

NATURAL GAS SERVICES GROUP INC

Form 10-Q

November 09, 2018

NATURAL GAS SERVICES GROUP INC Accelerated

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**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 September 30, 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 incorporation or organization) (I.R.S. Employer 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 every Interactive Data File to be submitted 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.

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)

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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**

As of November 5, 2018, there were 13,117,154 shares of the Registrant's common stock, \$0.01 par value, outstanding.

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**Part I - FINANCIAL  
INFORMATION**

**Item**

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**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements**

**NATURAL GAS SERVICES GROUP, INC.**  
**CONDENSED CONSOLIDATED**  
**BALANCE SHEETS**

*(in thousands, except per share amounts)*  
*(unaudited)*

September 30, 2018	December 31, 2017
<b>ASSETS</b>	
<b>Current Assets:</b>	
Cash and cash equivalents	
\$ 63,267	\$ 69,208
Trade accounts receivable, net of allowance for doubtful accounts of \$405 and \$569, respectively	
8,116	8,534
Inventory	
19,065	26,224
Prepaid income taxes	
3,240	3,443
Prepaid expenses and other	
1,436	817
Total current assets	
96,124	108,226
Long-term inventory, net	
2,829	

of allowance for obsolescence of \$21 and \$15, respectively

Rental equipment, net of accumulated depreciation

of \$173,891		167,099
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of \$161,094 and \$145,851, respectively

Property and equipment, net of accumulated depreciation

of \$13,253		7,652
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of \$11,429 and \$11,274, respectively

<b>Goodwill</b>		10,039
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Intangibles, net of accumulated amortization

of \$1,432		1,526
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\$1,727 and \$1,632, respectively

<b>Other assets</b>		939
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Total assets	298,752	\$	298,310
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**LIABILITIES AND**

**STOCKHOLDERS'  
EQUITY****Current  
Liabilities:**

Accounts payable	1,424	\$	4,162
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Accrued liabilities			3,106
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Deferred income			185
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Total current liabilities			7,453
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Line of credit, non-current portion			417
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Deferred income tax liability			32,163
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Other long-term liabilities			958
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Total liabilities			40,991
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**Commitments  
and  
contingencies  
(Note  
8)****Stockholders'  
Equity:**

Preferred stock, 5,000 shares authorized, no shares issued or outstanding			—
---	--	--	---

Common stock, 30,000			129
----------------------	--	--	-----

shares  
 authorized,  
 par  
 value  
 \$0.01;  
 13,001  
 and  
 12,880  
 shares  
 issued  
 and  
 outstanding,  
 respectively

Additional paid-up capital	107,104	105,325
----------------------------------	---------	---------

Retained earnings	152,573	151,865
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Total stockholders' equity	259,807	257,319
----------------------------------	---------	---------

Total liabilities and stockholders' equity	\$ 298,752	\$ 298,310
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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		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
<b>Revenue:</b>				
Rental income	\$ 12,039	\$ 11,292	\$ 34,937	\$ 34,634
Sales	3,947	4,256	13,328	15,300
Service and maintenance income	410	365	1,053	1,099
Total revenue	16,396	15,913	49,318	51,033
<b>Operating costs and expenses:</b>				
Cost of rentals, exclusive of depreciation stated separately below	5,363	4,333	15,262	13,256
Cost of sales, exclusive of depreciation stated separately below	3,081	3,237	10,196	12,405
Cost of service and maintenance	107	90	273	288



Selling, general and administrative expense	2,340	6,683	7,776	
Depreciation and amortization	5,320	16,372	15,958	
Total operating costs and expenses	15,320	48,786	49,683	
<b>Operating (loss) income</b>	593	532	1,350	
<b>Other income (expense):</b>				
Interest expense	(7)	(10)	(11)	
Other income, net	(7)	189	(1)	
Total other income (expense), net	(14)	179	(12)	
<b>Income before provision for income taxes</b>	579	711	1,338	
Income tax (benefit) expense	57	3	189	
<b>Net income</b>	\$ 236	\$ 708	\$ 1,149	
<b>Earnings per share:</b>				
Basic	\$ 0.02	\$ 0.05	\$ 0.09	
Diluted	\$ 0.02	\$ 0.05	\$ 0.09	

**Weighted  
average  
shares  
outstanding:**

Basic	12,977	12,838	12,953	12,825
Diluted	13,254	13,117	13,228	13,102

See accompanying notes to these unaudited condensed consolidated financial statements.

