NATURAL GAS SERVICES GROUP INC
Form 10QSB
August 07, 2003

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

FORM 10-QSB

(X) QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2003

OR

( ) TRANSITION REPORT UNDER 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 small business issuer as specified in its charter)

Colorado	75-2811855
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2911 SCR 1260
Midland, Texas 79706
(Address of principal executive offices)

(915) 563-3974
(Issuer's Telephone number)

N/A

(Former name, former address and former fiscal year, if changed since last report)

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY
PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court.

Yes ___ No ____

APPLICABLE ONLY TO CORPORATE ISSUERS

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

Class	Outstanding at June 30, 2003
Common Stock, $.001 par value	4,881,632

Transitional Small Business Disclosure Format (Check one): Yes ___ No X

NATURAL GAS SERVICES GROUP, INC.

Commission File Number: 1-31398

Quarter Ended June 30, 2003

FORM 10-QSB

Part I - FINANCIAL INFORMATION

Part II - OTHER INFORMATION

Natural Gas Services Group, Inc.
Consolidated Balance Sheet
(unaudited)
June 30, 2003

ASSETS

Current Assets:	
Cash and cash equivalents	$ 976,004
Accounts receivable - trade	1,482,762
Inventory	2,292,196
Prepaid expenses	81,156
Total current assets	4,832,118
Lease equipment, net	16,709,633
Other property, plant and equipment, net	2,616,661

Goodwill, net	2,589,655
Patents, net	127,684
Other assets	114,605
Total assets	$26,990,356

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities:	
Current portion of long term debt and capital lease	$ 2,278,951
Accounts payable and accrued liabilities	973,025
Unearned Income	588,007
Total current liabilities	3,839,983
Long term debt and capital lease, less current portion	6,708,947
Subordinated notes, net	1,376,865
Deferred income tax payable	1,492,573
Total liabilities	13,418,368
SHAREHOLDERS' EQUITY	
Preferred stock	3,577
Common stock	49,816
Paid in capital	11,167,733
Retained earnings	2,350,862
Total shareholders' equity	13,571,988
Total liabilities and shareholders' equity	$26,990,356

The accompanying notes are an integral part of the consolidated balance sheet.

1

Natural Gas Services Group, Inc.
Consolidated Income Statements
(unaudited)

	Three months ended June 30		Six months ended Jun	
	2003	2002	2003	20
Revenue:				
Sales	$ 939,838	$ 962,252	$ 1,505,110	$ 2,31
Service and maintenance	516,573	410,158	893,883	75
Leasing income	1,764,404	1,056,750	3,165,567	2,05
	3,220,815	2,429,160	5,564,560	5,11
Cost of revenue:				
Cost of sales	713,624	472,567	1,146,797	1,56
Cost of service and maintenance	335,928	348,634	671,229	65
Cost of leasing	406,867	303,764	767,784	58

	1,456,419	1,124,965	2,585,810	2,80
Gross Margin	1,764,396	1,304,195	2,978,750	2,31
Operating Cost:				
Selling expense	185,604	119,003	324,551	24
General and administrative expense	410,838	326,946	791,004	60
Amortization and depreciation	417,589	283,196	779,555	53
	1,014,031	729,145	1,895,110	1,38
Operating income	750,365	575,050	1,083,640	93
Interest expense	(175,706)	(265,480)	(329,789)	(52
Equity in earnings of joint venture	--	124,151	--	20
Other income	(21,760)	212	787	
Income before income taxes	552,899	433,933	754,638	61
Income tax expense	237,747	191,000	321,603	27
Net income	315,152	242,933	433,035	33
Preferred dividends	31,010	31,430	62,020	7
Net income available to common shareholders	$ 284,142	$ 211,503	$ 371,015	$ 26
Earnings per share:				
Basic	$ 0.06	$ 0.06	$ 0.08	$
Diluted	$ 0.06	$ 0.05	$ 0.07	$
Weighted average shares:				
Basic	4,875,324	3,357,632	4,866,527	3,35
Diluted	5,024,774	4,193,490	5,116,332	4,16

The accompanying notes are an integral part of the consolidated income statements.

