NATURAL GAS SERVICES GROUP INC
Form 10QSB
November 10, 2004

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

FORM 10-QSB

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2004

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 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)

(432) 563-3974
(Issuer's Telephone number, including area code)

N/A

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

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 October 22, 2004
Common Stock, $.01 par value	6,068,269

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

NATURAL GAS SERVICES GROUP, INC.

Part I - FINANCIAL INFORMATION

Item 1. Financial Statements

Part II - OTHER INFORMATION

Natural Gas Services Group, Inc.
Consolidated Balance Sheet
(unaudited)
September 30, 2004

ASSETS

Current Assets:	
Cash and cash equivalents	$ 4,408,170
Accounts receivable - trade	1,187,402
Inventory	3,179,066
Prepaid expenses	178,694
Total current assets	8,953,332

Lease equipment, net	25,818,667
Other property, plant and equipment, net	3,140,203
Goodwill, net	2,589,655
Patents, net	93,328
Other assets	95,501
Total assets	$40,690,686
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current Liabilities:	
Current portion of long term debt and capital lease	$ 3,145,056
Line of Credit	521,461
Accounts payable and accrued liabilities	1,647,514
Unearned Income	118,284
Total current liabilities	5,432,315
Long term debt and capital lease, less current portion	9,079,435
Subordinated notes, net	1,433,060
Deferred income tax payable	2,612,013
Total liabilities	18,556,823
SHAREHOLDERS' EQUITY	
Common stock	60,683
Paid in capital	16,249,850
Retained earnings	5,823,331
Total shareholders' equity	22,133,864
Total liabilities and shareholders' equity	$40,690,686

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

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

	Three months ended September 30,		Nine months end
	2004	2003	2004
Revenue:			
Sales	$ 702,679	$ 1,372,248	$ 2,444,899
Service and maintenance income	436,584	452,714	1,370,306
Leasing income	2,730,851	1,874,594	7,405,324
	3,870,113	3,699,556	11,220,529
Cost of revenue:			
Cost of sales	451,334	1,008,771	1,699,003

Cost of service and maintenance	338,312	290,008	1,030,167
Cost of leasing	843,725	545,309	2,174,185
	1,633,371	1,844,088	4,903,355
Gross Margin	2,236,742	1,855,468	6,317,174
Operating Cost:			
Selling expense	226,935	159,870	629,545
General and administrative expense	425,299	395,918	1,368,524
Depreciation and amortization	641,817	455,563	1,750,851
	1,294,050	1,011,351	3,748,919
Operating income	942,692	844,117	2,568,255
Interest expense	(205,532)	(170,971)	(580,083)
Other income	2,306	1,253	1,496,329
Income before income taxes	739,466	674,399	3,484,501
Provision for income tax	288,391	289,992	773,932
Net income	451,074	384,407	2,710,568
Preferred dividends	0	30,530	53,277
Net income available to common shareholders	$ 451,074	$ 353,877	$ 2,657,291
Earnings per share:			
Basic	$0.08	$0.07	$0.49
Diluted	$0.07	$0.07	$0.43
Weighted average Shares:			
Basic	5,626,280	4,995,713	5,428,146
Diluted	6,492,354	5,389,673	6,216,995

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

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

	Nine Months Ended September 30, 2004	S
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$ 2,710,568	$
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,750,851	
Deferred taxes	769,507	

Amortization of debt issuance costs	48,717
Gain on disposal of assets	6,911
Changes in operating assets and liabilities:	
Trade and other receivables	(370,807)
Inventory	(624,827)
Prepaid expenses and other	(71,663)
Accounts payable and accrued liabilities	575,362
Deferred income	(88,932)
Other	(16,745)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	4,688,942
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	(786,941)
Purchase of rental equipment	(8,150,073)
Acquisition of remaining interest in joint venture, net of cash acquired	--
Proceeds from sale of property and equipment	50,123
Decrease in lease receivable	--
Distribution from equity method investment	--
NET CASH USED IN INVESTING ACTIVITIES	(8,886,891)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net proceeds from bank loans	5,031,435
Net proceeds from line of credit	521,461
Repayments of long term debt	(1,821,111)
Repayments of line of credit	(300,000)
Proceeds from sale of common stock, exercised warrants and stock options	5,051,409
Dividends paid on preferred stock	(53,277)
NET CASH PROVIDED BY FINANCING ACTIVITIES	8,429,917
NET CHANGE IN CASH AND CASH EQUIVALENTS	4,231,968
CASH AT BEGINNING OF PERIOD	176,202
CASH AT END OF PERIOD	$ 4,408,170
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Interest paid	$ 580,083

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The accompanying unaudited financial statements present the consolidated results of our company 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 September 30, 2004 and the results of our operations for the nine month period ended September 30, 2004 and 2003 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 for the year ended December 31, 2003 on file with the SEC. 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 nine month period ended September 30, 2004 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2004.