**NATURAL GAS SERVICES GROUP,  
INC.**

**CONDENSED CONSOLIDATED  
STATEMENTS OF CASH FLOWS**

*(in thousands)*

*(unaudited)*

Nine months ended

September 30,

2018

2017

**CASH  
FLOWS  
FROM  
OPERATING  
ACTIVITIES:**

<b>Net</b>			
<b>income</b>	708	\$	1,149

**Adjustments  
to  
reconcile  
net  
income  
to  
net  
cash  
provided  
by  
operating activities:**

Depreciation and amortization	16,372		15,958
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Deferred income taxes	33		(3,233)
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Stock-based compensation	1,729		3,231
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Bad debt (recovery) allowance	(137)		70
--	-------	--	----

Gain on sale of assets	(49)		(49)
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Loss (gain) on company owned life insurance	(35)
<b>Changes in operating assets and liabilities:</b>	
Trade accounts receivables	145
Inventory	(1,305)
Prepaid expenses and prepaid income taxes	(416) (1,012)
Accounts payable and accrued liabilities	(2,397) 1,927
Deferred income	(51) (2,040)
Other	267 578
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	23,036 15,384
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Purchases of rental equipment and	(28,815) (5,892)

property and equipment	
Purchase of company owned life insurance	(571)
Proceeds from sale of	49
property and equipment	
<b>NET CASH USED IN</b>	<b>(6,414)</b>
<b>INVESTING ACTIVITIES</b>	
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>	
Payments from other long-term liabilities, net	(13)
Proceeds from exercise of stock options	517
Taxes paid related to net share settlement of equity	(644)

awards

**NET  
CASH  
PROVIDED  
BY(USED  
IN)  
FINANCING  
ACTIVITIES**

(140)

**NET  
CHANGE  
IN**

**CASH**

8,830

**AND  
CASH  
EQUIVALENTS**

**CASH  
AND  
CASH**

**EQUIVALENTS**

64,094

**AT  
BEGINNING  
OF  
PERIOD**

**CASH  
AND  
CASH**

**EQUIVALENTS**

\$ 72,924

**AT  
END  
OF  
PERIOD**

**SUPPLEMENTAL  
DISCLOSURE**

**OF  
CASH  
FLOW**

**INFORMATION:**

Interest  
paid

10

\$

11

Income  
taxes  
paid

66

\$

4,288

**NON-CASH  
TRANSACTIONS**

Transfer  
of  
rental  
equipment

144

\$

48

components  
to  
inventory

See accompanying notes to these unaudited condensed consolidated financial statements.

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**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 the accounts of the Company, its subsidiary, NGSG Properties, LLC and the rabbi trust associated with the Company's deferred compensations plan, see Note 4. All significant intercompany accounts and transactions for the periods presented have been eliminated in consolidation.

These financial statements include all adjustments, consisting of only normal recurring adjustments, which are necessary to make our financial position at September 30, 2018 and the results of our operations for the three and nine months ended September 30, 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 and nine months ended September 30, 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

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accordance with a bill and hold arrangements the customer accepts title and assumes the risk and rewards of ownership. We request some of our customers 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 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 change of control 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 control is shouldered by the customer and there are no exceptions to the customer's commitment to accept and pay for the manufactured equipment. Revenues recognized related to bill and hold arrangements for the nine months ended September 30, 2018 was approximately \$7.6 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 and nine months ended September 30, 2018 and 2017:

	Three months ended September 30, (in thousands)		Nine months ended September 30, (in thousands)	
	2018	2017	2018	2017
Compressors - sales	\$ 2,891	\$ 2,683	\$ 9,454	\$ 11,303

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Flares - sales	336	679	1,827	1,510
Other (Parts/Rebuilds) - sales	720	896	2,046	2,487
Service and maintenance <sup>1</sup>	5,221	4,878	15,022	14,959
Total revenue from contracts with customers	9,168	9,136	28,349	30,259
Add: non-ASC 606 rental revenue	7,228	6,777	20,969	20,774
Total revenue	\$ 16,396	\$ 15,913	\$ 49,318	\$ 51,033

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

**Contract Balances**

As of September 30, 2018 and December 31, 2017, we had the following receivables and deferred income from contracts with customers:

	September 30, 2018	December 31, 2017
	<i>(in thousands)</i>	
Accounts Receivable		
Accounts receivable - contracts with customers	\$ 5,313	\$ 5,454
Accounts receivable - non-ASC 606	3,208	3,649
Total Accounts Receivable	\$ 8,521	\$ 9,103
Less: Allowance for doubtful accounts	\$ (405)	\$ (569)
Total Accounts Receivable, net	\$ 8,116	\$ 8,534
Deferred income	\$ 134	\$ 185

The Company recognized \$176,000 in revenue for the period ended September 30, 2018 that was included in deferred income at the beginning of 2018. 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 2017.