Natural Gas Services Group, Inc.
Consolidated Statements of Cash Flows
(unaudited)

	Six Months Ended June 30, 2003	S Ju
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$ 433,035	$
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	779,555	
Deferred taxes	321,573	
Amortization of debt issuance costs	32,478	
Warrants Issued for debt guarantee	--	

Equity in earnings of joint venture	--
Gain on disposal of assets	10,547
Changes in operating assets and liabilities:	
Trade and other receivables	(836,812)
Inventory and work in progress	(746,248)
Prepaid expenses and other	92,146
Accounts payable and accrued liabilities	270,867
Unearned income	270,446
Other	(91,341)
NET CASH PROVIDED BY OPERATING ACTIVITIES	536,246
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	(4,465,223)
Acquisition of remaining interest in joint venture, net of cash acquired	242,753
Proceeds from sale of property and equipment	112,500
Decrease in lease receivable	210,512
Distribution from equity method investee	49,090
NET CASH USED IN INVESTING ACTIVITIES	(3,850,368)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net proceeds from bank loans and line of credit	2,438,997
Repayments of long term debt	(1,000,489)
Deferred offering costs	--
Proceeds from stock offering, net of offering cost	--
Dividends paid on preferred stock	(62,020)
Proceeds from exercise of warrants	200,000
NET CASH PROVIDED BY FINANCING ACTIVITIES	1,576,488
NET CHANGE IN CASH AND CASH EQUVALENTS	(1,737,634)
CASH AT BEGINNING OF PERIOD	2,713,638
CASH AT END OF PERIOD	$ 976,004
SUPPLEMENTAL DICLOSURE OF CASH FLOW INFORMATION:	
Interest paid	$ 329,789
Income taxes paid	$ --

The accompanying notes are an integral part of the consolidated statements of cash flows.

3

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The accompanying unaudited financial statements present the consolidated results of our company and its wholly-owned subsidiaries taken from our books and records. In our opinion, such information includes all adjustments, consisting of only normal recurring adjustments, which are necessary to make our financial position at June 30, 2003 and the results of our operations for the six months periods ended June 30, 2003 and 2002 not misleading. As permitted by the rules and regulations of the Securities and

Exchange Commission (SEC) the accompanying financial statements do not include all disclosures normally required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-KSB on file with the SEC. Investments in joint ventures in which our company does not have majority voting control are accounted for by the equity method. All intercompany balances and transactions have been eliminated in consolidation. In our opinion , the 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 six months ended June 30, 2003 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2003

(2) Stock-based Compensation

Statement of Financial Accounting Standards No. 123, ("SFAS 123") "Accounting for Stock-Based Compensation," encourages, but does not require, the adoption of a fair value-based method of accounting for employee stock-based compensation transactions. We have elected to apply the provisions of Accounting Principles Board Opinion No. 25 ("Opinion 25"), "Accounting for Stock Issued to Employees," and related interpretations, in accounting for our employee stock-based compensation plans. Under Opinion 25, compensation cost is measured as the excess, if any, of the quoted market price of our stock at the date of the grant above the amount an employee must pay to acquire the stock.

Had compensation costs for options granted to our employees been determined based on the fair value at the grant dates consistent with the method prescribed by SFAS No. 123, our pro forma net income and earnings per share would have been reduced to the pro forma amounts listed below:

	Three Months Ended June 30		Six Months June 3
	2003	2002	2003
Pro forma impact of fair value method			
Income applicable to common shares, as reported	$ 284,142	$ 211,503	$ 371,015
Pro-forma stock-based compensation costs under the fair value method, net of related tax	(7,683)	(14,010)	(15,365)
Pro-forma income applicable to common shares under the fair-value method	$ 276,459	$ 197,493	$ 355,650
Earnings per common share			
Basic earnings per share reported	$ 0.06	$ 0.06	$ 0.08
Diluted earnings per share reported	$ 0.06	$ 0.05	$ 0.07
Pro-forma basic earnings per share under the fair value method	$ 0.06	$ 0.06	$ 0.07
Pro-forma diluted earnings per share under the fair value method	$ 0.05	$ 0.05	$ 0.07
Weighted average Black-Scholes fair value assumptions:			
Risk free rate	4.0% - 5.2%		
Expected life	5-10 yrs		
Expected volatility	50.0%		
Expected dividend yield	0.0%		

