

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2023

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.)

404 Veterans Airpark Ln., Ste 300

Midland, Texas 79705

(Address of principal executive offices)

(432) 262-2700

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, Par Value \$0.01	NGS	New York Stock Exchange

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.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

Yes

No

As of May 08, 2023 there were 12,501,597 shares of the Registrant's common stock, \$0.01 par value, outstanding.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

NATURAL GAS SERVICES GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value)
(unaudited)

	March 31, 2023	December 31, 2022
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 7,412	\$ 3,372
Trade accounts receivable, net	14,971	14,668
Inventory	25,077	23,414
Federal income tax receivable (Note 4)	11,538	11,538
Prepaid income taxes	10	10
Prepaid expenses and other	648	1,145
Total current assets	59,656	54,147
Long-term inventory, net of allowance for obsolescence of \$40 and \$120, respectively	1,588	1,557
Rental equipment, net of accumulated depreciation of \$182,560 and \$177,729, respectively	287,181	246,450
Property and equipment, net of accumulated depreciation of \$17,554 and \$16,981, respectively	22,420	22,176
Right of use assets - operating leases, net of accumulated amortization \$760 and \$721, respectively	309	349
Intangibles, net of accumulated amortization of \$2,290 and \$2,259, respectively	869	900
Other assets	4,784	2,667
Total assets	\$ 376,807	\$ 328,246
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 24,835	\$ 6,481
Accrued liabilities	16,946	23,726
Current operating leases	123	155
Deferred income	114	37
Total current liabilities	42,018	30,399
Long-term debt	61,011	25,000
Deferred income tax liability	39,946	39,798
Long-term operating leases	186	194
Other long-term liabilities	2,897	2,779
Total liabilities	146,058	98,170
Commitments and contingencies (Note 9)		
Stockholders' Equity:		
Preferred stock, 5,000 shares authorized, no shares issued or outstanding	—	—
Common stock, 30,000 shares authorized, par value \$0.01; 13,548 and 13,519 shares issued, respectively	135	135
Additional paid-in capital	115,714	115,411
Retained earnings	129,904	129,534
Treasury shares, at cost, 1,310 shares, respectively	(15,004)	(15,004)
Total stockholders' equity	230,749	230,076
Total liabilities and stockholders' equity	\$ 376,807	\$ 328,246

See accompanying notes to these unaudited condensed consolidated financial statements.

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

	Three months ended March 31,	
	2023	2022
Revenue:		
Rental income	\$ 22,723	\$ 17,129
Sales	2,992	2,893
Service and maintenance income	905	314
Total revenue	<u>26,620</u>	<u>20,336</u>
Operating costs and expenses:		
Cost of rentals, exclusive of depreciation stated separately below	11,645	9,230
Cost of sales, exclusive of depreciation stated separately below	3,237	1,988
Cost of service and maintenance, exclusive of depreciation stated separately below	609	173
Selling, general and administrative expenses	4,562	2,502
Depreciation and amortization	6,165	6,061
Total operating costs and expenses	<u>26,218</u>	<u>19,954</u>
Operating income	402	382
Other income (expense):		
Interest expense	—	(24)
Other income (expense), net	118	(32)
Total other income, net	<u>118</u>	<u>(56)</u>
Income before provision for income taxes	520	326
Income tax (expense) benefit	(150)	11
Net income	<u>\$ 370</u>	<u>\$ 337</u>
Earnings per share:		
Basic	\$ 0.03	\$ 0.03
Diluted	\$ 0.03	\$ 0.03
Weighted average shares outstanding:		
Basic	12,213	12,537
Diluted	12,354	12,698

See accompanying notes to these unaudited condensed consolidated financial statements.

NATURAL GAS SERVICES GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)
(unaudited)

	Preferred Stock		Common Stock			Additional Paid-In Capital	Retained Earnings	Treasury Stock		Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares			Amount		
BALANCES, January 1, 2022	—	\$ —	13,394	\$ 134	\$ 114,017	\$ 130,103	775	\$ (8,344)	\$ 235,910	
Compensation expense on common stock options	—	—	—	—	21	—	—	—	21	
Issuance of restricted stock	—	—	79	—	—	—	—	—	—	
Compensation expense on restricted common stock	—	—	—	1	401	—	—	—	402	
Taxes paid related to net shares settlement of equity awards	—	—	—	—	(359)	—	—	—	(359)	
Purchase of treasury shares	—	—	—	—	—	—	247	(2,928)	(2,928)	
Net income	—	—	—	—	—	337	—	—	337	
BALANCES, March 31, 2022	<u>—</u>	<u>\$ —</u>	<u>13,473</u>	<u>\$ 135</u>	<u>\$ 114,080</u>	<u>\$ 130,440</u>	<u>1,022</u>	<u>\$ (11,272)</u>	<u>\$ 233,383</u>	
BALANCES, January 1, 2023			13,519	\$ 135	\$ 115,411	\$ 129,534	1,310	\$ (15,004)	\$ 230,076	
Compensation expense on common stock options	—	—	—	—	22	—	—	—	22	
Issuance of restricted stock	—	—	29	—	—	—	—	—	—	
Compensation expense on restricted common stock	—	—	—	—	465	—	—	—	465	
Taxes paid related to net shares settlement of equity awards	—	—	—	—	(184)	—	—	—	(184)	
Net income	—	—	—	—	—	370	—	—	370	
BALANCES, March 31, 2023	<u>—</u>	<u>\$ —</u>	<u>13,548</u>	<u>\$ 135</u>	<u>\$ 115,714</u>	<u>\$ 129,904</u>	<u>1,310</u>	<u>\$ (15,004)</u>	<u>\$ 230,749</u>	