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:

<i>(in thousands)</i>	2019 <sup>(1)</sup>	2020	2021	2022	2023	Total
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Service and Maintenance	\$	559	\$	1,773	\$	1,375	\$	1,375	\$	462	\$	5,544
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(1) For the three months starting October 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 2018.

***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 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 (variable rate debt) 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 has a greater than 50 percent likely of being realized upon ultimate settlement. We have no uncertain tax positions as of September 30, 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 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for finance 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. The ASU initially required a modified retrospective transition method where a company applies the new leases standard at the beginning of the earliest period presented in the financial statements, but in July 2018 the FASB issued ASU 2018-11. ASU 2018-11 added an optional transition method where a company applies the new leases standard at the adoption date and recognizes a cumulative effect adjustment to the opening balance of retained earnings. 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 anticipate applying certain practical expedients provided by ASU 2016-02 that allow companies to not reassess leases that are in effect prior to adoption and the practical expedient in ASU 2018-11 that allows lessors to not separate lease and non-lease components for certain asset classes. We are in the process of reviewing our leases and evaluating what impact the new standard will have on our accounting policies, internal controls and condensed consolidated balance sheet. We expect there will be an increase in assets and liabilities on the condensed consolidated balance sheets at adoption due to recording the right-of-use assets and corresponding lease liabilities, but do not believe this to be a significant impact at this time. We also expect an increase in our disclosures revolving around leases. We anticipate our review to be completed in the fourth quarter 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 nine months ended September 30, 2018 is presented below.

	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value <i>(in thousands)</i>
Outstanding, December 31, 2017	327,270	\$ 20.21	4.28	\$ 2,255
Exercised	(38,250)	17.79	—	216
Canceled/Forfeited	(5,334)	24.02	—	3
Outstanding, September 30, 2018	283,686	\$ 20.46	3.83	\$ 970
Exercisable, September 30, 2018	262,821	\$ 19.85	3.47	\$ 970

The following table summarizes information about our stock options outstanding at September 30, 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	64,852	0.77	\$ 9.75	64,852	\$ 9.75
\$15.71-17.84	42,000	1.82	17.54	42,000	17.54
\$17.82-20.48	50,500	2.59	19.43	50,500	19.43
\$20.49-33.36	105,469	6.57	27.35	105,469	27.19
	283,686	3.83	\$ 20.46	262,821	\$ 19.85

The summary of the status of our unvested stock options as of December 31, 2017 and changes during the nine months ended September 30, 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
Canceled/Forfeited	(1,167)	11.93
Unvested at September 30, 2018	20,865	\$ 11.93

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As of September 30, 2018, there was \$158,759 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 \$127,055 and \$286,500 for the nine months ended September 30, 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 annual 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 annual 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 \$1,602,265 and \$2,945,020 for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, there was a total of \$3,242,095 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 September 30, 2018 and December 31, 2017, respectively, consisted of the following amounts:

	September 30, 2018	December 31, 2017
	<i>(in thousands)</i>	
Raw materials - current	\$ 15,080	\$ 22,813
Raw materials - long term	3,815	2,829
Finished Goods	1,022	1,022
Work in process	2,963	2,389
	\$ 22,880	\$ 29,053

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

During the nine months ended September 30, 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 \$1.1 million and \$814,000 as of September 30, 2018 and 2017, respectively. For the nine months ending September 30, 2018, we reported in other (expense) income in the consolidated income statement a loss related to the policy of approximately \$15,000 and for the same period in 2017, a gain of approximately \$35,000.

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 \$1.2 million and \$779,000 as of September 30, 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 September 30, 2018, 102,793 unvested restricted stock units have been deferred of which 33,834 units have been released and issued to the deferred compensation plan with a value of \$856,837.

## **(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, extending 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 September 30, 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 nine month period ended September 30, 2018, our weighted average interest rate was 3.50%.