(3) Acquisitions

On March 31, 2003 we acquired 28 gas compressor packages from Hy-Bon Engineering Company, Inc. ("Hy-Bon"). The adjusted purchase price amounted to approximately $2,140,000. As part of the purchase and sale agreement, Hy-Bon withdrew as a member of Hy-Bon Rotary Compression, L.L.C. ("Joint Venture") effective as of January 1, 2003. We, as the other member of Hy-Bon Rotary Compression, L.L.C., retained all assets of Hy-Bon Rotary Compression, L.L.C. that as of December 31, 2002 had an unaudited aggregate value of $346,511. We plan to dissolve Hy-Bon Rotary Compression, L.L.C. and have agreed not to operate under the name Hy-Bon. We have consolidated the operations of the Joint Venture beginning January 1, 2003 and then began recording our share of the profit of the acquired interest beginning April 1, 2003.

(4) Long Term Debt

We entered into a new loan agreement with our bank, as of March 26, 2003 that included new borrowing of $2,150,000 in the form of a term loan with monthly principal payments of $35,833 with interest at 1% over prime but not less than 5.25% for 60 months. The proceeds from this new borrowing were used to purchase the 28 gas compressors from Hy-Bon Engineering Company, Inc. The new loan agreement also included the renewal of our line of credit for $750,000 with interest at 1% over prime but not less than 5.25% for one year.

(5) Segment Information

FAS No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for public companies relating to the reporting of information about their operating segments in financial statements. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by chief operating decision-makers in deciding how to allocate resources and in assessing performance.

Our segment information is set forth in the following table:

(in thousands) Six Months Ended June 30, 2003	Rotary Gas	NGE Leasing	Great Lakes Compression	Natural Gas Services Group	Total
Revenue	$ 1,200	$ 2,070	$ 2,295	$ --	$ 5,565
Inter-segment revenue	2,744	35	8	--	2,787
Net Income (loss)	(54)	874	394	(781)	433
Segment Assets	4,323	12,986	9,195	486	26,990

(in thousands) Six Months Ended June 30, 2002	Rotary Gas	NGE Leasing	Great Lakes Compression	Natural Gas Services Group	Total
Revenue	$ 1,571	$ 1,059	$ 2,490	$ --	$ 5,120

Inter-segment revenue	3,046	--	--	--	3,046
Net Income (loss)	196	515	188	(560)	339
Segment Assets	4,504	6,711	9,160	695	21,070

5

(in thousands) Three Months Ended June 30, 2003	Rotary Gas	NGE Leasing	Great Lakes Compression	Natural Gas Services Group	Total
Revenue	$ 756	$ 1,211	$ 1,254	$ --	$ 3,221
Inter-segment revenue	1,337	18	3	--	1,358
Net Income (loss)	(11)	541	265	(480)	315

(in thousands) Three Months Ended June 30, 2002	Rotary Gas	NGE Leasing	Great Lakes Compression	Natural Gas Services Group	Total
Revenue	$ 704	$ 560	$ 1,166	$ --	$ 2,430
Inter-segment revenue	1,629	--	--	--	1,629
Net Income (loss)	179	282	134	(352)	243

(6) Earnings per common share

The following table reconciles the numerators and denominators of the basic and diluted earnings per share computation.

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months End June 30, 2003	
Basic earnings per share Numerator:				
Net income	$ 315,152	$ 242,933	$ 433,035	$
Less: dividends on preferred shares	(31,010)	(31,430)	(62,020)	
Net income available to common shareholders	$ 284,142	$ 211,503	$ 371,015	$
Denominator -				
Weighted average common shares outstanding	4,875,324	3,357,632	4,866,527	3,
Basic earnings per share	$ 0.06	$ 0.06	$ 0.08	$
Diluted earnings per share Numerator:				
Net income	$ 315,152	$ 242,933	$ 433,035	$
Less: dividends on preferred shares (1)	(31,010)	(31,430)	(62,020)	
Net income available to common shareholders	$ 284,142	$ 211,503	$ 371,015	$

Denominator :				
Weighted average common shares outstanding	4,875,324	3,357,632	4,866,527	3,
Common stock options and warrants	149,450	835,858	249,805	
Conversion of preferred shares (1)	--	--	--	
	5,024,774	4,193,490	5,116,332	4,
Diluted earnings per share	$ 0.06	$ 0.05	$ 0.07	$

(1) Preferred shares were anti-dilutive for the six and three months ended June 30, 2003 and 2002.