See accompanying notes to these unaudited condensed consolidated financial statements.

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

	Three months ended	
	March 31,	
	2023	2022
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 370	\$ 337
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,165	6,061
Amortization of debt issuance costs	52	12
Deferred income tax (benefit) expense	148	(11)
Stock-based compensation	487	423
Bad debt allowance	48	—
Gain on sale of assets	(25)	(36)
Loss (gain) on company owned life insurance	(18)	130
Changes in operating assets and liabilities:		
Trade accounts receivables	(351)	(2,494)
Inventory	(986)	2,085
Prepaid expenses and prepaid income taxes	497	238
Accounts payable and accrued liabilities	11,574	(349)
Deferred income	77	(1,312)
Other	184	(89)
NET CASH PROVIDED BY OPERATING ACTIVITIES	18,222	4,995
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of rental equipment, property and other equipment	(47,792)	(8,212)
Purchase of company owned life insurance	(50)	(47)
Proceeds from sale of property and equipment	—	37
NET CASH USED IN INVESTING ACTIVITIES	(47,842)	(8,222)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from loan	36,011	—
Payments of other long-term liabilities, net	(36)	(2)
Payments of debt issuance costs	(2,131)	—
Purchase of treasury shares	—	(2,928)
Taxes paid related to net share settlement of equity awards	(184)	(359)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	33,660	(3,289)
NET CHANGE IN CASH AND CASH EQUIVALENTS	4,040	(6,516)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	3,372	22,942
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 7,412	\$ 16,426
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid	\$ 855	\$ 12
NON-CASH TRANSACTIONS		
Right of use asset acquired through an operating lease	\$ —	\$ 91
Transfer of rental equipment to inventory	\$ 708	\$ —

See accompanying notes to these unaudited condensed consolidated financial statements.

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

1. Description of Business

Natural Gas Services Group, Inc. (the "Company", "NGS", "Natural Gas Services Group", "we" or "our") (a Colorado corporation), is a provider of natural gas compression equipment and services to the energy industry. The Company manufactures, fabricates, rents, sells and maintains natural gas compressors systems for oil and natural gas production and plant facilities. NGS is headquartered in Midland, Texas, with fabrication facilities located in Tulsa, Oklahoma and Midland, Texas, and service facilities located in major oil and natural gas producing basins in the U.S.

2. Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

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 compensation plan. 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 March 31, 2023 and the results of our operations for the three months ended March 31, 2023 and 2022 not misleading. As permitted by the rules and regulations of the Securities and Exchange Commission (the "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 consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2022 on file with the SEC. In our opinion, the condensed consolidated financial statements are a fair presentation of the financial position, results of operations, changes in stockholders' equity and cash flows for the periods presented.

The results of operations for the three months ended March 31, 2023 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2023.

Revenue Recognition Policy

The Company recognizes revenue in accordance with ASC 606, Revenue from Contracts with Customers ("ASC 606"), except for rental revenue as discussed below. Under ASC 606, 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). Revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration that we expect to receive for those goods or services. To recognize revenue, we (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when, or as, we satisfy the performance obligation(s). Shipping and handling costs incurred are accounted for as fulfillment costs and are included in cost of revenues in our condensed consolidated statements of operations.

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 systems to our customers. These contracts, which all qualify as operating leases under ASC Topic 842, Leases (ASC 842), may also include a fee for servicing the compressor during the rental contract period. Our rental contracts typically range from six to 24 months, with our larger horsepower compressors having contract terms of up to 60 months. Our revenue is recognized over time, generally monthly, in accordance with payment terms under 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 ASC 842, we have applied the practical expedient ASC 842-10-15-42A, which allows the Company to combine lease and non-lease components.

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

Custom/fabricated compressors - The Company designs and fabricates compressors 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 package is complete and shipped, or in accordance with a bill and hold arrangement, 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 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 that we ship the equipment per their direction from our manufacturing facility at a later specified date and that we segregate this equipment from our finished goods, such that this equipment is 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 and 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 maintained by the customer and there are no exceptions to the customer's commitment to accept and pay for the manufactured equipment. There was no revenue recognized for bill and hold arrangements for the three months ended March 31, 2023 or 2022.

