk Page 17

Item 4. Controls and Procedures Page 17

Part II - OTHER INFORMATION

Item 1. Legal Proceedings Page 18

Item 1A. Risk Factors Page 18

Item 6. Exhibits Page 19

Signatures Page 21

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

NATURAL GAS SERVICES GROUP, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (in thousands, except per share amounts)
 (unaudited)

	March 31, 2018	December 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	\$65,138	\$69,208
Trade accounts receivable, net of allowance for doubtful accounts of \$495 and \$569, respectively	7,719	8,534
Inventory	25,749	26,224
Prepaid income taxes	3,443	3,443
Prepaid expenses and other	329	817
Total current assets	102,378	108,226
Long-term inventory, net of allowance for obsolescence of \$21 and \$15, respectively	3,315	2,829
Rental equipment, net of accumulated depreciation of \$150,859 and \$145,851, respectively	168,790	167,099
Property and equipment, net of accumulated depreciation of \$11,528 and \$11,274, respectively	9,277	7,652
Goodwill	10,039	10,039
Intangibles, net of accumulated amortization of \$1,664 and \$1,632, respectively	1,495	1,526
Other assets	1,066	939
Total assets	\$296,360	\$298,310
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$1,322	\$4,162
Accrued liabilities	3,407	3,106
Deferred income	294	185
Total current liabilities	5,023	7,453
Line of credit, non-current portion	417	417
Deferred income tax liability	32,211	32,163
Other long-term liabilities	1,075	958
Total liabilities	38,726	40,991
Commitments and contingencies (Note 8)		
Stockholders' Equity:		
Preferred stock, 5,000 shares authorized, no shares issued or outstanding	—	—
Common stock, 30,000 shares authorized, par value \$0.01; 12,949 and 12,880 shares issued and outstanding, respectively	129	129
Additional paid-in capital	105,415	105,325
Retained earnings	152,090	151,865
Total stockholders' equity	257,634	257,319
Total liabilities and stockholders' equity	\$296,360	\$298,310

See accompanying notes to these unaudited condensed consolidated financial statements.

NATURAL GAS SERVICES GROUP, INC.
 CONDENSED CONSOLIDATED INCOME STATEMENTS
 (in thousands, except earnings per share)
 (unaudited)

	Three months ended March 31,	
	2018	2017
Revenue:		
Rental income	\$ 11,471	\$ 11,922
Sales	2,998	6,637
Service and maintenance income	249	343
Total revenue	14,718	18,902
Operating costs and expenses:		
Cost of rentals, exclusive of depreciation stated separately below	4,704	4,668
Cost of sales, exclusive of depreciation stated separately below	2,191	5,423
Cost of service and maintenance	65	94
Selling, general and administrative expense	2,021	3,046
Depreciation and amortization	5,387	5,328
Total operating costs and expenses	14,368	18,559
Operating income	350	343
Other income (expense):		
Interest expense	(3)	(2)
Other (expense) income , net	(73)	3
Total other (expense) income, net	(76)	1
Income before provision for income taxes	274	344
Provision for income taxes	49	92
Net income	\$ 225	\$ 252
Earnings per share:		
Basic	\$ 0.02	\$ 0.02
Diluted	\$ 0.02	\$ 0.02
Weighted average shares outstanding:		
Basic	12,920	12,804
Diluted	13,169	13,056

See accompanying notes to these unaudited condensed consolidated financial statements.

NATURAL GAS SERVICES GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three months ended March 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$225	\$252
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,387	5,328
Deferred income taxes	48	(1,266)
Stock-based compensation	428	1,532
Bad debt allowance	(50)	60
Gain on sale of assets	—	(27)
Loss (gain) on company owned life insurance	67	(12)
Changes in operating assets and liabilities:		
Trade accounts receivables	865	2,637
Inventory	15	1,661
Prepaid expenses and prepaid income taxes	488	1,930
Accounts payable and accrued liabilities	(2,539)	68
Deferred income	109	(1,741)
Other	85	43
NET CASH PROVIDED BY OPERATING ACTIVITIES	5,128	10,465
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of rental equipment and property and equipment	(8,712)	(144)
Purchase of company owned life insurance	(139)	(93)
Proceeds from sale of property and equipment	—	27
NET CASH USED IN INVESTING ACTIVITIES	(8,851)	(210)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments from other long-term liabilities, net	(9)	(4)
Proceeds from exercise of stock options	157	517
Taxes paid related to net share settlement of equity awards	(495)	(492)
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(347)	21
NET CHANGE IN CASH AND CASH EQUIVALENTS	(4,070)	10,276
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	69,208	64,094
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$65,138	\$74,370
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid	\$3	\$2
Income taxes paid	\$—	\$—
NON-CASH TRANSACTIONS		
Transfer of rental equipment components to inventory	\$40	\$48

See accompanying notes to these unaudited condensed consolidated financial statements.

Natural Gas Services Group, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

(1) Basis of Presentation and Summary of Significant Accounting Policies

These notes apply to the unaudited condensed consolidated financial statements of Natural Gas Services Group, Inc. a Colorado corporation (the "Company", "NGSG", "Natural Gas Services Group", "we" or "our").

The accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of only normal recurring adjustments, which are necessary to make our financial position at March 31, 2018 and the results of our operations for the three months ended March 31, 2018 and 2017 not misleading. As permitted by the rules and regulations of the Securities and Exchange Commission (SEC), the accompanying condensed consolidated financial statements do not include all disclosures normally required by generally accepted accounting principles in the United States of America (GAAP). These financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 on file with the SEC. In our opinion, the condensed consolidated financial statements are a fair presentation of the financial position, results of operations and cash flows for the periods presented.

The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2018.

Revenue Recognition Policy

The Company adopted ASC 606, Revenue from Contracts with Customers ("ASC 606") on January 1, 2018. As a result, the Company has changed its accounting policy for revenue recognition as detailed below.

The Company applied ASC 606 using the cumulative effect method. We had no significant changes in our recognition of revenue at adoption and our review of all open revenue from contracts with customers on January 1, 2018 indicated we had no adjustment to be made. If an adjustment had been needed, we would have recognized the cumulative effect of initially applying ASC 606 with an adjustment to the opening balance of equity at January 1, 2018. Therefore, our consolidated financial statements for 2017 reported under ASC 605 are comparable to the consolidated financial statements for 2018 reported under ASC 606, since an adjustment was not needed, except for the respective additional disclosures as detailed below.