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

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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 September 30, 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 September 30, 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 September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net income	\$ 236	\$ 522	\$ 708	\$ 1,149
Denominator for basic net income per common share:				
Weighted average common shares outstanding	12,977	12,838	12,953	12,825
Denominator for diluted net income per share:				
Weighted average common shares outstanding	12,977	12,838	12,953	12,825
Dilutive effect of stock options and restricted stock				
	277	279	275	277
Diluted weighted average shares				
	13,254	13,117	13,228	13,102

Earnings per  
common  
share:

Basic	\$	0.02	\$	0.04	\$	0.05	\$	0.09
Diluted	\$	0.02	\$	0.04	\$	0.05	\$	0.09

In the three months ended September 30, 2018, options to purchase 126,334 shares of common stock with exercise prices ranging from \$22.90 to \$33.36 were not included in the computation of diluted income per share, due to their antidilutive effect.

In the nine months ended September 30, 2018, options to purchase 82,167 shares of common stock with exercise prices ranging from \$28.15 to \$33.36 were not included in the computation of diluted income per share, due to their antidilutive effect.

In the three and nine months ended September 30, 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 diluted 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 September 30, 2018 (in thousands):**

Rental	Sales	Service & Maintenance	Corporate	Total
Revenue 12,039	\$ 3,947	\$ 410	\$ —	\$ 16,396
Operating costs and corporate expenses	1,363	107	7,889	16,440
Total other income, net	—	—	180	180
Income before provision for income taxes	\$ 866	\$ 303	\$ (7,709)	\$ 136

**For the three months ended September 30, 2017 (in thousands):**

Rental	Sales	Service & Maintenance	Corporate	Total
Revenue 11,292	\$ 4,256	\$ 365	\$ —	\$ 15,913
Operating costs and corporate expenses	1,333	90	7,660	15,320
—	—	—	(14)	(14)



Total other expense, net					
Income before provision for income taxes	6,959	\$ 1,019	\$ 275	\$ (7,674)	\$ 579

**For the nine months ended September 30, 2018 (in thousands):**

Rental	Sales	Service & Maintenance	Corporate	Total	
Revenue	34,937	\$ 13,328	\$ 1,053	\$ —	\$ 49,318
Operating costs and corporate expenses	15,262	10,196	273	23,055	48,786
Total other income, net	—	—	179	179	
Income before provision for income taxes	19,675	\$ 3,132	\$ 780	\$ (22,876)	\$ 711

**For the nine months ended September 30, 2017 (in thousands):**

Rental	Sales	Service & Maintenance	Corporate	Total	
Revenue	34,634	\$ 15,300	\$ 1,099	\$ —	\$ 51,033
Operating costs and corporate expenses	13,256	12,405	288	23,734	49,683
Total other expense, net	—	—	(12)	(12)	
Income before provision for income taxes	21,378	\$ 2,895	\$ 811	\$ (23,746)	\$ 1,338



## **(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 \$7.0 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 September 30, 2018, we had 1,324 natural gas compressors totaling 217,315 horsepower rented to 87 customers compared to 1,251 natural gas compressors totaling 180,433 horsepower rented to 80 customers at September 30, 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 packages are acquired through periodic purchase orders placed with third-party suppliers on an "as needed" basis, which presently require lead times between three to six months 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. Formal maintenance agreements typically have terms of six 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,

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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 oil and natural gas industry, with changes in domestic natural gas production and consumption levels and prices affecting our business marginally more 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 oil shale plays which are more dependent on crude oil prices. With this shift towards oil-associated gas production the demand for overall compression services and products is driven by two general factors; declining reservoir pressure in maturing natural gas producing fields, especially non-conventional production, and an increased focus by producers on artificial lift applications; e.g., production enhancement with compression assisted gas lift. These type of applications have historically been serviced by wellhead size compressors, and continue to be, but there has also been an economic move by our customers towards centralized drilling and production facilities which have increased the market need for larger horsepower compressor packages. We recognized this need over the past two to three years and have been shifting our cash and fabrication resources towards designing, fabricating and renting gas compressor packages that range from 400 horsepower up to 1380 horsepower. While this is a response to market conditions and trends, it also provides us with the opportunity to compete as a full-line compression provider.

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 and variable period to period, we believe the long-term trend in our market is favorable.