(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 net income and earnings per share would have been reduced to the pro forma amounts listed below:

	Three Months Ended September 30		Nine Mont Septem
	2004	2003	2004
Pro forma impact of fair value method			
Income applicable to common shares, as reported	$ 451,074	$ 353,877	$ 2,657,291
Pro-forma stock-based compensation costs under the fair value method, net of related tax	(10,000)	(7,683)	(30,000)
Pro-forma income applicable to common shares under the fair-value method	$ 441,074	$ 346,194	$ 2,627,291
Earnings per common share			
Basic earnings per share reported	$0.08	$0.07	$0.49
Diluted earnings per share reported	$0.07	$0.07	$0.43
Pro-forma basic earnings per share under the fair value method	$0.08	$0.07	$0.48
Pro-forma diluted earnings per share under the fair value method	$0.07	$0.06	$0.42

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) Merger

On January 1, 2004, we merged our subsidiaries, Rotary Gas Systems Inc, NGE Leasing Inc, and Great Lakes Compression Inc. with their parent Company, Natural Gas Services Group Inc. This had no effect on our consolidated financial position or results of operations, with the exception of a small impact on our state tax expenses.

(4) Preferred Stock Conversion

In accordance with the provisions of the Convertible Series A Preferred Stock of Natural Gas Services Group, Inc., on March 26, 2004 each share of Preferred Stock automatically converted to one share of Common Stock. The conversion occurred after the closing market price of the stock was equal to or higher than $6.50 for 20 consecutive trading days. 315,154 Preferred shares were converted at that time. Dividends payable at the conversion date were approximately $25,355.

(5) Common Stock Private Placement

On July 20, 2004, Natural Gas Services Group, Inc. and CBarney Investments, Ltd. entered into a Securities Purchase Agreement. Under this agreement, Natural Gas Services Group issued and sold 649,574 shares of its common stock to CBarney at $7.69736 per share. The per share price was determined by multiplying (x) $8.747, the average closing market price of the common stock on the American Stock Exchange for the twenty consecutive trading days ended July 15, 2004, times (y) eighty-eight percent. Natural Gas Services Group received aggregate gross proceeds of $5,000,000 and net proceeds of $4,950,000. We plan to use $2,950,000 of the net proceeds we received from CBarney to reduce our existing bank debt, and to use the remainder of such proceeds to obtain one or more letters of credit in the aggregate face amount of $2,000,000 that will secure the promissory notes to be issued by us in correction with the Screw Compression Systems, Inc. transaction described in note (8) below.

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(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 September 30, 2004	Three Months Ended September 30, 2003	Nine Months September 2004	
Basic earnings per share Numerator:				
Net income	$ 451,074	$ 384,407	$ 2,710,568	
Less: dividends on preferred shares	--	(30,530)	(53,277)	
Net income available to common shareholders	$ 451,074	$ 353,877	$ 2,657,291	$
Denominator -				
Weighted average common shares outstanding	5,626,280	4,995,713	5,428,146	
Basic earnings per share	$ 0.08	$ 0.07	$ 0.49	$
Diluted earnings per share Numerator:				
Net income	$ 451,074	$ 384,407	$ 2,710,568	$
Less: dividends on preferred shares (1)	--	(30,530)	(53,277)	
Net income available to common shareholders	$ 451,074	$ 353,877	$ 2,657,291	$
Denominator :				
Weighted average common shares outstanding	5,626,280	4,995,713	5,428,146	
Dilutive effect of common stock options and warrants	866,074	393,960	788,849	
	6,492,354	5,389,673	6,216,995	
Diluted earnings per share	$ 0.07	$ 0.07	$ 0.43	$

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(1) Preferred shares were anti-dilutive for the three and nine months ended September 30, 2004 and 2003

(7) Other Income

On March 15, 2004 the President and C.E.O. of our company, Mr. Wayne L. Vinson, passed away after a battle with cancer. The Company held 2 life insurance policies on him, 1 for $1,000,000 and 1 for $500,000, with the Company as the beneficiary. The proceeds of $1,500,000 were recorded as other income.