Revenue is measured based on a consideration specified in a customer's contract, excluding any sale incentives and taxes collected on behalf of third parties (i.e. sales and property taxes). We recognize revenue once a performance obligation has been satisfied and control over a product or service has transferred to the customer. Shipping and handling costs incurred are accounted for as fulfillment costs and are included in cost of revenues in our condensed consolidated income statement.

Nature of goods and Services

The following is a description of principal activities from which the Company generates its revenue:

Rental Revenue. The Company generates revenue from renting compressors and flare systems to our customers. These contracts may also include a fee for servicing the compressor or flare during the rental contract. Our rental contracts range from six to twenty-four months, with revenue being recognized over time, in equal payments over the term of the contract. After the terms of the contract have expired, a customer may renew their contract or continue renting on a monthly basis thereafter. In accordance with generally accepted accounting principles, the revenue earned from servicing rental equipment is recognized in accordance with ASC 606, while the revenue earned from the rental of the equipment is recognized in accordance with ASC 840 - Leases.

Sales Revenue. The Company generates revenue by the sale of custom/fabricated compressors, flare systems and parts, as well as, exchange/rebuilding customer owned compressors and sale of used rental equipment.

Custom/fabricated compressors and flare systems - The Company designs and fabricates compressors and flares based on the customer's specifications outlined in their contract. Though the equipment being built is customized by the customer, control under these contracts does not pass to the customer until the compressor or flare package is complete and shipped, or in accordance with a bill and hold arrangements the customer accepts title and assumes the risk and rewards of ownership. We request some of our customer's to make progressive payments as the product is being built; these payments are recorded as a contract liability on the Deferred Income line on the condensed consolidated balance sheet until control has been transferred. These contracts also may

4

include an assurance warranty clause to guarantee the product is free from defects in material and workmanship for a set duration of time; this is a standard industry practice and is not considered a performance obligation.

From time to time, upon the customer's written request, we recognize revenue when manufacturing is complete and the equipment is ready for shipment. At the customer's request, we will bill the customer upon completing all performance obligations, but before shipment. The customer will formally request we ship the equipment per their direction from our manufacturing facility at a later specified date and that we segregate the equipment from our finished goods, such that they are not available to fill other orders. Per the customer's agreement, title of the equipment, all risk of ownership including, the risk of loss, is passed to the customer once the equipment is complete and ready for shipment. We have operated using bill and hold agreements with certain customers for many years, with consistent satisfactory results for both the customer and us. The credit terms on these agreements are consistent with the credit terms on all other sales. All risks of loss are shouldered by the customer, and there are no exceptions to the customer's commitment to accept and pay for the manufactured equipment. Revenues recognized at the completion of manufacturing for the three months ended March 31, 2018 was approximately \$1.7 million.

Parts - Revenue is recognized after the customer obtains control of the parts. Control is passed either by the customer taking physical possession or the parts being shipped. The amount of revenue recognized is not adjusted for expected returns, as our historical part returns have been de minimis.

Exchange or rebuilding customer owned compressors - Based on the contract, the Company will either exchange a new/rebuilt compressor for the customer's malfunctioning compressor or rebuild the customer's compressor. Revenue is recognized after control of the replacement compressor has transferred to the customer by physical delivery, delivery and installment or shipment of the compressor.

Used compressors or flares - From time to time, a customer may request to purchase a used compressor or flare out of our rental fleet. Revenue from the sale of rental equipment is recognized when the control has passed to the customer, when the customer has taken physical possession or the equipment has been shipped.

Service and Maintenance Revenue. The Company provides routine or call-out services on customer owned equipment. Revenue is recognized after services in the contract are rendered.

Payment terms for sales revenue and service and maintenance revenue discussed above are generally 30 to 60 days although terms for specific customers can vary. Also, the transaction prices are not subject to variable consideration constraints.

Disaggregation of Revenue

The following table shows the Company's revenue disaggregated by product or service type for the three months ended March 31, 2018 and 2017:

Three months ended March 31, (in thousands)	
2018	2017
Compressors	
\$1,829	\$5,640
sales	
Flares	
522	269
sales	

Other		
(Parts/Rebuilds)		
	647	727
	-	
sales		
Service		
and		
4,837	5,116	
maintenance		
	1	
Total		
revenue		
from		
7,835	11,752	
contracts		
with		
customers		
Add:		
non-ASC		
608	7,150	
rental		
revenue		
Total		
\$14,718	\$18,902	
revenue		

¹Service and maintenance includes revenue from servicing our own rental equipment contracted to customers and third party equipment.

Contract Balances

As of March 31, 2018 and December 31, 2017, we had the following receivables and deferred income from contracts with customers:

	March 31, 2018	December 31, 2017
	(in thousands)	
Accounts Receivable		
Accounts receivable - contracts with customers	\$5,080	\$ 5,454
Accounts receivable - non-ASC 606	3,134	3,649
Total Accounts Receivable	\$8,214	\$ 9,103
Less: Allowance for doubtful accounts	\$(495)	\$(569)
Total Accounts Receivable, net	\$7,719	\$ 8,534
 Deferred income	 \$294	 \$ 185

The Company did not recognize any revenue for the period ended March 31, 2018 that were included in deferred income at the beginning of the period. For the period ended December 31, 2017, the Company recognized revenue of \$1.9 million from amounts related to sales that were included in deferred income at the beginning of the period.

The increases (decreases) of Accounts Receivable and deferred income were primarily due to normal timing differences between our performance and the customers' payments.

Transaction Price Allocated to the Remaining Performance Obligations

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) at the end of the reporting period:

(in thousands)	2019 ⁽¹⁾	2020	2021	2022	2023	Total
Service and Maintenance	\$ 610	\$595	\$542	\$542	\$ 9	\$2,298

(1) For the nine months starting April 2019.

All consideration from contracts with customers is included in the amounts presented above.

The Company applies the practical expedient in ASC 606-10-50-14 and does not disclose information about remaining performance obligations that have original expected durations of one year or less.