Item 2. Management's Discussion and Analysis or Plan of Operation

Overview

We include the operations of Rotary Gas Systems, NGE Leasing and Great Lakes Compression, which are wholly owned subsidiaries. These entities provide products and services to the oil and gas industry and are engaged in (1) the manufacture, service, sale, and rental of natural gas compressors to enhance the productivity of oil and gas wells, and (2) the manufacture, sale and rental of flares and flare ignition systems for plant and production facilities. We are the parent company and provide administrative and management support and therefore, have expenses associated with that activity.

Liquidity and Capital Resources

We have funded our operations through public and private offerings of our common and preferred stock, subordinated debt and bank debt. Proceeds were primarily used to pay debt and to fund the manufacture and fabrication of additional units for our rental fleet of gas compressors.

At June 30, 2003, we had cash and cash equivalents of $976,004, working capital of $992,135 and non-subordinated debt of $8,987,898, of which $2,278,951 was classified as current. We had net cash flow from operating activities of $536,246 during the first six months of 2003. This was primarily from net income of $433,035 plus depreciation and amortization of $779,555, an increase in accounts payable and accrued liabilities of $270,867, an increase in deferred taxes of $321,573 and an increase in deferred income of $270,446, offset by an increase in inventory of $746,248 and accounts receivable of $836,812.

On October 24, 2002, we paid off the note of $6,952,464 payable to Dominion Michigan, used for the acquisition of the compression related assets of Great Lakes Compression. $3,452,464 of the funds to pay the note came from the proceeds of our initial public offering, and $3,500,000 came from additional bank financing to be amortized over 60 months at prime plus 1%.

We entered into a new loan agreement with our bank, dated as of March 26, 2003. This included new borrowing of $2,150,000 in the form of a term loan with monthly principal payments of $35,833 with interest at 1% over prime but not less than 5.25% for 60 months. The proceeds from this new borrowing were used to purchase the 28 gas compressors from Hy-Bon. The new loan agreement also included the renewal of our line of credit for $750,000 with interest at 1% over prime for one year. We have not drawn from the line of credit as of June 30, 2003.

Funds from the initial public offering, which closed on October 24, 2002, will permit us to actively pursue adding gas compressors to our rental fleet. We expect to fund additional rental units through the use of the offering proceeds, additional bank debt and cash flow from operations.

A summary of the use of proceeds from our initial public offering as of June 30, 2003 is as follows:

- $3,458,464 to reduce indebtedness;
- $2,577,870 for the manufacture of gas compressors placed in our rental fleet and
- $492,836 in temporary investments - Bank Money Market Account.

Results of Operations

Six Months Ended June 30, 2003. Compared to the Six Months Ended June 30, 2002.

(in thousands)	Rotary Gas	NGE Leasing	Great Lakes Compression	Natural Gas Services Group	Tot
Six Months Ended June 30, 2003					
Revenue	$ 1,200	$ 2,070	$ 2,295	$ --	$
Inter-segment revenue	2,744	35	8	--	
Gross margin	479	1,554	946	--	
Selling, general and administrative expense	460	86	135	434	
Depreciation and amortization expense	70	379	319	12	
Operating income (loss)	(51)	1,089	492	(446)	
Interest expense	3	224	89	13	
Other income or (expense)	--	9	(9)	--	
Provision for income tax	--	--	--	322	
Net Income (loss)	$ (54)	$ 874	$ 394	$ (781)	$
Six Months Ended June 30, 2002					