## Results of Operations

### *Three months ended September 30, 2018, compared to the three months ended September 30, 2017.*

The table below shows our revenues and percentage of total revenues of each of our product lines for the three months ended September 30, 2018 and 2017.

	Revenue Three months ended September 30, (in thousands)			
	2018		2017	
Rental	\$ 12,039	7%	\$ 11,292	7%
Sales	3,947	2%	4,256	2%
Service and Maintenance	410	3%	365	2%
Total	\$ 16,396		\$ 15,913	

Total revenue increased to \$16.4 million from \$15.9 million, or 3%, for the three months ended September 30, 2018, compared to the same period ended September 30, 2017. The increase is mainly a result of an increase in rental revenue due to a greater number of units and higher horsepower with higher rates being rented.

Rental revenue increased to \$12.0 million from \$11.3 million for the three months ended September 30, 2018, compared to the same period ended September 30, 2017. We ended the quarter with 2,567 compressor packages in our

fleet, up from 2,538 units at September 30, 2017. The rental fleet had a utilization of 51.6% as of September 30, 2018 compared to 49.3% utilization as of September 30, 2017. The rise in utilization is mainly the result of the rise in demand for our higher horsepower units. We have experienced some relief in the number of sets versus returns in recent months. In the event that oil and natural gas prices remain steady or continue to increase, we expect to see an increase in the utilization of our fleet.

Sales revenue decreased to \$3.9 million from \$4.3 million for the three months ended September 30, 2018 compared to the same period ended September 30, 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.

Our overall operating income decreased to a loss of \$44,000 compared to income of \$593,000 for the three months ended September 30, 2018 and September 30, 2017, respectively. The lower operating income was largely due to lower sales and higher depreciation expenses.

Selling, general, and administrative expense increased slightly to \$2.4 million from \$2.3 million for the three months ended September 30, 2018, and September 30, 2017.

Depreciation and amortization expense increased to \$5.5 million for the three months ended September 30, 2018, from \$5.3 million for the period ended September 30, 2017. This increase is the result of larger horsepower units being added to the fleet. We added 34 units (approximately 29,000 horsepower) to our fleet over the past 12 months. Twenty-six of these were 400 horsepower or larger; representing 98% of the horsepower added.

We had an income tax benefit of \$100,000 and an expense of \$57,000 for the three months ended September 30, 2018 and September 30, 2017, respectively. The decrease in the provision is due to a decrease in taxable income and an increase in bonus depreciation.

***Nine months ended September 30, 2018, compared to the nine months ended September 30, 2017.***

The table below shows our revenues and percentage of total revenues of each of our product lines for the nine months ended September 30, 2018 and 2017.

	Revenue Nine months ended September 30, (in thousands)			
	2018		2017	
Rental	34,937	7%	\$ 34,634	6%
Sales	13,328	2%	15,300	3%
Service and Maintenance	1,053	2%	1,099	2%
Total	\$ 49,318		\$ 51,033	

Total revenue decreased to \$49.3 million from \$51.0 million, or 3%, for the nine months ended September 30, 2018, compared to the same period ended September 30, 2017. The decrease is mainly a result of the fluctuation in sales due to the timing of industry activity.

Rental revenue increased slightly to \$34.9 million from \$34.6 million for the nine months ended September 30, 2018, compared to the same period ended September 30, 2017. This increase is the result of more units being set. We ended the quarter with 2,567 compressor packages in our rental fleet up from 2,538 units at September 30, 2017. The rental fleet had a utilization of 51.6%, as of September 30, 2018 compared to 49.3% utilization as of September 30, 2017. The rise in utilization is mainly the result of more compressors units being rented. We have experienced some relief in the number of sets versus returns in recent quarters.

Sales revenue decreased to \$13.3 million from \$15.3 million for the nine months ended September 30, 2018, compared to the same period ended September 30, 2017. This decrease is the result of the 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. There was an offsetting increase in flares during this comparative period, due to customer demand.

Our overall operating income decreased to \$532,000 from \$1.4 million for the nine months ended September 30, 2018 and September 30, 2017, respectively. Operating margin percentage decrease to 1% from 3%, respectively for the nine months ended September 30, 2018 and September 30, 2017. The low operating margin was due to the decrease in rental revenue.

Selling, general, and administrative expense decreased to \$6.7 million from \$7.8 million, for the nine months ended September 30, 2018, as compared to the same period ended September 30, 2017, primarily due to the decrease in stock compensation expense.