The Company applies the transition practical expedient in ASC 606-10-65-1(f)(3) and does not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the Company expects to recognize that amount as revenue for 2017.

Contract Costs

The Company applies the practical expedient in ASC 340-40-25-4 and recognizes the incremental costs of obtaining contracts as an expense when incurred if the amortization period of the assets that the Company otherwise would have

recognized is one year or less. These costs are included in selling, general and administrative expense on our consolidated income statement.

Fair Value of Financial Instruments

Our financial instruments consist principally of cash and cash equivalents, accounts receivable, accounts payable, deferred compensation plan (cash portion) and our line of credit. Pursuant to ASC 820 (Accounting Standards Codification), the fair value

6

of our cash equivalents is determined based on “Level 1” inputs, which consist of quoted prices in active markets for identical assets. We believe that the recorded values of all of our other financial instruments approximate their fair values because of their nature and relatively short maturity dates or durations.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases, and operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

ASC Topic 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In order to record any financial statement benefit, we are required to determine, based on technical merits of the position, whether it is more likely than not (a likelihood of more than 50 percent) that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes. If that step is satisfied, then we must measure the tax position to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of the benefit that is greater than 50 percent likely of being realized upon ultimate settlement. We have no uncertain tax positions as of March 31, 2018.

Our policy regarding income tax interest and penalties is to expense those items as other expense.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “2017 Tax Act”), which makes broad and complex changes to the U.S. tax code. Certain income tax effects of the 2017 Tax Act are reflected in the Company’s financial results in accordance with Staff Accounting Bulletin No. 118 (“SAB 118”), which provides SEC staff guidance regarding the application of Accounting Standards Codification Topic 740 Income Taxes (“ASC 740”). As we do not have all of the necessary information to analyze all income tax effects of the 2017 Tax Act, we will continue to evaluate tax reform and adjust the provisional amounts as additional information is obtained. We expect to complete our detailed analysis no later than the fourth quarter of 2018.

Recently Issued Accounting Pronouncements

On February 25, 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for capital and operating leases with lease terms of more than 12 months. Additionally, this ASU will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The new standard will be effective during our first quarter ending March 31, 2019. The process of reviewing our leases and evaluating the impact of the new standard on our condensed consolidated financial statements and disclosures is ongoing, but we expect our review to be completed in the latter half of 2018.

Reclassification of Prior Period Balances

Certain reclassifications have been made to prior period amounts to conform to the current-year presentation. These reclassifications had no effect on the reported results of operations.

(2) Stock-Based Compensation

Stock Options:

A summary of option activity under our 1998 Stock Option Plan as of December 31, 2017, and changes during the three months ended March 31, 2018 is presented below.

	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, December 31, 2017	327,270	\$ 20.21	4.28	\$ 2,255
Exercised	(8,500)	18.51		86
Outstanding, March 31, 2018	318,770	\$ 20.25	4.07	\$ 1,638
Exercisable, March 31, 2018	296,738	\$ 19.67	3.72	\$ 1,638

The following table summarizes information about our stock options outstanding at March 31, 2018:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$0.01-15.70	65,852	1.31	\$ 9.82	65,852	\$ 9.82
\$15.71-17.81	67,750	1.62	17.53	67,750	17.53
\$17.82-20.48	54,250	3.22	19.39	54,250	19.39
\$20.49-33.36	130,918	7.09	27.27	108,886	27.09
	318,770	4.07	\$ 20.25	296,738	\$ 19.67

The summary of the status of our unvested stock options as of December 31, 2017 and changes during the three months ended March 31, 2018 is presented below.

	Shares	Weighted Average Grant Date Fair Value Per Share
Unvested stock options:		
Unvested at December 31, 2017	48,581	\$ 11.41
Vested	(26,549)	10.97
Unvested at March 31, 2018	22,032	\$ 11.93

As of March 31, 2018, there was \$223,511 of unrecognized compensation cost related to unvested options. Such cost is expected to be recognized over a weighted-average period of two years. Total compensation expense for stock

options was \$66,625 and \$124,331 for the three months ended March 31, 2018 and 2017, respectively.

Restricted Shares/Units:

In accordance with the Company's employment agreement with Stephen Taylor, the Company's Chief Executive Officer, the Compensation Committee reviewed his performance in determining the issuance of restricted common stock. Based on this review which included consideration of the Company's 2017 performance, Mr. Taylor, was awarded 84,700 restricted shares/units on March 15, 2018, which vest over three years, in equal installments, beginning March 15, 2019. On March 15, 2018, the Compensation Committee awarded 20,000 restricted shares/units to each of G. Larry Lawrence, our CFO, and James Hazlett, our Vice President of Technical Services. The restricted shares to Messrs. Lawrence and Hazlett vest over three years, in equal installments, beginning March 15, 2019. We also awarded and issued 16,288 shares of restricted common stock to the independent members of our Board of Directors as partial payment for 2018 services as directors. The restricted stock issued to our directors vests over one year, in quarterly installments, beginning March 31, 2019. Total compensation expense related to restricted awards was \$361,630 and \$1,408,265 for the three months ended March 31, 2018 and 2017, respectively. As of March 31, 2018, there was a total of \$4,408,825 of unrecognized compensation expense related to these shares/units which is expected to be recognized over the next three years.

(3) Inventory

Our inventory, net of allowance for obsolescence of \$20,785 and \$15,000 at March 31, 2018 and December 31, 2017, respectively, consisted of the following amounts:

	March 31	December 31,
	2018	2017
	(in thousands)	
Raw materials - current	\$21,482	\$ 22,813
Raw materials - long term	3,315	2,829
Finished Goods	1,022	1,022
Work in process	3,245	2,389
	\$29,064	\$ 29,053

Our long-term inventory consists of raw materials that remain viable but that the Company does not expect to sell within the year.

During the three months ended March 31, 2018 and 2017, there were no write-offs of obsolete inventory against the allowance for obsolescence.