Revenue	$ 1,571	$ 1,059	$ 2,490	$ --	$
Inter-segment revenue	3,046	--	--	--	
Gross margin	656	761	897	--	
Selling, general and administrative expense	398	80	126	240	
Depreciation and amortization expense	59	189	270	20	
Operating income (loss)	199	492	501	(260)	
Interest expense	4	186	313	20	
Equity in earnings from joint venture	--	208	--	--	
Other income or (expense)	1	1	--	--	
Provision for income tax	--	--	--	280	
Net income (loss)	$ 196	$ 515	$ 188	$ (560)	$

Rotary Gas Systems Operations

Revenue from outside sources decreased 24% or $371,000 for the six months ended June 30, 2003, as compared to the same period ended June 30, 2002. Because our products are custom-built, fluctuations in revenue from outside sources are expected. This decrease was mainly the result of a reduction in the sale of flare units to third parties.

The gross margin percentage decreased from 42% for the six months ended June 30, 2002, to 40% for the same period ended June 30, 2003. The cost of revenue is comprised of expenses associated with service, parts and manufacturing expenses. This decrease resulted mainly from a change in the product mix.

Selling, general and administrative expense increased $62,000 or 16% for the six months ended June 30, 2003, as compared to the same period ended June 30, 2002. This was mainly the result of the addition of new salesmen in the Farmington, New Mexico and West Texas areas.

Depreciation expense increased 19% or $11,000 for the six months ended June 30, 2003, as compared to the same period ended June 30, 2002. This increase was mainly due to the purchase of additional sales vehicles, shop and office equipment.

There was a decrease of $1,000 in interest expense for the six months ended June 30, 2003, as compared to the same period ended June 30, 2002, mainly due to the reduction in loan balances on vehicles.

NGE Leasing Operations

Revenue from our rental of natural gas compressors increased 95% for the six months ended June 30, 2003, as compared to the same period in 2002. This increase is the result of units added to our rental fleet. From June 30, 2002, to June 30, 2003, we added 137 gas compressor units to our rental fleet, which included the 28 units we purchased from Hy-Bon Engineering Company, Inc. on

March 31, 2003. The revenue from the Joint Venture, which was previously using the equity method, has been consolidated beginning January 1, 2003. The revenue from the units purchased from Hy-Bon Engineering Company, Inc. is included in our consolidated revenue beginning April 1, 2003.

The gross margin percentage increased from 72% for the six months ended June 30, 2002 to 75% for the same period ending 2003. This increase mainly resulted from a slight reduction in the maintenance expenses associated with the compressor units and also additional revenue recognized from the sale of our irrigation pump engines.

Selling, general and administrative expense increased $6,000 or 8% for the six months ended June 30, 2003, as compared to the same period in 2002. This was mainly the result of an increase in sales commissions from increased rental revenue.

Depreciation expense increased 101% or $190,000 for the six months ended June 30, 2003, as compared to the same period ended June 30, 2002. This increase was the result of new gas compressor rental units being added to the rental fleet during the period.

There was an increase in interest expense of 20% from $186,000 for the six months ended June 30, 2002, to $224,000 for the same period ended June 30, 2003. This is mainly as a result of an increase in bank debt used to purchase equipment for the rental fleet.

Great Lakes Compression

Revenue decreased 8% for the six months ended June 30, 2003, compared to the same period in 2002. This decrease resulted from a decrease in the sales of compressor units to third parties. In the period ended June 30, 2002 we had unit sales of approximately $501,000 to third parties while in the same period 2003 we had no unit sales to third parties. At the same time our rental revenue increased 5% and our parts sales increased 2%. Because our compressor units are custom-built, fluctuations in revenue from outside sources are expected.

The gross margin percentage increased from 36% for the six months ended June 30, 2002 to 41% for the same period in 2003. The cost of revenue is comprised of expenses associated with the maintenance of the gas compressor rental activity, service, parts and manufacturing expenses. This increase resulted mainly from a change in the sales product mix.

Selling, general and administrative expense increased by 7% or $9,000 for the six months ended June 30, 2003, as compared to the same period in 2002. This is mainly the result of an increase in selling expense.