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 based on the terms of the contract, i.e., by physical delivery, delivery and installment, or shipment of the compressor.

Used compressors - From time to time, a customer may request to purchase a used compressor out of our rental fleet. Revenue from the sale of rental equipment is recognized when the control has passed to the customer based on the terms of the contract, i.e., 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, transaction prices are not subject to variable consideration constraints.

Disaggregation of Revenue

The following table shows the Company's revenue disaggregated by product or service type for the three months ended March 31, 2023 and 2022:

	Three months ended March 31,	
	2023	2022
	<i>(in thousands)</i>	
Compressors - sales	\$ 969	\$ 1,968
Other (parts/rebuilds) - sales	2,023	925
Service and maintenance	905	314
Total revenue from contracts with customers	3,897	3,207
Add: ASC 842 rental revenue	22,723	17,129
Total revenue	<u>\$ 26,620</u>	<u>\$ 20,336</u>

Contract Balances

As of March 31, 2023 and December 31, 2022, we had the following receivables and deferred income from contracts with customers:

	<u>March 31, 2023</u>	<u>December 31, 2022</u>
	<i>(in thousands)</i>	
Accounts Receivable		
Accounts receivable - contracts with customers	\$ 4,245	\$
Accounts receivable - ASC 842	11,107	11,107
Total Accounts Receivable	15,352	15,352
Less: Allowance for doubtful accounts	(381)	(381)
Total Accounts Receivable, net	<u>\$ 14,971</u>	<u>\$ 14,971</u>
Deferred income	<u>\$ 114</u>	<u>\$ 114</u>

The Company recognized sales revenues of \$37,000 for the three months ended March 31, 2023 that was included in deferred income at the beginning of 2023.

The increase in accounts receivable and decrease in deferred income were primarily due to normal timing differences between our performance and the customers' payments.

Remaining Performance Obligations

As of March 31, 2023, the Company had deferred revenue of \$114 thousand related to unsatisfied performance obligations.

Contract Costs

The Company 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 expenses on our condensed consolidated statements of operations.

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 carryforwards. 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. Valuation allowances are established to reduce deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized. To the extent we establish a valuation allowance or increase this allowance in a period, we include an expense in the tax provision in our condensed consolidated statements of operations.

We account for uncertain tax positions in accordance with guidance in ASC 740, which prescribes the minimum recognition threshold a tax position taken or expected to be taken in a tax return is required to meet before being recognized in the condensed consolidated financial statements. Tax benefits are recognized only for tax positions that are more likely than not to be sustained upon examination by tax authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely to be realized upon settlement. A liability for unrecognized tax benefits is recorded for any tax benefits claimed in our tax returns that do not meet these recognition and measurement standards. We have no liabilities for uncertain tax positions as of March 31, 2023.

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

Capitalized Interest

Beginning January 1, 2023, the Company began capitalizing interest from external borrowings on significant expenditures for the fabrication of its natural gas compressor equipment until such projects are ready for their intended use. Capitalized interest is added to the cost of the underlying asset and is amortized over the useful lives of the assets in the same manner as the underlying assets. For the three months ended March 31, 2023, the Company capitalized interest aggregating approximately \$855,000.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (ASC Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments to ASC Topic 326 require immediate recognition of estimated credit losses expected to occur over the remaining life of many financial assets, including trade receivables. For companies that qualify as smaller reporting companies, the amendments in this update are effective for interim and annual periods beginning after January 1, 2023. We have adopted ASU 2016-13 on January 1, 2023. The adoption did not result in any material change to our financial statements.

3. Inventory

Our inventory, net of allowance for obsolescence of \$40,000 at March 31, 2023 and \$120,000 at December 31, 2022, consisted of the following amounts:

	March 31, 2023	December 31, 2022
	<i>(in thousands)</i>	
Raw materials - current	\$ 24,281	\$ 24,281
Work-in-process	796	796
Inventory - current	25,077	25,077
Raw materials - long term (net of allowances of \$40 and \$120, respectively)	1,588	1,588
Inventory - total	\$ 26,665	\$ 26,665

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.

Inventory Allowance

We routinely review our inventory allowance balance to account for slow moving or obsolete inventory costs that may not be recoverable in the future.