(8) Agreement to Purchase SCS.

On October 18, 2004, Natural Gas Services Group, Inc. entered into a Stock Purchase Agreement with Screw Compression Systems, Inc., or "SCS", and the stockholders of SCS. Under this agreement, Natural Gas Services Group agreed to purchase all of the outstanding shares of capital stock of SCS.

SCS is a privately owned manufacturer of natural gas compressors, with its principal offices located in Tulsa, Oklahoma.

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The stockholders of SCS will receive, in proportionate shares (based on their stock ownership of SCS), a total of $15 million, consisting of:

o $8 million in cash;

- promissory notes issued by Natural Gas Services in the aggregate principal amount of $3 million bearing interest at the rate of four percent (4.00%) per annum, maturing three years from the date of closing and secured by a letter of credit in the face amount of $2 million; and
- 609,576 shares of Natural Gas Services common stock valued at $4 million, based on the average of the daily closing prices of the common stock for the ninety consecutive trading days ended April 28, 2004. All of the shares, upon issuance, will be "restricted" securities within the meaning of Rule 144 under the Securities Act of 1933, as amended, and will bear a legend to that effect.

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

Overview

Our company provides products and services to the oil and gas industry and is 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.

Critical Accounting Policies and New Accounting Pronouncements

See our December 31, 2003 Form 10-KSB on file with the SEC for a discussion of our critical accounting policies and new accounting pronouncements. There have been no substantive changes since that time.

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 natural gas compressors.

At September 30, 2004, we had cash and cash equivalents of approximately $4,408,000, working capital of $3,521,000 and non-subordinated debt of $12,225,000 of which approximately $3,145,000 was classified as current. We had positive net cash flow from operating activities of approximately $4,689,000 during the first nine months of 2004. This was primarily from net income of $2,711,000 plus depreciation and amortization of $1,751,000, an increase in deferred taxes of $770,000, an increase in accounts payable and accrued liabilities of $575,000, offset by an increase in accounts receivable-trade of $371,000, a decrease in deferred income of $17,000, and an increase in inventory of $625,000.

On November 24, 2003 we completed a new $10 million senior credit facility with a $7 million initial borrowing base. The credit facility is a Multiple Advance Term Promissory Note arranged by Western National Bank, Midland, Texas. The interest rate is one percent over Wall Street prime rate. Funds have been drawn under this line as of September 30, 2004 totaling $5,715,000. Substantially all of our equipment, inventory and accounts receivables have been pledged as collateral for our bank loans.

Our line of credit for $750,000 with interest at 1% over prime for one year expired March 15, 2004 but was renewed on May 28, 2004. Funds have been drawn under the line of credit as of September 30, 2004 totaling $521,461.

In accordance with the provisions of the Convertible Series A Preferred Stock of Natural Gas Services Group, Inc., on March 26, 2004 each share of Preferred Stock automatically converted to one share of Common Stock. The conversion occurred after the closing market price of the stock was equal to or higher than $6.50 for 20 consecutive trading days. 315,154 Preferred shares were converted at that time. As a result the conversion we will have a reduction in expected dividend payments of approximately $68,000 for the remainder of the year 2004.

On July 20, 2004, Natural Gas Services Group, Inc. and CBarney Investments, Ltd. entered into a Securities Purchase Agreement. Under this agreement, Natural Gas Services Group agreed to issue and sell 649,574 shares of its common stock to CBarney at $7.69736 per share. The per share price was determined by multiplying (x) $8.747, the average closing market price of the common stock on the American Stock Exchange for the twenty consecutive trading days ended July 15, 2004, times (y) eighty-eight percent. Natural Gas Services Group received net proceeds of $4,950,000. We plan to use $2,950,000 of the net proceeds we received from CBarney to reduce our existing bank debt, and to use the remainder of such proceeds to obtain one or more letters of credit in the aggregate face amount of $2,000,000 that will service the promissory notes to be issued by us in correction with the Screw Compression Systems, Inc. transaction described in following paragraph.

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On October 18, 2004, Natural Gas Services Group, Inc. entered into a Stock Purchase Agreement with Screw Compression Systems, Inc., or "SCS", and the stockholders of SCS. Under this agreement, Natural Gas Services Group agreed to purchase all of the outstanding shares of capital stock of SCS.

SCS is a privately owned manufacturer of natural gas compressors, with its principal offices located in Tulsa, Oklahoma.