Depreciation expense increased from $270,000 for the six months ended June 30, 2002, to $319,000 for the same period ended June 30, 2003. The increase is the result of equipment that was added to the rental fleet and the replacement of several service vehicles.

There was a decrease in interest expense of 72% from $313,000 for the six months ended June 30, 2002 to $89,000 for the six months ended June 30, 2003. This decrease resulted from a reduction of the debt owed to Dominion Michigan. Part of the proceeds from our initial public offering was used to reduce debt in the amount of $3,452,464 and our bank financed the remaining balance of $3,500,000 at a more favorable interest rate.

Natural Gas Services Group

Selling, general and administrative expense increased 81% from $240,000 for the six months ended June 30, 2002, as compared to $434,000 for the same period ended June 30, 2003. This was mainly the result of the added expense for being a publicly held company such as legal fees, auditor fees, underwriters and public relations fees.

Amortization and depreciation expense decreased 40% from $20,000 for the six months ended June 30, 2002, to $12,000 for the same period ended June 30, 2003. This mainly resulted from vehicles that were moved to our subsidiary, Great Lakes Compression.

Interest expense decreased 35% from $20,000 for the six months ended June 30, 2002, to $13,000 for the same period ended June 30, 2003. This decrease resulted from a reduction in the interest rate and from bank notes for vehicles moved to our subsidiary.

Provision for income tax is accounted for on a consolidated basis. Therefore, the tax for all companies is included in the provision for income tax for Natural Gas Services Group Inc. Income tax expense increased $42,000 or 15%, which is consistent with and pursuant to changes in state and federal tax statutes and the increase in net taxable income.

Three Months Ended June 30, 2003. Compared to the Three Months Ended June 30, 2003.

(in thousands)	Rotary Gas	NGE Leasing	Great Lakes Compression	Natural Gas Services Group	Tot
Three Months Ended June 30, 2003					
Revenue	$ 756	$ 1,211	$ 1,254	$ --	$
Inter-segment revenue	1,337	18	3	--	
Gross margin	276	923	566	--	
Selling, general and administrative expense	250	45	70	230	
Depreciation and amortization Expense	36	215	161	7	
Operating income (loss)	(10)	663	335	(237)	
Interest expense	2	124	44	5	
Other income or (expense)	1	2	(26)	--	
Provision for income tax	--	--	--	(238)	
Net Income (loss)	$ (11)	$ 541	$ 265	$ (480)	$
Three Months Ended June 30, 2002					
Revenue	$ 704	$ 560	$ 1,166	$ --	$
Inter-segment revenue	1,629	--	--	--	
Gross margin	410	399	495	--	
Selling, general and administrative					

expense	199	42	65	139	
Depreciation and amortization					
Expense	30	103	140	11	
Operating income (loss)	181	254	290	(150)	
Interest expense	2	96	156	11	
Equity in earnings from joint venture	--	124	--	--	
Provision for income tax	--	--	--	191	
Net income (loss)	$ 179	$ 282	$ 134	$ (352)	$

10

Rotary Gas Systems Operations

Revenue from outside sources decreased $52,000 or 7% for the three months ended June 30, 2003, as compared to the same period ended June 30, 2002. Because our products are custom-built, fluctuations in revenue from outside sources are expected. This decrease was mainly the result of a reduction in the sale of flare units to third parties.

The gross margin percentage decreased to 37% for the three months ended June 30, 2003, as compared to 58% for the same period ended June 30, 2002. The cost of revenue is comprised of expenses associated with service, parts and manufacturing expenses. This decrease resulted mainly from a change in the product-mix.

Selling, general and administrative expense increased 26% or $51,000 for the three months ended June 30, 2003, as compared to the same period ended June 30, 2002. This was mainly the result of the addition of new salesmen in the Farmington, New Mexico and West Texas areas. Depreciation expense increased 20% from $30,000 for the three months ended June 30, 2002, to $36,000 for the same period ended June 30, 2003. This increase was mainly due to the purchase of additional service vehicles, shop and office equipment.

There was a slight decrease in interest expense for the three months ended June 30, 2003, as compared to the same period ended June 30, 2002, mainly due to the reduction in loan balances on vehicles.