(4) Deferred Compensation Plans

The Company has a non-qualified deferred compensation plan for executive officers, directors and certain eligible employees. The assets of the deferred compensation plan are held in a rabbi trust and are subject to additional risk of loss in the event of bankruptcy or insolvency of the Company. The plan allows for deferral of up to 90% of a participant's base salary, bonus, commissions, director fees and restricted stock unit awards. A Company owned life insurance policy held in a rabbi trust is utilized as a source of funding for the plan. The cash surrender value of the life insurance policy is \$966,000 and \$312,000 as of March 31, 2018 and 2017, respectively. For the three months ending March 31, 2018, we reported in other (expense) income in the consolidated income statement a loss related to the policy of approximately \$67,000 and for the same period in 2017, a gain of approximately \$12,000.

For deferrals of base salary, bonus, commissions and director fees, settlement payments are made to participants in cash, either in a lump sum or in periodic installments. The obligation to pay the deferred compensation and the deferred director fees is adjusted to reflect the positive or negative performance of investment measurement options selected by each participant and was \$992,000 and \$261,000 as of March 31, 2018 and 2017, respectively. The deferred obligation is included in other long-term liabilities in the condensed consolidated balance sheet.

For deferrals of restricted stock units, the plan does not allow for diversification, therefore, distributions are paid in shares of common stock and the obligation is carried at grant value. As of March 31, 2018, 104,590 unvested restricted stock units have been deferred and 32,037 units have been released; carrying a value of \$816,373 to the deferred compensation plan.

(5) Credit Facility

We have a senior secured revolving credit agreement the ("Amended Credit Agreement") with JP Morgan Chase Bank, N.A (the "Lender") with an aggregate commitment of \$30 million, subject to collateral availability. We also have a right to request from the Lender, on an uncommitted basis, an increase of up to \$20 million on the aggregate commitment (which could potentially increase the commitment amount to \$50 million). On August 31, 2017, we amended and renewed the Amended Credit Agreement, which was set to expire on December 31, 2017. The Credit Agreement Amendment extended the maturity date to December 31, 2020. No other material revisions were made to the credit facility.

Borrowing Base. At any time before the maturity of the Amended Credit Agreement, we may draw, repay and re-borrow amounts available under the borrowing base up to the maximum aggregate availability discussed above. Generally, the borrowing base equals the sum of (a) 80% of our eligible accounts receivable plus (b) 50% of the book value of our eligible general inventory (not to exceed 50% of the commitment amount at the time) plus (c) 75% of the book value of our eligible equipment inventory. The Lender may adjust the borrowing base components if material deviations in the collateral are discovered in future audits of the collateral. We had \$29.5 million borrowing base availability at March 31, 2018 under the terms of our Amended Credit Agreement.

Interest and Fees. Under the terms of the Amended Credit Agreement, we have the option of selecting the applicable variable rate for each revolving loan, or portion thereof, of either (a) LIBOR multiplied by the Statutory Reserve Rate (as defined in the Amended Credit Agreement), with respect to this rate, for Eurocurrency funding, plus the Applicable Margin ("LIBOR-based"), or (b) CB Floating Rate, which is the Lender's Prime Rate less the Applicable Margin; provided, however, that no more than three LIBOR-based borrowings under the agreement may be outstanding at any one time. For purposes of the LIBOR-based interest rate, the Applicable Margin is 1.50%. For purposes of the CB Floating Rate, the Applicable Margin is 1.50%. For the three month period ended March 31, 2018, our weighted average interest rate was 3.16%.

Accrued interest is payable monthly on outstanding principal amounts, provided that accrued interest on LIBOR-based loans is payable at the end of each interest period, but in no event less frequently than quarterly. In addition, fees and expenses are payable in connection with our requests for letters of credit (generally equal to the Applicable Margin for LIBOR-related borrowings multiplied by the face amount of the requested letter of credit) and administrative and legal costs.

Maturity. The maturity date of the Amended Credit Agreement is December 31, 2020, at which time all amounts borrowed under the agreement will be due and outstanding letters of credit must be cash collateralized. The agreement may be terminated early upon our request or the occurrence of an event of default.

Security. The obligations under the Amended Credit Agreement are secured by a first priority lien on all of our inventory and accounts and leases receivables, along with a first priority lien on a variable number of our leased compressor equipment the book value of which must be maintained at a minimum of 2.00 to 1.00 commitment coverage ratio (such ratio being equal to (i) the amount of the borrowing base as of such date to (ii) the amount of the commitment as of such date.)

Covenants. The Amended Credit Agreement contains customary representations and warranties, as well as covenants which, among other things, limit our ability to incur additional indebtedness and liens; enter into transactions with affiliates; make acquisitions in excess of certain amounts; pay dividends; redeem or repurchase capital stock or senior notes; make investments or loans; make negative pledges; consolidate, merge or effect asset sales; or change the

nature of our business. In addition, we also have certain financial covenants that require us to maintain on a consolidated basis a leverage ratio less than or equal to 2.50 to 1.00 as of the last day of each fiscal quarter.

Events of Default and Acceleration. The Amended Credit Agreement contains customary events of default for credit facilities of this size and type, and includes, without limitation, payment defaults; defaults in performance of covenants or other agreements contained in the loan documents; inaccuracies in representations and warranties; certain defaults, termination events or similar events; certain defaults with respect to any other Company indebtedness in excess of \$50,000; certain bankruptcy or insolvency events; the rendering of certain judgments in excess of \$150,000; certain ERISA events; certain change in control events and the defectiveness of any liens under the secured revolving credit facility. Obligations under the Amended Credit Agreement may be accelerated upon the occurrence of an event of default.

As of March 31, 2018, we were in compliance with all covenants in our Amended Credit Agreement. A default under our Credit Agreement could trigger the acceleration of our bank debt so that it is immediately due and payable. Such default would likely limit our ability to access other credit. At March 31, 2018 and December 31, 2017 our outstanding balance on the line of credit was \$417,000.

(6) Earnings per Share

The following table reconciles the numerators and denominators of the basic and diluted earnings per share computation(in thousands, except per share data):

	Three months ended March 31, 2018 2017	
Numerator:		
Net income	\$225	\$ 252
Denominator for basic net income per common share:		
Weighted average common shares outstanding	12,920	12,804
Denominator for diluted net income per share:		
Weighted average common shares outstanding	12,920	12,804
Dilutive effect of stock options and restricted stock	249	252
Diluted weighted average shares	13,169	13,056
Earnings per common share:		
Basic	\$0.02	\$ 0.02
Diluted	\$0.02	\$ 0.02

In the three months ended March 31, 2018 and 2017, options to purchase 83,917 shares of common stock with exercise prices ranging from \$28.15 to \$33.36 were not included in the computation of dilutive income per share, due to their antidilutive effect.