Depreciation and amortization expense increased to \$16.4 million for the nine months ended September 30, 2018, compared to \$16.0 million for the period ended September 30, 2017. This increase is the result of larger horsepower units

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being added to the fleet. We added 34 units (approximately 29,000 horsepower) to our fleet over the past 12 months. Twenty-six of these were 400 horsepower or larger; representing 98% of the horsepower added.

Provision for income tax decreased to \$3,000 from \$189,000 and is the result of the decrease in taxable income and an increase in bonus depreciation.

### Liquidity and Capital Resources

Our working capital positions as of September 30, 2018 and December 31, 2017 are set forth below:

	September 30, 2018 <i>(in thousands)</i>	December 31, 2017
Current Assets:		
Cash and cash equivalents	\$ 63,267	\$ 69,208
Trade accounts receivable, net	8,116	8,534
Inventory	19,065	26,224
Prepaid income taxes	3,240	3,443
Prepaid expenses and other	1,436	817
Total current assets	95,124	108,226
Current Liabilities:		
Accounts payable	1,424	4,162
Accrued liabilities	3,447	3,106
Deferred income	134	185
Total current liabilities	5,005	7,453
Total working capital	\$ 90,119	\$ 100,773

For the nine months ended September 30, 2018, we invested \$28.8 million in property and equipment. During these nine months, we've added \$19.8 million in new equipment to our rental fleet, \$5.3 million in payments related to the construction of our new corporate office and \$898,000 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 an increase to the property and equipment of \$2.6 million. 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 September 30, 2018, we had cash and cash equivalents of \$63.3 million compared to \$69.2 million at December 31, 2017. Our cash flow from operations of \$23.0 million was offset by capital expenditures of \$28.8 million, during the nine months ended September 30, 2018. We had working capital of \$90.1 million at September 30, 2018 compared to \$100.8 million at December 31, 2017. On September 30, 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 \$23.0 million during the first nine months of 2018 compared to \$15.4 million for the first nine months of 2017. The cash flow from operations of \$23.0 million was primarily the result of the net income of \$708,000 and the non-cash items of depreciation of \$16.4 million, \$1.7 million related to the expenses associated with stock-based compensation, and an increase in cash flows related to working capital and other of \$4.1 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 with respect to compression equipment will be directly dependent upon our

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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, extending the maturity date to December 31, 2020. No other material revisions were made to the credit facility. We had \$29.5 million borrowing base availability at September 30, 2018, under the terms of our Amended Credit Agreement, and our balance on the line of credit was \$417,000. For further information, see Footnote 5 "Credit Facility" on page 10.

#### *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 September 30, 2018:

Cash Contractual Obligations	<b>Obligations Due in Period</b> <i>(in thousands)</i>					Total
	2018 (1)	2019	2020	2021	Thereafter	
Line of credit (secured)	\$ —	\$ —	\$ 417	\$ —	\$ —	\$ 417
Interest on line of credit <sup>(2)</sup>	4	17	17	—	—	38
Purchase obligations <sup>(3)</sup>	130	300	300	302	34	1,066
Other long-term liabilities	—	—	—	67	—	67
Facilities and office leases	159	215	36	14	—	424
<b>Total</b>	<b>\$ 293</b>	<b>\$ 532</b>	<b>\$ 770</b>	<b>\$ 383</b>	<b>\$ 34</b>	<b>\$ 2,012</b>

The Company also has a contractual obligation related to the construction of a new corporate office of approximately \$7.0 million, which we intend to finance 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 three 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**

For further information, see Footnote 1 "Basis of Presentation and Summary of Significant Accounting Policies" on page 4.

### **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 September 30, 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 September 30, 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.

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**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.)



- 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.)
- 10.2
- 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.)
- 10.3
- 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.)
- 10.4
- Fifth Amendment  
of Credit  
Agreement between  
Natural Gas
- 10.5

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.)

10.6 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.)

10.7 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.)

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.)

10.8

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.)

10.9

10.10 The Executive Nonqualified Excess Plan Adoption Agreement,

referred to as the  
Nonqualified  
Deferred  
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	/s/ G. Larry Lawrence
Stephen C. Taylor	G. Larry Lawrence
President and Chief Executive Officer	Vice President and Chief Financial Officer
(Principal Executive Officer)	(Principal Accounting Officer)

November 9, 2018