A summary of our inventory allowance is as follows:

	March 31, 2023	December 31, 2022
	<i>(in thousands)</i>	
Beginning balance	\$ 120	\$ 64
Accruals	—	83
Write-offs	(80)	(27)
Ending balance	\$ 40	\$ 120

4. Federal Income Tax Receivable

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted in response to the economic impact caused by the COVID-19 pandemic. The CARES Act allowed NOLs incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid federal income taxes. The Company generated significant NOLs during 2018 and 2019, and has filed amended returns to carryback these losses for five years. Accordingly, during 2020, the Company recorded a federal income tax receivable of \$15.0 million and an increase to its

deferred income tax liability of \$10.1 million on its condensed consolidated balance sheet. During the third quarter of 2020, the Company received refunds totaling \$3.9 million related to its 2018 NOLs, which reduced its federal income tax receivable to \$11.5 million on its condensed consolidated balance sheet as of March 31, 2023 and December 31, 2022.

5. Rental Equipment

Our rental equipment and associated accumulated depreciation as of March 31, 2023 and December 31, 2022, respectively, consisted of the following:

	March 31, 2023	December 31, 2022
	<i>(in thousands)</i>	
Compressor units	\$ 404,175	\$ 387,145
Work-in-process	65,566	37,034
Rental equipment	469,741	424,179
Accumulated depreciation	(182,560)	(177,729)
Rental equipment, net of accumulated depreciation	<u>\$ 287,181</u>	<u>\$ 246,450</u>

We evaluated our rental equipment for potential impairment as of March 31, 2023, and determined that no such impairment existed as of that date.

6. Long-term Debt

Our long-term debt consists of the following:

	March 31, 2023	December 31, 2022
	<i>(in thousands)</i>	
Total long-term debt	<u>\$ 61,011</u>	<u>\$ 25,000</u>

Credit Agreement

On May 11, 2021, we entered into a five year senior secured revolving credit agreement ("Credit Agreement") with Texas Capital Bank, National Association (the "Lender") with an initial commitment of \$20 million and an accordion feature that would increase the maximum commitment to \$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 \$30 million on the aggregate commitment; provided, however, the aggregate commitment amount is not permitted to exceed \$50 million. The maturity date of the Credit Agreement is May 11, 2026. The obligations under the Credit Agreement are secured by a first priority lien on a variety of our assets, including inventory and accounts receivable as well as a variable number of our leased compressor equipment. As of December 31, 2022, we were in compliance with all financial covenants in our Credit Agreement. At December 31, 2022, we had \$25 million outstanding under the Credit Agreement with a weighted average interest rate of 7.32%.

Amended and Restated Credit Agreement

On February 28, 2023, we entered into a five-year senior secured revolving credit agreement ("Amended and Restated Credit Agreement") with Texas Capital Bank, as administrative agent (the "Lender"), TCBI Securities, Inc., as joint lead arranger and sole book runner and Bank of America, N.A., as joint lead arranger, with an initial commitment of \$175 million as of the closing date. Subject to collateral availability, we also have a right to request from the Lender, on an uncommitted basis, an increase of up to \$125 million on the aggregate commitment; provided, however, the aggregate commitment amount is not permitted to exceed \$300 million. The maturity date of the Amended and Restated Credit Agreement is February 28, 2028. The obligations under the Amended and Restated Credit Agreement are secured by a first priority lien on a variety of our assets, including inventory and accounts receivable as well as a variable number of our leased compressor equipment.

Borrowing Base. At any time before the maturity of the Amended and Restated 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) 85% of eligible accounts receivable owed to the Company, plus (b) 50% of the eligible inventory, valued at the lower of cost or market value at such time, subject to a cap of the component not to exceed \$2.5 million, plus (c) the lesser of (i) 95% of the net book value of the compressors that the Lender has determined are eligible

for the extension of credit, valued at the lower of cost or market value with depreciation not to exceed 25 years, at such time and (ii) 80% of the net liquidation value percentage of the net book value of the eligible compressors that the Lender has determined are eligible for the extension of credit, valued at the lower of cost or market value with depreciation not to exceed 25 years, at such time, plus (d) 80% of the net book value, valued at the lower cost (excluding any costs for capitalized interest or other non-cash capitalized costs) or market of the eligible new compressor fleet, minus (e) any required availability reserves determined by the Lender in its sole discretion. The Lender may adjust the borrowing base components if the material deviations in the collateral are discovered in the future audits of the collateral. At March 31, 2023, our borrowing base was approximately \$138 million.

Interest and Fees. Under the terms of the Amended and Restated Credit Agreement, we have the option of selecting the applicable variable rate for each revolving loan, or portion thereof, of either (a) the Base Rate (as defined below) plus the Applicable Margin, or (b) in the case of a Term SOFR ("Secured Overnight Financing Rate") Loan, the Adjusted Term SOFR rate plus the Applicable Margin. "Base Rate" means, for any day, a rate of interest per annum equal to the highest of (a) the prime rate for such a day; (b) the sum of the federal funds rate for such day plus 0.50%; and (c) the Adjusted Term SOFR for such day plus 1.00%. The Applicable Margin is determined based upon the leverage ratio as set forth in the most recent compliance certificate received by the Lender for each fiscal quarter from time to time pursuant to the Amended and Restated Credit Agreement. Depending on the leverage ratio, the Applicable Margin can be 2.00% to 2.75% for Base Rate Loans (as defined in Amended and Restated Credit Agreement) and 3.00% to 3.75% for Term SOFR Loans and for requested letters of credit. In addition, we are required to pay a monthly commitment fee on the daily average unused amount of the commitment while the Amended and Restated Credit Agreement is in effect at an annual rate equal to 0.50% of the unused commitment amount. Accrued interest is payable monthly on outstanding principal amounts and unused commitment fee, provided that accrued interest on Term SOFR Loans is payable at the end of each interest period, but in no event less frequently than quarterly.