(7) Segment Information

ASC 280-10-50, "Operating Segments", defines the characteristics of an operating segment as: a) being engaged in business activity from which it may earn revenue and incur expenses, b) being reviewed by the Company's chief operating decision maker (CODM) for decisions about resources to be allocated and assess its performance and c) having discrete financial information. Although we look at our products to analyze the nature of our revenue, other financial information, such as certain costs and expenses, net income and EBITDA are not captured or analyzed by these categories. Our CODM does not make resource allocation decisions or access the performance of the business based on these categories, but rather in the aggregate. Based on this, management believes that it operates in one business segment.

In their analysis of product lines as potential operating segments, management also considered ASC 280-10-50-11, "Aggregation Criteria", which allows for the aggregation of operating segments if the segments have similar economic characteristics and if the segments are similar in each of the following areas:

- ☐ The nature of the products and services;
- ☐ The nature of the production processes;
- ☐ The type or class of customer for their products and services;
- ☐ The methods used to distribute their products or provide their services; and

- The nature of the regulatory environment, if applicable.

We are engaged in the business of designing and manufacturing compressors and flares. Our compressors and flares are sold and rented to our customers. In addition, we provide service and maintenance on compressors in our fleet and to third parties. These business activities are similar in all geographic areas. Our manufacturing process is essentially the same for the entire Company and is performed in-house at our facilities in Midland, Texas and Tulsa, Oklahoma. Our customers primarily consist of entities in the business of producing natural gas and crude oil. The maintenance and service of our products is consistent across the entire Company and is performed via an internal fleet of vehicles. The regulatory environment is similar in every

jurisdiction in that the most impacting regulations and practices are the result of federal energy policy. In addition, the economic characteristics of each customer arrangement are similar in that we maintain policies at the corporate level.

For the three months ended March 31, 2018 (in thousands):

	Rental	Sales	Service & Maintenance	Corporate	Total
Revenue	\$11,471	\$2,998	\$ 249	\$—	\$14,718
Operating costs and corporate expenses	4,704	2,191	65	7,408	14,368
Total other expense, net	—	—	—	(76)	(76)
Income before provision for income taxes	\$6,767	\$807	\$ 184	\$(7,484)	\$274

For the three months ended March 31, 2017 (in thousands):

	Rental	Sales	Service & Maintenance	Corporate	Total
Revenue	\$11,922	\$6,637	\$ 343	\$—	\$18,902
Operating costs and corporate expenses	4,668	5,423	94	8,374	18,559
Total other income, net	—	—	—	1	1
Income before provision for income taxes	\$7,254	\$1,214	\$ 249	\$(8,373)	\$344

(8) Commitments and Contingencies

From time to time, we are a party to various legal proceedings in the ordinary course of our business. While management is unable to predict the ultimate outcome of these actions, it believes that any ultimate liability arising from these actions will not have a material adverse effect on our financial position, results of operations or cash flow. We are not currently a party to any material legal proceedings, and we are not aware of any threatened material litigation.

The Company also has a contractual obligation related to the construction of a new corporate office of approximately \$10.5 million, financed by cash on hand. Construction of a new office began in late 2017 and is expected to be completed in early 2019.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The discussion and analysis of our financial condition and results of operations are based on, and should be read in conjunction with, our condensed, consolidated financial statements and the related notes included elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC.

Overview

We fabricate, manufacture, rent, and sell natural gas compressors and related equipment. Our primary focus is on the rental of natural gas compressors. Our rental contracts generally provide for initial terms of six to 24 months. After the initial term of our rental contracts, many of our customers have continued to rent our compressors on a month-to-month basis. Rental amounts are billed monthly in advance and include maintenance of the rented compressors. As of March 31, 2018, we had 1,213 natural gas compressors totaling 183,927 horsepower rented to 84 customers compared to 1,261 natural gas compressors totaling 180,594 horsepower rented to 75 customers at March 31, 2017.

We also fabricate natural gas compressors for sale to our customers, designing compressors to meet unique specifications dictated by well pressures, production characteristics, and particular applications for which compression is sought. Fabrication of compressors involves our purchase of engines, compressors, coolers, and other components, and our assembling of these components on skids for delivery to customer locations. The major components of our compressors are acquired through periodic purchase orders placed with third-party suppliers on an “as needed” basis, which presently requires a two to three month lead time with delivery dates scheduled to coincide with our estimated production schedules. Although we do not have formal continuing supply contracts with any major supplier, we believe we have adequate alternative sources available. In the past, we have not

experienced any sudden and dramatic increases in the prices of the major components for our compressors. However, the occurrence of such an event could have a material adverse effect on the results of our operations and financial condition, particularly if we were unable to increase our rental rates and sales prices proportionate to any such component price increases.

We also manufacture a proprietary line of compressor frames, cylinders and parts, known as our CiP (Cylinder-in-Plane) product line. We use finished CiP component products in the fabrication of compressor units for sale or rental by us or sell the finished component products to other compressor fabricators. We also design, fabricate, sell, install, and service flare stacks and related ignition and control devices for onshore and offshore incineration of gas compounds such as hydrogen sulfide, carbon dioxide, natural gas and liquefied petroleum gases. To provide customer support for our compressor and flare sales businesses, we stock varying levels of replacement parts at our Midland, Texas facility and at field service locations. We also provide an exchange and rebuild program for screw compressors and maintain an inventory of new and used compressors to facilitate this business.

We provide service and maintenance to our customers under written maintenance contracts or on an as-required basis in the absence of a service contract. Maintenance agreements typically have terms of nine months to one year and require payment of a monthly fee.

The oil and natural gas equipment rental and services industry is cyclical in nature. The most critical factor in assessing the outlook for the industry is the worldwide supply and demand for natural gas and crude oil and the corresponding changes in commodity prices. As demand and prices increase, oil and natural gas producers increase their capital expenditures for drilling, development and production activities. Generally, the increased capital expenditures ultimately result in greater revenues and profits for services and equipment companies.