The stockholders of SCS will receive, in proportionate shares (based on their stock ownership of SCS), a total of $15 million, consisting of:

- $8 million in cash;
- promissory notes issued by Natural Gas Services in the aggregate principal amount of $3 million, bearing interest at the rate of four percent (4.00%) per annum, maturing three years from the date of closing and secured by a letter of credit in the face amount of $2 million; and
- 609,576 shares of Natural Gas Services common stock valued at $4 million, based on the average of the daily closing prices of the common stock for the ninety consecutive trading days ended April 28, 2004. All of the shares, upon issuance, will

be "restricted" securities within the meaning of Rule 144 under the Securities Act of 1933, as amended, and will bear a legend to that effect.

Results of Operations

Nine Months Ended September 30, 2004, Compared to the Nine Months Ended September 30, 2003.

Total revenue increased from $9,264,000 to $11,221,000 or 21% for the nine months ended September 30, 2004 compared to the same period ended September 30, 2003. This was mainly the result of increased leasing income.

Sales revenue from outside sources decreased from $2,877,000 to $2,445,000, or 15% for the nine months ended September 30, 2004 compared to the same period ended September 30, 2003. Sales from outside sources included: (1) Compressor unit sales, (2) Flare sales, (3) Parts sales and (4) Compressor rebuilds. This decrease was mainly the result of a reduction in the sale of compressor units to outside third parties in the nine months ended September 30, 2004 compared to the same period in 2003. Because our products are custom-built, fluctuations in revenue from outside sources is not unusual and our focus has been more on building a rental base than on the sale of equipment.

Service and maintenance revenue increased from $1,347,000 to $1,370,000, or 2% for the nine months ended September 30, 2004 compared to the same period ended September 30, 2003.

Leasing revenue increased from $5,040,000 to $7,405,000, or 47% for the nine months ended September 30, 2004 compared to the same period ended September 30, 2003. This increase was the result of additional units added to our rental fleet and leased to third parties. The company ended the period with 533 compressor packages in its rental fleet, up from 399 units at December 31, 2003 and 354 units at September 30, 2003.

Total Revenue Breakdown for Nine Months Ended September 30, 2004	
Sales Revenue	22%
Service & Maintenance Revenue	12%
Leasing Revenue	66%

The gross margin percentage increased from 52% for the nine months ended September 30, 2003, to 56% for the same period ended September 30, 2004. This improvement resulted mainly from the relative increase in leasing revenue as a percentage of the total revenue. Our rental fleet carries a gross margin averaging 70%, and an increase in rentals improves our total gross margin.

Selling, general and administrative expense increased from $1,671,000 to $1,998,000 or 20% for the nine months ended September 30, 2004, as compared to the same period ended September 30, 2003. This was mainly the result of the increase in commissions from additional leasing contracts on gas compressors to third parties, an increase in legal expenses related to an internal investigation concerning an employee matter that was settled in April 2004.

Depreciation and amortization expense increased 42 % from $1,235,000 to $1,751,000 for the nine months ended September 30, 2004, compared to the same period ended September 30, 2003. This increase was the result of 179 new gas compressor rental units being added to rental equipment from September 30, 2003 to September 30, 2004.

Other income and expense increased approximately $1,494,000 for the nine months ended September 30, 2004, compared to the same period ended September 30, 2003. This increase was due mainly from the receipt of $1,500,000 in life insurance payable in connection with the death of Mr. Wayne L. Vinson, our former President and C.E.O. His death on March 15, 2004 left the company as the beneficiary of two life insurance policies, one for $1,000,000, and one for $500,000.

Interest expense increased 16% for the nine months ended September 30, 2004 compared to the same period ended September 30, 2003, mainly due to the increased loan balances on vehicles and rental equipment.

Provision for income tax increased $162,000 or 26%, primarily due to the increase in net taxable income. The income from the life insurance proceeds described above is not subject to federal income tax.

Three Months Ended September 30, 2004, Compared to the Three Months Ended September 30, 2003.

Total revenue increased from $3,700,000 to $3,870,000 or 5% for the three months ended September 30, 2004 compared to the same period ended September 30, 2003. This was mainly the result of increased leasing income and offset by a decrease in outside sales as outlined below.