NGE Leasing Operations

Revenue from our rental of natural gas compressors increased 116% for the three months ended June 30, 2003, as compared to the same period in 2002. This increase is the result of the revenue from units added to our rental fleet and also additional revenue recognized from the sale of our irrigation pump engines.

The gross margin percentage increased from 71% for the three months ended June 30, 2002, to 76% the same period in 2003. This increase mainly resulted from the sale of the irrigation pump engines mentioned above and slight reduction in the maintenance expenses associated with the compressor units.

Selling, general and administrative expense increased from $42,000 for the three months ended June 30, 2002, to $45,000 for the same period in 2003. This was mainly the result of an increase in sales commissions due to increased rental revenue.

Depreciation expense increased 109% from $103,000, for the three months ended June 30, 2002 to $215,000 for the three months ended June 30, 2003. This increase was the result of new gas compressor rental units being added to the rental fleet during the period.

There was an increase in interest expense from $96,000 for the three months ended June 30, 2002, to $124,000 for the same period ended June 30, 2003. This is mainly a result of an increase in bank debt used to purchase equipment for the rental fleet.

Great Lakes Compression

Revenue increased 8% for the three months ended June 30, 2003, as compared to the same period in 2002. This increase was the result of an increase in maintenance, labor and parts sales to third parties.

The gross margin percentage increased from 42% for the three months ended June 30, 2002, to 45% for the same period in 2003. The cost of revenue is comprised of expenses associated with the maintenance of the gas compressor rental activity, service, parts and manufacturing expenses. This increase resulted mainly from a change in the sales product mix.

Selling, general and administrative expense increased from $65,000 for the three months ended June 30, 2002, to $70,000 for the same period in 2003. This is mainly the result of an increase in selling expense.

Depreciation expense increased from $140,000 for the three months ended June 30, 2002, to $161,000 for the same period ended June 30, 2003. The increase is the result of equipment that was added to the rental fleet.

There was a decrease in interest expense from $156,000 for the three months ended June 30, 2002, to $44,000 for the same period ended June 30, 2003. This decrease resulted from a reduction of the debt owed to Dominion Michigan. Part of the proceeds from our initial public offering was used to reduce debt in the amount of $3,452,464 and our bank financed the remaining balance of $3,500,000 at a more favorable interest rate.

Natural Gas Services Group

Selling, general and administrative expense increased 65% from $139,000 for the three months ended June 30, 2002, to $230,000 for the same period ended June 30, 2003. This was mainly the result of an added expense for being a publicly held company such as legal fees, auditor fees, underwriters and public relations fees.

Amortization and depreciation expense decreased 36% from $11,000 for the three months ended June 30, 2002, to $7,000 for the same period ended June 30, 2003. This mainly resulted from vehicles that were moved to our subsidiary, Great Lakes Compression.

Interest expense decreased 55% from $11,000 for the three months ended June 30, 2002, to $5,000 for the same period ended June 30, 2003. This decrease resulted from a reduction in the interest rate and for bank notes for vehicles moved to our subsidiary.

Provision for income tax is accounted for on a consolidated basis. Therefore, the tax for all companies is included in the provision for income tax for Natural Gas Services Group, Inc. Income tax expense increased $47,000 or 25%, which is consistent with and pursuant to changes in state and federal tax statutes. This increase is mainly due to an increase in income before taxes.

Item 3. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-14(c) under the Securities Exchange Act of 1934) as of a date (the "Evaluation Date") within 90 days prior to the filing date of this report. Based upon that evaluation, our chief executive officer and chief financial officer concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective in timely alerting them to the material information relating to us and our consolidated subsidiaries required to be included in our periodic filings with the SEC.

(b) Changes in internal controls.

There were no significant changes made in our internal controls during the period covered by this report or, to our knowledge, in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II - OTHER INFORMATION

Item 2. Changes in Securities and Use of Proceeds

(c) During the three months ended June 30, 2003, holders of 24,000 shares of our outstanding 10% Convertible Series A Preferred Stock converted the shares into 24,000 shares of our common stock. There was no underwriter involved in the transactions. The shares of our common stock were all issued in reliance upon the exemption contained in Section 4(2) of the Securities Act of 1933, as amended, because all of the persons were accredited investors and appropriate restrictive legends were placed on the certificates unless the shares were sold pursuant to the provisions of Rule 144.