In general, we expect our overall business activity and revenues to track the level of activity in the natural gas industry, with changes in domestic natural gas production and consumption levels and prices more significantly affecting our business than changes in crude oil and condensate production and consumption levels and prices. However, in recent years we have increased our rental and sales in the non-conventional shale plays which are more dependent on crude oil prices. We also believe that demand for compression services and products is driven by declining reservoir pressure in maturing natural gas producing fields and, more recently, by increased focus by producers on non-conventional natural gas production, such as coalbed methane, gas shales and tight gas, which typically requires more compression than production from conventional natural gas reservoirs.

We typically experience a decline in demand during periods of low crude oil and natural gas prices. Low crude oil and natural gas prices experienced throughout 2016 continued into mid-2017. In the latter half of 2017, we began to see an increase in oil prices and activity that has continued into 2018. We anticipate a continuation of these increased prices and activity in E&P companies for the remainder of 2018. While the continuation of this increased activity is uncertain, we believe the long-term trend in our market is favorable.

Results of Operations

Three months ended March 31, 2018, compared to the three months ended March 31, 2017.

The table below shows our revenues and percentage of total revenues of each of our product lines for the three months ended March 31, 2018 and 2017.

Revenue Three months
ended March 31,

Edgar Filing: NATURAL GAS SERVICES GROUP INC - Form 10-Q

(in thousands)

	2018		2017	
Rental	\$11,471	78 %	\$11,922	63 %
Sales	2,998	20 %	6,637	35 %
Service and Maintenance	249	2 %	343	2 %
Total	\$14,718		\$18,902	

Total revenue decreased to \$14.7 million from \$18.9 million, or 22%, for the three months ended March 31, 2018, compared to the same period ended March 31, 2017. The decrease is mainly a result of the fluctuation in sales due to the timing of industry activity.

Rental revenue decreased to \$11.5 million from \$11.9 million for the three months ended March 31, 2018, compared to the same period ended March 31, 2017. We ended the quarter with 2,552 compressor packages in our fleet, up from 2,531 units at March 31, 2017. The rental fleet had a utilization of 47.5% as of March 31, 2018 compared to 49.8% utilization as of March 31, 2017. The drop in utilization is mainly the result of compressor rental units being returned due to the slow reaction to changes in oil and natural gas prices. We have experienced some relief in the number of sets versus returns over the last twelve months. In the event that oil and natural gas prices keep steady or continued to increase, we expect to see an increase in the utilization of our fleet.

Sales revenue decreased to \$3.0 million from \$6.6 million for the three months ended March 31, 2018 compared to the same period ended March 31, 2017. This decrease is the result of fluctuations in timing of industry activity related to capital projects. We believe this timing is reflective of the typical sales cycle, resulting in fluctuating compressor unit sales to third parties from our Tulsa and Midland operations. We had an increase in our flares product line during this comparative period, due to customer demand.

Our overall operating income was relatively flat at \$350,000 compared to \$343,000 for the three months ended March 31, 2018 and March 31, 2017, respectively. Operating margin percentage also remained flat at 2% for the three months ended March 31, 2018 and March 31, 2017. The low operating margin was due to the reduction in revenue.

Selling, general, and administrative expense decreased to \$2.0 million from \$3.0 million for the three months ended March 31, 2018, and March 31, 2017, primarily due to a \$1.1 million decrease in stock compensation expense.

Depreciation and amortization expense was relatively flat at \$5.4 million for the three months ended March 31, 2018, compared to \$5.3 million for the period ended March 31, 2017. This slight increase is the result of larger horsepower units being added to the fleet. We added 25 units to our fleet over the past 12 months, with 19 being 400 horsepower or larger.

Provision for income tax was \$49,000 and \$92,000 for the three months ended March 31, 2018 and March 31, 2017, respectively. The decrease in the provision is due to a change in effective tax rate between the two periods. The change in effective tax rate is driven by the U.S. government enacted Tax Cuts and Jobs Act (effective December 2017), which reduced the corporate rate from 35 percent to 21 percent.

Liquidity and Capital Resources

Our working capital positions as of March 31, 2018 and December 31, 2017 are set forth below:

	March 31, 2018	December 31, 2017
	(in thousands)	
Current Assets:		
Cash and cash equivalents	\$65,138	\$69,208
Trade accounts receivable, net	7,719	8,534
Inventory	25,749	26,224
Prepaid income taxes	3,443	3,443
Prepaid expenses and other	329	817
Total current assets	102,378	108,226
Current Liabilities:		

Edgar Filing: NATURAL GAS SERVICES GROUP INC - Form 10-Q

Accounts payable	1,322	4,162
Accrued liabilities	3,407	3,106
Deferred income	294	185
Total current liabilities	5,023	7,453
Total working capital	\$97,355	\$100,773

14

For the three months ended March 31, 2018, we invested \$8.7 million in property and equipment. During these three months, we've added \$7.4 million in new equipment to our rental fleet, \$1.4 million in payments related to the construction of our new corporate office and \$477 thousand in vehicles. Our investment in property and equipment also includes any changes between work in progress related to rental fleet jobs started and completed during the period, this change was a decrease to the property and equipment of \$529 thousand. Even though we have idle rental equipment, at times we do not have the specific type of equipment that our customers require, therefore we have to build new equipment to satisfy their needs. We financed this activity with cash flow from operations and cash on hand.

Cash flows

At March 31, 2018, we had cash and cash equivalents of \$65.1 million compared to \$69.2 million at December 31, 2017. Our cash flow from operations of \$5.1 million was offset by capital expenditures of \$8.7 million, during the three months ended March 31, 2018. We had working capital of \$97.4 million at March 31, 2018 compared to \$100.8 million at December 31, 2017. On March 31, 2018 and December 31, 2017, we had outstanding debt of \$417,000, which is all related to our line of credit. We had positive net cash flow from operating activities of \$5.1 million during the first three months of 2018 compared to \$10.5 million for the first three months of 2017. The cash flow from operations of \$5.1 million was primarily the result of the net income of \$225,000 and the non-cash items of depreciation of \$5.4 million, \$428,000 related to the expenses associated with stock-based compensation, and a decrease in cash flows related to working capital and other of \$1.0 million.