Sales revenue from outside sources decreased from $1,372,000 to $703,000, or 49% for the three months ended September 30, 2004 compared to the same period ended September 30, 2003. This decrease was mainly the result of a reduction in the sales of compressor units and parts. Because our products are custom-built, fluctuations in compressor unit revenue from outside sources is not unusual. The reduction in parts sales is the result of a change in our discount status with a major supplier in northern Michigan. We expect this to be a temporary situation. Also our customer base has dictated the trend toward leasing since most would rather rent than buy. Also our current plant capacity is used to fill our existing customer needs for rental equipment.

Service and maintenance revenue decreased from $452,000 to $437,000, or 4% for the three months ended September 30, 2004 compared to the same period ended September 30, 2003. This revenue source is subject to seasonal change since over 90% of this activity is generated in northern Michigan and is subject to swings in weather conditions.

Leasing revenue increased from $1,875,000 to $2,731,000, or 47% for the three months ended September 30, 2004 compared to the same period ended September 30, 2003. This increase was the result of additional units added to our rental unit fleet and leased to third parties. The company added 45 gas compressors to its rental fleet in the quarter ended September 30, 2004.

Total Revenue Breakdown for Three Months Ended September 30, 2004	
Sales Revenue	18%
Service & Maintenance Revenue	11%
Leasing Revenue	71%

The gross margin percentage increased from 50% for the three months ended September 30, 2003 to 58% for the same period ended September 30, 2004. Although we expect our margins to increase as our rental revenue increases because our rental fleet carries a gross margin averaging 70%, changes in the product mix during the quarter help to average out the gross margin company wide.

Selling, general and administrative expense increased from $556,000 to $652,000 or 17% for the three months ended September 30, 2004, as compared to the same period ended September 30, 2003. This was mainly the result of the increase in commissions from additional leasing contracts on gas compressors to third parties and an increase in sales and administration salary expense.

Depreciation and amortization expense increased 41% from $456,000 to $642,000 for the three months ended September 30, 2004, compared to the same period ended September 30, 2003. This increase was the result of 45 new gas compressor rental units being added to rental equipment during the three months ended September 30, 2004.

There was a 20% increase in interest expense for the three months ended September 30, 2004 compared to the same period ended September 30, 2003, which was mainly due to the increase in loan balances for rental equipment.

Provision for income tax decreased $2,000, or 1%, primarily due from a change in our effective tax rate. The effective tax rate changed because of a reduction in our state taxes as a result the merger of our subsidiaries effective January 1, 2004.

Forward Looking Statements

Some statements contained in this Report, and the documents incorporated by reference, are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 (or Securities Act) and Section 21E of the Exchange Act. These statements include, without limitation, statements relating to oil and gas prices, demand for oil and gas, budgets, business strategies and other plans, intentions and objectives of our management for future operations and activities and other such matters. The words "believe", "budget", "plan", "estimate", "expect", "intend", "strategy", "project", "will", "could", "may",

"anticipate", "continue", and similar expressions identify forward-looking statements. We believe the assumptions and expectations reflected in these forward-looking statements are reasonable. However, we cannot give any assurance that our expectations will prove to be correct or that we will be able to take any actions that are presently planned. Actual results could differ materially from those expressed in the forward-looking statements. Factors that could cause such a difference include:

- fluctuations in prices of oil and gas;
- future capital requirements and availability of financing;
- competition;
- general economic conditions;
- governmental regulations;
- receipt of amounts owed to us by our customers;
- events similar to 9/11; and
- fluctuations in interest rates and availability of capital.

You are cautioned not to place undue reliance on any of our forward-looking statements, which speak only as of the date of the document or in the case of documents incorporated by reference, the date of those documents.

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-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, our chief executive officer and chief financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective in timely alerting them to the material information relating to us that are required to be included in our periodic filings with the SEC.

(b) Changes in internal controls.

There were no changes made in our internal controls during the period covered by this report that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting. In addition, to our knowledge there were no changes, in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II - OTHER INFORMATION

NATURAL GAS SERVICES GROUP, INC.

Item 1. Legal Proceedings

From time to time, we are a party to ordinary routine litigation incidental to our business. We are not currently a party to any pending litigation, and we are not aware of any threatened litigation.