(d) On October 21, 2002, our Registration Statement (File No. 333-88314) was declared effective.

Since October 21, 2002, we have incurred an aggregate of approximately $1,345,830 of expenses in connection with the offering, including underwriting discounts ($708,750), expenses paid to or for the underwriter ($157,500), and other expenses of the offering ($479,680). Such amounts were not paid directly or indirectly to the directors, the officers or to persons owning 10% or more of any class of our equity securities or to our affiliates. Rather, such payments were to others. After deducting the total expenses, we received net offering proceeds of approximately $6,529,170. Through June 30, 2003, the net offering proceeds have been used for:

- $3,458,464 to reduce indebtedness;
- $2,577,870 for the manufacture of gas compressors placed in our rental fleet and
- $492,836 in temporary investments - Bank Money Market Account.

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

On June 18, 2003, we held our Annual Meeting of Shareholders. At the Annual Meeting of Shareholders, Richard L. Yadon was elected for a term expiring at the Annual Meeting of Shareholders to be held in 2004, Gene A. Strasheim was elected for a term expiring at the Annual Meeting of Shareholders to be held in 2005, and James T. Grigsby and Scott W. Sparkman were elected for terms expiring at the Annual Meeting of Shareholders to be held in 2006. The terms of Charles G. Curtis, Wallace O. Sellers and Wayne L. Vinson as directors continued after the Annual Meeting of Shareholders until the Annual Meetings of Shareholders held in 2005, 2005 and 2004, respectively.

Voting for Richard L. Yadon

For:	4,680,928	Withheld:	25	Abstentions:	-0-

Voting for Gene A. Strasheim

For:	4,680,928	Withheld:	25	Abstentions:	-0-

Voting for James T. Grisgby

For:	4,680,928	Withheld:	25	Abstentions:	-0-

Voting for Scott W. Sparkman

For:	4,680,928	Withheld:	25	Abstentions:	-0-

Also, at the Annual Meeting of Shareholders held on June 18, 2003, the shareholders adopted an amendment to the Articles of Incorporation to reduce the number of designated shares of 10% Convertible Series A Preferred Stock. The votes were as follows:

For: 3,431,554	Against: 25	Abstentions: 71,150	Broker Non-Votes: -0-

NATURAL GAS SERVICES GROUP, INC.

Commission File Number: 1-31398
Quarter Ended June 30, 2003
Form 10-QSB

Item 6. Exhibits and Reports on Form 8-K
(a) Exhibits

2.1 Purchase and Sale Agreement by and between Hy-Bon Engineering Company, Inc. and NGE Leasing, Inc. (previously filed as Exhibit 2.1 to Natural Gas Services Group, Inc. Current Report on Form 8-K filed on March 6, 2003, File No. 1-31398, and incorporated herein by reference)

3.1 Articles of Amendment to the Articles of Incorporation filed on June 19, 2003

10.1 First Amended and Restated Loan Agreement between Natural Gas Services Group, Inc. and Western National Bank (previously filed as Exhibit 10.1 to Natural Gas Services Group, Inc. Current Report on Form 8-K filed on April 14, 2003, File No. 1-31398, and incorporated herein by reference)

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

(b) Reports on Form 8-K

On April 14, 2003, we filed a Current Report on Form 8-K dated March 27, 2003, reporting under Item 5 the closing of the agreement to acquire certain compressor packages from Hy-Bon Engineering Company, Inc., and filing the Purchase and Sale Agreement and the First Amended and Restated Loan Agreement as an Exhibits under Item 7.

On May 8, 2003, we filed a Current Report on Form 8-K dated May 9, 2003, filing a news release as an Exhibit under Item 7.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NATURAL GAS SERVICES GROUP, INC.

By: /s/ Wayne L. Vinson

Wayne L. Vinson
President and Chief Executive Officer

By: /s/ Earl R. Wait

Earl R. Wait
Chief Financial Officer
And Treasurer

August 7, 2003

EXHIBIT INDEX

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