Strategy

For the remainder of the fiscal year 2018, our overall plan is to continue monitoring and holding expenses in line with the anticipated level of activity, fabricate rental fleet equipment only in direct response to market requirements, emphasize marketing of our idle gas compressor units and limit bank borrowing in line with market conditions. For the remainder of 2018, our forecasted capital expenditures will be directly dependent upon our customers' compression requirements and are not anticipated to exceed our internally generated cash flows and cash on hand. Any required capital will be for additions to our compressor rental fleet and/or addition or replacement of service vehicles. We believe that cash flows from operations, our current cash position and our line of credit will be sufficient to satisfy our capital and liquidity requirements for the foreseeable future. We may require additional capital to fund any unanticipated expenditures, including any acquisitions of other businesses, although that capital, beyond our line of credit, as discussed below may not be available to us when we need it or on acceptable terms.

Bank Borrowings

We have a senior secured revolving credit agreement the ("Amended Credit Agreement") with JP Morgan Chase Bank, N.A. (the "Lender") with an aggregate commitment of \$30 million, subject to collateral availability. We also have a right to request from the lender, on an uncommitted basis, an increase of up to \$20 million on the aggregate commitment (which could potentially increase the commitment amount to \$50 million). On August 31, 2017, we amended and renewed the Amended Credit Agreement, which was set to expire on December 31, 2017. The Credit Agreement Amendment extended the maturity date to December 31, 2020. No other material revisions were made to the credit facility.

Borrowing Base. At any time before the maturity of the Amended Credit Agreement, we may draw, repay and re-borrow amounts available under the borrowing base up to the maximum aggregate availability discussed above. Generally, the borrowing base equals the sum of (a) 80% of our eligible accounts receivable plus (b) 50% of the book value of our eligible general inventory (not to exceed 50% of the commitment amount at the time) plus (c) 75% of the book value of our eligible equipment inventory. The Lender may adjust the borrowing base components if material

deviations in the collateral are discovered in future audits of the collateral. We had \$29.5 million borrowing base availability at March 31, 2018, under the terms of our Amended Credit Agreement.

Interest and Fees. Under the terms of the Amended Credit Agreement, we have the option of selecting the applicable variable rate for each revolving loan, or portion thereof, of either (a) LIBOR multiplied by the Statutory Reserve Rate (as defined in the Amended Credit Agreement), with respect to this rate, for Eurocurrency funding, plus the Applicable Margin (“LIBOR-based”), or (b) CB Floating Rate, which is the Lender's Prime Rate less the Applicable Margin; provided, however, that no more than three LIBOR-based borrowings under the agreement may be outstanding at any one time. For purposes of the LIBOR-based interest rate, the Applicable Margin is 1.50%. For purposes of the CB Floating Rate, the Applicable Margin is 1.50%. For the three month period ended March 31, 2018, our weighted average interest rate was 3.16%.

Accrued interest is payable monthly on outstanding principal amounts, provided that accrued interest on LIBOR-based loans is payable at the end of each interest period, but in no event less frequently than quarterly. In addition, fees and expenses are payable in connection with our requests for letters of credit (generally equal to the Applicable Margin for LIBOR-related borrowings multiplied by the face amount of the requested letter of credit) and administrative and legal costs.

Maturity. The maturity date of the Amended Credit Agreement is December 31, 2020, at which time all amounts borrowed under the agreement will be due and outstanding letters of credit must be cash collateralized. The agreement may be terminated early upon our request or the occurrence of an event of default.

Security. The obligations under the Amended Credit Agreement are secured by a first priority lien on all of our inventory and accounts and leases receivables, along with a first priority lien on a variable number of our leased compressor equipment the book value of must be maintained at a minimum of 2.00 to 1.00 commitment coverage ratio (such ratio being equal to (i) the amount of the borrowing base as of such date to (ii) the amount of the commitment as of such date.)

Covenants. The Amended Credit Agreement contains customary representations and warranties, as well as covenants which, among other things, limit our ability to incur additional indebtedness and liens; enter into transactions with affiliates; make acquisitions in excess of certain amounts; pay dividends; redeem or repurchase capital stock or senior notes; make investments or loans; make negative pledges; consolidate, merge or effect asset sales; or change the nature of our business. In addition, we also have certain financial covenants that require us to maintain on a consolidated basis a leverage ratio less than or equal to 2.50 to 1.00 as of the last day of each fiscal quarter.

Events of Default and Acceleration. The Amended Credit Agreement contains customary events of default for credit facilities of this size and type, and includes, without limitation, payment defaults; defaults in performance of covenants or other agreements contained in the loan documents; inaccuracies in representations and warranties; certain defaults, termination events or similar events; certain defaults with respect to any other Company indebtedness in excess of \$50,000; certain bankruptcy or insolvency events; the rendering of certain judgments in excess of \$150,000; certain ERISA events; certain change in control events and the defectiveness of any liens under the secured revolving credit facility. Obligations under the Amended Credit Agreement may be accelerated upon the occurrence of an event of default.

As of March 31, 2018, we were in compliance with all covenants in our Amended Credit Agreement. A default under our Credit Agreement could trigger the acceleration of our bank debt so that it is immediately due and payable. Such default would likely limit our ability to access other credit. At March 31, 2018, our balance on the line of credit was \$417,000.

Contractual Obligations and Commitments

We have contractual obligations and commitments that affect the results of operations, financial condition and liquidity. The following table is a summary of our significant cash contractual obligations as of March 31, 2018:

Cash Contractual Obligations	Obligations Due in Period (in thousands)					
	2018 (1)	2019	2020	2021	Thereafter	Total
Line of credit (secured)	\$—	\$—	\$417	\$—	\$—	\$417
Interest on line of credit ⁽²⁾	13	17	17	—	—	47
Purchase obligations ⁽³⁾	157	300	300	300	266	1,323
Other long-term liabilities	—	—	—	—	83	83
Facilities and office leases	379	122	9	1	—	511
Total	\$549	\$439	\$743	\$301	\$349	\$2,381

The Company also has a contractual obligation related to the construction of a new corporate office of approximately \$10.5 million, financed by cash on hand. Construction of a new office began in late 2017 and is expected to be

completed in early 2019.