Item 6. Exhibits

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

Exhibit No.	Description

2.1	Purchase and Sale Agreement by and between Hy-Bon Engineering Company, Inc. and NGE Leasing, Inc. (Incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K dated February 28, 2003 and filed with the Securities and Exchange Commission on March 6, 2003)
*3.1	Articles of Incorporation, as amended
3.2	Bylaws (Incorporated by reference to Exhibit 3.4 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.1	Form of warrant certificate (Incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.2	Form of warrant agent agreement (Incorporated by reference to Exhibit 4.2 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.3	Form of lock-up agreement (Incorporated by reference to Exhibit 4.3 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.4	Form of representative's option for the purchase of common stock (Incorporated by reference to Exhibit 4.4 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.5	Form of representative's option for the purchase of warrants (Incorporated by reference to Exhibit 4.5 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
10.1	1998 Stock Option Plan (Incorporated by reference to Exhibit 10.1 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
10.2	Asset Purchase Agreement, dated January 1, 2001, between the Registrant and Great Lakes Compression, Inc. (Incorporated by reference to Exhibit 10.2 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)

Exhibit No.	Description
10.3	Exhibits 3(c)(1), 3(c)(2), 3(c)(3), 3(c)(4), 13(d)(1), 13(d)(2) and 13(d)(3) to Asset Purchase Agreement, dated January 1, 2001, between the Registrant and Great Lakes Compression, Inc. (Incorporated by reference to Exhibit 10.14 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
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10.10	Form of warrant issued in April 2002 for guaranteeing debt (Incorporated by reference to Exhibit 10.13 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
10.11	Articles of Organization of Hy-Bon Rotary Compression, L.L.C., dated April 17, 2000 (Incorporated by reference to Exhibit 10.18 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)

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10.15	Form of Termination of Employment Agreement Letter relating to the Employment Agreement of Wayne Vinson (Incorporated by reference to Exhibit 10.26 of the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002)

10.16	Form of Termination of Employment Agreement Letter relating to the Employment Agreement of Earl Wait (Incorporated by reference to Exhibit 10.27 of the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002)
10.17	Triple Net Lease Agreement, dated June 1, 2003, between NGE Leasing, Inc. and Steven J. & Katherina L. Winer (Incorporated by reference to Exhibit 10.17 of the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2003)
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10.19	Lease Agreement, dated March 1, 2004, between the Registrant and the City of Midland, Texas (Incorporated by reference to Exhibit 10.19 of the Registrant's Form 10-QSB for the fiscal quarter ended June 30, 2004)
10.20	Second Amended and Restated Loan Agreement, dated November 3, 2003, between the Registrant and Western National Bank (Incorporated by reference to Exhibit 10.20 of the Registrant's Form 10-QSB for the fiscal quarter ended June 30, 2004)
10.21	Securities Purchase Agreement, dated July 20, 2004, between the Registrant and CBarney Investments, Ltd. (Incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K dated July 20, 2004 and filed with the Securities and Exchange Commission on July 27, 2004)

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10.22	Stock Purchase Agreement, dated October 18, 2004, by and among the Registrant, Screw Compression Systems, Inc., Paul D. Hensley, Jim Hazlett and Tony Vohjesus (Incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K dated October 18, 2004 and filed with the Securities and Exchange Commission on October 21, 2004)
*31.1	Certification of Chief Executive Officer required by Section 302 of the Sarbanes-Oxley Act of 2002
*31.2	Certification of Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act of 2002
*32.1	Certification required by Section 906 of the Sarbanes-Oxley Act of 2002
*32.2	Certification required by Section 906 of the Sarbanes-Oxley Act of 2002

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* Filed herewith.

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/ Wallace Sparkman

Wallace Sparkman
President and Chief Executive Officer

By: /s/ Earl R. Wait

Earl R. Wait
Chief Financial Officer
And Treasurer

November 9, 2004

INDEX TO EXHIBITS:

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2.1	Purchase and Sale Agreement by and between Hy-Bon Engineering Company, Inc. and NGE Leasing, Inc. (Incorporated by reference to Exhibit 2.1 of the Registrant's Current Report on Form 8-K dated February 28, 2003 and filed with the Securities and

	Exchange Commission on March 6, 2003)
*3.1	Articles of Incorporation, as amended
3.2	Bylaws (Incorporated by reference to Exhibit 3.4 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.1	Form of warrant certificate (Incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.2	Form of warrant agent agreement (Incorporated by reference to Exhibit 4.2 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.3	Form of lock-up agreement (Incorporated by reference to Exhibit 4.3 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.4	Form of representative's option for the purchase of common stock (Incorporated by reference to Exhibit 4.4 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
4.5	Form of representative's option for the purchase of warrants (Incorporated by reference to Exhibit 4.5 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
10.1	1998 Stock Option Plan (Incorporated by reference to Exhibit 10.1 of the Registrant's Registration Statement on Form SB-2, No. 333-88314)
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