Covenants. The Amended and Restated Credit Agreement contains customary representations and warranties, as well as covenants which, among other things, condition or 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 are subject to certain financial covenants during certain trigger periods in the Amended and Restated Credit Agreement that require us to maintain (i) a leverage ratio, as defined, lesser than or equal to 3.50 to 1.00 as of the last day of each fiscal quarter thereafter and (ii) a fixed charge coverage ratio greater than or equal to 1.25 to 1.00 as of the last day of each fiscal quarter.

Events of Default and Acceleration. The Amended and Restated 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 Amended and Restated Credit Agreement and the other transaction 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 \$1.0 million; certain bankruptcy or insolvency events; the rendering of certain judgments in excess of \$1.0 million; certain ERISA events; certain change in control events and the defectiveness of any liens under the secured revolving credit agreement. Obligations outstanding under the Amended and Restated Credit Agreement may be accelerated upon the occurrence of an event of default.

As of March 31, 2023, we were in compliance with all financial covenants in our 2023 Amended and Restated Credit Agreement. At March 31, 2023, we had \$61 million outstanding under our Amended and Restated Credit Agreement with a weighted average interest rate of 8.55%. At March 31, 2023, we had approximately \$77 million available for borrowing under the Amended and Restated Credit Agreement, subject to borrowing base determination.

7. Stock-Based and Other Long-Term Incentive Compensation

Stock Options

A summary of all option activity as of December 31, 2022, and changes during the three months ended March 31, 2023 is presented below:

	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, December 31, 2022	201,584	\$ 19.32	3.90	\$ —
Cancelled / Forfeited	(2,667)	\$ 10.58	—	\$ 3
Expired	(13,000)	\$ 18.75	—	\$ —
Outstanding, March 31, 2023	185,917	\$ 19.49	3.84	\$ —
Exercisable, March 31, 2023	147,084	\$ 21.72	2.51	\$ —

The following table summarizes information about our stock options outstanding at March 31, 2023:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$0.01-18.00	103,333	5.24	\$ 13.37	64,500	\$ 14.78
\$22.01-26.00	29,667	2.04	\$ 22.90	29,667	\$ 22.90
\$26.01-30.00	20,750	3.89	\$ 28.15	20,750	\$ 28.15
\$30.01-34.00	32,167	0.97	\$ 30.41	32,167	\$ 30.41
	185,917	3.84	\$ 19.49	147,084	\$ 21.72

The summary of the status of our unvested stock options as of December 31, 2022 and changes during the three months ended March 31, 2023 is presented below:

Unvested Stock Options:	Shares	Weighted Average Grant Date Fair Value Per Share
Unvested at December 31, 2022	41,500	\$ 5.48
Cancelled/Forfeited	(2,667)	\$ 5.15
Unvested at March 31, 2023	38,833	\$ 5.50

As of March 31, 2023, there was \$157 thousand of unrecognized compensation cost related to unvested options. For the three months ended March 31, 2023, there was \$22 thousand of compensation expense for stock options. For the three months ended March 31, 2022, there was \$21 thousand of compensation expense for stock options.

Restricted Shares/Units

On April 26, 2022, 4,212 shares of restricted common stock were awarded to each of our three independent Board members. The restricted stock issued to these directors vest in one year from the date of grant. On August 15, 2022, the Compensation Committee awarded 32,040 shares of restricted common stock to two executive officers that vest ratably over three years, beginning on April 25, 2023. In addition, on August 15, 2022, the Compensation Committee awarded 60,839 shares of restricted stock to Mr. Stephen Taylor, our Interim Chief Executive Officer, that will vest in full on June 30, 2023. On April 25, 2023, the Compensation Committee awarded 27,840 shares of restricted stock to our Chief Technical Officer that vest ratably over three years, beginning on April 25, 2024. Pursuant to the Retirement Agreement dated May 17, 2022, between the Company and Stephen C. Taylor, our Interim Chief Executive Officer, on April 25, 2023, the Compensation Committee awarded 58,790 fully vested shares of common stock to Mr. Stephen Taylor, our Interim Chief Executive Officer that vest immediately.

Total compensation expense related to these and previously granted restricted stock awards was \$0.5 million and \$0.4 million for the three months ended March 31, 2023, and 2022, respectively.