- (1) For the nine months remaining in 2018.
- (2) Assumes an interest rate of 4.0% and no additional borrowings.
- (3) Vendor exclusive purchase agreement related to paint and coatings.

Critical Accounting Policies and Practices

There have been no changes in the critical accounting policies disclosed in the Company's Form 10-K for the year ended December 31, 2017.

Recently Issued Accounting Pronouncements

On February 25, 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for capital and operating leases with lease terms of more than 12 months. Additionally, this ASU will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The new standard will be effective during our first quarter ending March 31, 2019. We are currently determining the impacts of the new standard on our condensed consolidated financial statements and the additional applicable disclosure requirements.

Off-Balance Sheet Arrangements

From time-to-time, we enter into off-balance sheet arrangements and transactions that can give rise to off-balance sheet obligations. As of March 31, 2018, the off-balance sheet arrangements and transactions that we have entered into include operating lease agreements and purchase agreements. We do not believe that these arrangements are reasonably likely to materially affect our liquidity, availability of, or requirements for, capital resources.

Special Note Regarding Forward-Looking Statements

Except for historical information contained herein, the statements in this report are forward-looking and made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks and uncertainties, which may cause our actual results in future periods to differ materially from forecasted results. Those risks include, among other things, the loss of market share through competition or otherwise; the introduction of competing technologies by other companies; a prolonged, substantial reduction in oil and natural gas prices which could cause a decline in the demand for our products and services; and new governmental safety, health and environmental regulations which could require us to make significant capital expenditures. The forward-looking statements included in this Form 10-Q are only made as of the date of this report, and we undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances. A discussion of these and other risk factors is included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no changes in the market risks disclosed in the Company's Form 10-K for the year ended December 31, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

An evaluation was carried out under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Vice President and Principal Accounting Officer, of the effectiveness of the design and of our “disclosure controls and procedures” (as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended or, the “Exchange Act”) as of the end of the period covered by this report pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the President and Chief Executive Officer and our Vice President and Principal Accounting Officer have concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. These include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our principal executive and financial officers as appropriate to allow timely decisions regarding required disclosures. Due to the inherent limitations of control systems, not all misstatements or omissions may be detected. Those inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because

of simple errors or mistakes. Additionally, controls could be circumvented by the individual acts of some persons or by collusion of two or more people. Our controls and procedures can only provide reasonable, not absolute, assurance that the above objectives have been met.

Changes in Internal Controls.

On January 1, 2018, the Company adopted ASU No. 2014-09, Revenue from Contracts with Customers using the modified retrospective method of transition applied to all contracts. This ASU formed ASC 606, Revenue from Contracts with Customers ("ASC 606"), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP and includes a five step process to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services.

During the first quarter of 2018, we added internal control processes over financial reporting as a result of the adoption of ASC 606. There have been no other changes in our internal control over financial reporting that occurred during our fiscal quarter ended March 31, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are a party to various legal proceedings in the ordinary course of our business. While management is unable to predict the ultimate outcome of these actions, it believes that any ultimate liability arising from these actions will not have a material adverse effect on our financial position, results of operations or cash flow. We are not currently a party to any material legal proceedings and we are not aware of any threatened litigation.

Item 1A. Risk Factors

Please refer to and read "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 for a discussion of the risks associated with our Company and industry.

Item 6. Exhibits

The following exhibits are filed herewith or incorporated herein by reference, as indicated:

Exhibit No.	Description
<u>3.1</u>	Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3.1 of the 10-QSB filed and dated November 10, 2004)
<u>3.2</u>	Bylaws as amended (Incorporated by reference to Exhibit 3.1 of the Registrant's current report on form 8-K filed with the Securities and Exchange Commission on June 21, 2016.
<u>10.1</u>	Lease Agreement, dated January 9, 2018, between WNB Tower, LTD and Natural Gas Services Group, Inc. (Incorporated by reference to Exhibit 10.15 of the Registrant's Form 10-K for the fiscal year ended December 31, 2017 and filed with the Securities and Exchange Commission on March 9, 2018.)
<u>10.2</u>	2009 Restricted Stock/Unit Plan, as amended (Incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K dated June 3, 2014 and filed with the Securities and Exchange Commission on June 6, 2014.)
<u>10.3</u>	Stock Option Plan, as amended and restated (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 21, 2016.)
<u>10.4</u>	Credit Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated December 10, 2010 (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 24, 2014.)
<u>10.5</u>	Fifth Amendment of Credit Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated August 31, 2017 (Incorporated by reference to Exhibit 10.2 of the Registrant's Current report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.)
<u>10.6</u>	Security Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated December 10, 2010 (Incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 16, 2011.)
<u>10.7</u>	Fourth Security Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated August 31, 2017 (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.)
<u>10.8</u>	Promissory Note in the aggregate amount of \$30,000,000 issued to JPMorgan Chase Bank, N.A., dated August 31, 2017, in connection with the revolving credit line under the Credit Agreement with JPMorgan Chase Bank, N.A. (Incorporated by reference to Exhibit 10.3 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.)
<u>10.9</u>	Amended and restated Employment Agreement dated April 27, 2015 between Natural Gas Services Group, Inc. and Stephen C. Taylor (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 29, 2015.)

The Executive Nonqualified Excess Plan Adoption Agreement, referred to as the Nonqualified Deferred 10.10 Compensation Plan (Incorporated by reference to Exhibit 10.11 of the Registrant's Quarterly report on Form 10-Q filed with the Securities and Exchange Commission on May 6, 2016.)

- 10.11 Annual Incentive Bonus Plan (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission December 18, 2012.)
- *31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- *31.2 Certification of Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- *32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- *32.2 Certification of Principal Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NATURAL GAS SERVICES GROUP, INC.

/s/ Stephen C. Taylor

Stephen C. Taylor

President and Chief Executive Officer

(Principal Executive Officer)

/s/ G. Larry Lawrence

G. Larry Lawrence

Vice President and Chief Financial Officer

(Principal Accounting Officer)

May 10, 2018