A summary of all restricted stock/units outstanding as of December 31, 2022 and activity during the three months ended March 31, 2023 is presented below:

	Number of Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, December 31, 2022	250,847	\$ 9.14	1.42	\$ 2,681
Granted	8,944	\$ 10.81		\$ 100
Vested	(48,583)	\$ 10.04		\$ 467
Canceled/Forfeited	(14,357)	\$ —		\$ 158
Outstanding, March 31, 2023	<u>196,851</u>	\$ 8.40	1.20	\$ 1,587

Other Long-Term Incentive Compensation

On April 26, 2022, subject to vesting we granted a \$50,000 cash award to each of our three independent Board members. These awards vested on April 26, 2023 and have been paid. There were no long-term incentive awards issued to executives during the three months ended March 31, 2023. The Company accounts for these other long-term incentive awards as liabilities under accrued liabilities on our condensed consolidated balance sheet. In general the vesting of long term awards is subject to acceleration upon certain events, such as (i) death or disability of the recipient, (ii) certain circumstances in connection with a change of control of the Company, (iii) for executive officers, termination without cause (as defined in the agreement), and (iv) for executive officers, resignation for good reason (as defined). Total compensation expense related to these and other long-term incentive awards was approximately \$300,000 and \$700,000 for the three months ended March 31, 2023 and 2022, respectively. As of March 31, 2023, there was a total of \$200,000 of unrecognized compensation expense related to these other long-term incentive awards which is expected to be recognized over the next 3 months.

8. Earnings per Share

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

	Three months ended	
	March 31,	
	2023	2022
	<i>(in thousands, except per share data)</i>	
Numerator:		
Net income	\$ 370	\$ 337
Denominator for earnings per basic common share:		
Weighted average common shares outstanding	12,213	12,537
Denominator for earnings per diluted common share:		
Weighted average common shares outstanding	12,213	12,537
Dilutive effect of stock options and restricted stock/units	141	161
Diluted weighted average shares	12,354	12,698
Earnings per common share:		
Basic	\$ 0.03	\$ 0.03
Diluted	\$ 0.03	\$ 0.03

9. 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 believes it maintains adequate insurance coverage against any potential litigation loss.

10. Subsequent Events

In accordance with ASC 855 - Subsequent Events - the Company has evaluated all events subsequent to the balance sheet date as of March 31, 2023 through the date of this report and believes nothing is required thereunder.

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, 2022 filed with the SEC.

This report and our Annual Report on Form 10-K contain certain forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended, and information pertaining to us, our industry and the oil and natural gas industry that is based on the beliefs of our management, as well as assumptions made by and information currently available to our management. All statements, other than statements of historical facts contained in this report as well as our Annual Report on Form 10-K, including statements regarding our future financial position, growth strategy, budgets, projected costs, plans and objectives of management for future operations, are forward-looking statements. We use the words "may," "will," "expect," "anticipate," "estimate," "believe," "continue," "intend," "plan," "budget" and other similar words to identify forward-looking statements. You should read statements that contain these words carefully and should not place undue reliance on these statements because they discuss future expectations, contain projections of results of operations or of our financial condition and/or state other "forward-looking" information. We do not undertake any obligation to update or revise publicly any forward-looking statements. Although we believe our expectations reflected in these forward-looking statements are based on reasonable assumptions, no assurance can be given that these expectations or assumptions will prove to have been correct.

Please read Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2022, as it contains important factors that could cause actual results to differ materially from the expectations reflected in the forward-looking statements.

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 typically provide for initial terms of six to 24 months, with our larger horsepower units having contract terms of up to 60 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 our rented compressors. As of March 31, 2023, we had 1,245 natural gas compressors totaling 335,314 horsepower rented to 74 customers compared to 1,276 natural gas compressors totaling 306,834 horsepower rented to 79 customers at March 31, 2022.

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 compressor 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. Recent inflationary pressures have created price increases in both major and minor components for our compressors as well as longer than normal lead times for such components. To date, we have been able to increase our rental rates and sales prices proportionally; however, if cost increases continue and we are no longer able to increase our rental rates and sales prices such an event could have a material adverse effect on the results of our operations and financial condition.

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. To provide customer support for our compressor sales businesses, we stock varying levels of replacement parts at our Midland, Texas facility and at field service locations. We also provide an exchange and rebuild program for screw compressors and maintain an inventory of new and used compressors to facilitate this business.

We provide service and maintenance to our customers under written maintenance contracts or on an as-required basis in the absence of a service contract. Maintenance agreements typically have terms of 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 oil and natural gas and the corresponding changes in commodity prices. As demand and prices increase, oil and natural gas producers typically increase their capital expenditures for drilling, development and production activities, although recent equity capital constraints and demands from institutional investors to keep spending within operating cash flow have meaningfully restrained capital expenditure budgets of domestic exploration and production companies. Generally, increased capital expenditures ultimately result in greater revenues and profits for service 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 crude oil and condensate production and consumption levels and prices affecting our business more than changes in domestic natural gas production and consumption levels and prices. In recent years we have increased our rentals and sales in unconventional oil shale plays, which are more dependent on crude oil prices. With this shift towards oil production, the demand for overall compression services and products is driven by two general factors: an increased focus by producers on artificial lift applications, e.g., production enhancement with compression assisted gas lift; and declining reservoir pressure in maturing natural gas producing fields, especially unconventional production. These types 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 in recent 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 2,500 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. In addition, recent heightened focus on the emissions profile of our customers has created a shift in demand from natural gas powered compression to electric motor compression in areas where the electric infrastructure can accommodate the energy demands of these units.

Industry Update

We typically experience a decline in demand during periods of low crude oil and natural gas prices. During the first quarter of 2020, we saw a substantial decline in the prices for oil and natural gas. Commodity prices stabilized during 2021 with a sharp increase in 2023. Historically, activity levels of exploration and production companies have been dependent on commodity prices. However, recent capital market focus on cash returns from exploration and production companies has restricted capital spending below levels that have historically been observed during higher commodity price environments. Generally, though, we feel that production activities (in which we are involved) will fare better than drilling activity. This is reflected in both the stability of our rental revenues, which is driven by production activities, and the volatility of our compressor sales, which tends to fluctuate with capital allocations. As such, we still expect compressor sales to be low for the remainder of 2023, as exploration and production companies have elected to rent compression units rather than allocating capital dollars to purchase new compression.

Results of Operations

Three months ended March 31, 2023, compared to the three months ended March 31, 2022.

The table below shows our revenues and percentage of total revenues of each of our product lines for the three months ended March 31, 2023 and 2022.

	Three months ended March 31,			
	2023		2022	
	<i>(in thousands)</i>			
Rental	\$ 22,723	85.4 %	\$ 17,129	84.2 %
Sales	2,992	11.2 %	2,893	14.2 %
Service and Maintenance	905	3.4 %	314	1.5 %
Total	<u>\$ 26,620</u>		<u>\$ 20,336</u>	

Total revenue increased 30.9% to \$26.6 million for the three months ended March 31, 2023 compared to \$20.3 million for the three months ended March 31, 2022. This increase was primarily a result of higher rental revenue (32.7% increase) during 2023.

Rental revenue increased to \$22.7 million for the three months ended March 31, 2023 compared to \$17.1 million for the same period in 2022. This increase during the first quarter of 2023 was attributable to (i) an increase in high horsepower compression rentals as these units carry a higher rental revenue rate than our lower horsepower units and (ii) rental rate increases across a portion of our fleet intended to offset inflationary pressures related to the costs of our rental fleet.

As of March 31, 2023, we had 1,875 compressor packages in our fleet, down from 2,033 units at March 31, 2022 due to the retirement of units during the fourth quarter of 2022 and the disposition of a small number of compressors from the fleet during this year. The Company's total unit horsepower increased slightly to 433,013 horsepower at March 31, 2023 compared to 421,422 horsepower at March 31, 2022, due to the aforementioned unit retirements and dispositions partially offset by the addition to the Company's fleet of 42 high horsepower compressors over the past 12 months. As of March 31, 2023, we had 1,245 natural gas compressors with a total of 335,314 horsepower rented to 74 customers, compared to 1,276 natural gas compressors with a total of 306,834 horsepower rented to 79 customers as of March 31, 2022. As a result, our total rented horsepower as of March 31, 2023 increased by 9.3% over the last twelve months. Our rental fleet had unit utilization as of March 31, 2023, and 2022, respectively, of 66.4% and 62.8%, and our horsepower utilization for the same dates increased to 77.4% from 72.8%. Our total rented horsepower increased by 9.3% contrasted against a 2.4% decrease in total rented units. This illustrates the growing demand for our high horsepower units while the demand for our smaller and medium horsepower units has not recovered in line with recent commodity price increases.

Sales revenue increased 3.5% to \$3.0 million for the three months ended March 31, 2023 compared to \$2.9 million for the three months ended March 31, 2022. This increase is primarily attributable to increased parts sales during the first quarter of 2023 compared to the same period in 2022. Sales are subject to fluctuations in timing of industry activity related to our customers' capital projects and, as such, can vary substantially between periods.

Cost of rentals increased to \$11.6 million during the three months ended March 31, 2023 compared to \$9.2 million during the three months ended March 31, 2022. While rental revenues increased 32.7%, this 26.2% increase in costs of rentals is primarily due to inflationary pressures on labor and parts as well higher make ready charges accrued at quarter end. While repair and maintenance expenses are customary in our business, the timing of such expenses can fluctuate between periods resulting in periods with larger than normal expenses.

Cost of sales increased 62.8% to \$3.2 million during the three months ended March 31, 2023 compared to \$2.0 million during the three months ended March 31, 2022. This increase was primarily due to an increase in the volume of parts sales at margins below our historical realizations.

Selling, general, and administrative ("SG&A") expenses increased 82.3% to \$4.6 million for the three months ended March 31, 2023 compared \$2.5 million during the same period in 2022. This increase in SG&A expenses was primarily attributable to (i) \$1.0 million of severance expenses related to the retirement agreement between NGS and Stephen C. Taylor, our prior and current interim Chief Executive Officer, (ii) \$200,000 increase in stock option compensation expenses, (iii) a \$300,000 increase in executive recruiting charges.

Depreciation and amortization expense increased to \$6.2 million for the three months ended March 31, 2023 compared to \$6.1 million for the three months ended March 31, 2022.

We recorded an income tax expense of approximately \$150,000 for the three months ended March 31, 2023 compared to an income tax benefit of \$11,000 for the three months ended March 31, 2022. For interim periods, our income tax benefit (expense) is computed based upon our estimated annual effective tax rate and any discrete items that impact the interim periods. Our estimated annual effective tax rate differs from the U.S. federal statutory rate of 21% primarily as a result of expenses not deductible for income tax purposes.

Non-GAAP Financial Measures

Our definition and use of Adjusted EBITDA

“Adjusted EBITDA” is a non-GAAP financial measure that we define as earnings (net (loss) income) before interest, taxes, depreciation and amortization, as well as non-cash stock compensation, severance expenses, impairment of goodwill, an increase in inventory allowance and inventory write-offs, and retirement of rental equipment. This term, as used and defined by us, may not be comparable to similarly titled measures employed by other companies and is not a measure of performance calculated in accordance with GAAP. Adjusted EBITDA should not be considered in isolation or as a substitute for operating income, net income or loss, cash flows provided by operating, investing and financing activities, or other income or cash flow statement data prepared in accordance with GAAP. However, management believes Adjusted EBITDA is useful to an investor in evaluating our operating performance because:

- it is widely used by investors in the energy industry to measure a company’s operating performance without regard to items excluded from the calculation of Adjusted EBITDA, which can vary substantially from company to company depending upon accounting methods and book value of assets, capital structure and the method by which assets were acquired, among other factors;
- it helps investors to more meaningfully evaluate and compare the results of our operations from period to period by removing the impact of our capital structure and asset base from our operating structure; and
- it is used by our management for various purposes, including as a measure of operating performance, in presentations to our Board of Directors, and as a basis for strategic planning and forecasting.

Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under generally accepted accounting principles. Some of these limitations are:

- Adjusted EBITDA does not reflect our cash expenditures, future requirements for capital expenditures, or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the cash requirements necessary to service interest or principal payments on our debts; and
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any capital expenditures for such replacements.

There are other material limitations to using Adjusted EBITDA as a measure of performance, including the inability to analyze the impact of certain recurring items that materially affect our net income or loss, and the lack of comparability of results of operations of different companies. Please read the table below under “Reconciliation” to see how Adjusted EBITDA reconciles to our net (loss) income, for the three months ended March 31, 2023 and 2022, the most directly comparable GAAP financial measure.

Reconciliation

The following table reconciles our net income, the most directly comparable GAAP financial measure, to Adjusted EBITDA:

	Three months ended March 31,	
	2023	2022
	<i>(in thousands)</i>	
Net income	\$ 370	\$ 337
Interest expense	—	24
Income tax expense (benefit)	150	(11)
Depreciation and amortization	6,165	6,061
Non-cash stock compensation expense	487	423
Severance expenses	612	—
Adjusted EBITDA	<u>\$ 7,784</u>	<u>\$ 6,834</u>

For the three months ended March 31, 2023, Adjusted EBITDA increased \$1.0 million (13.9%) due primarily to a \$6.3 million increase in total revenues partially offset by a \$2.4 million increase in costs of rentals.

Liquidity and Capital Resources

Our working capital positions as of March 31, 2023 and December 31, 2022 are set forth below:

	March 31,	December 31,
	2023	2022
	<i>(in thousands)</i>	
Current Assets:		
Cash and cash equivalents	\$ 7,412	\$ 3,372
Trade accounts receivable, net	14,971	14,668
Inventory	25,077	23,414
Federal income tax receivable	11,538	11,538
Prepaid income taxes	10	10
Prepaid expenses and other	648	1,145
Total current assets	<u>59,656</u>	<u>54,147</u>
Current Liabilities:		
Accounts payable	24,835	6,481
Accrued liabilities	16,946	23,726
Current operating leases	123	155
Deferred income	114	37
Total current liabilities	<u>42,018</u>	<u>30,399</u>
Total working capital	<u>\$ 17,638</u>	<u>\$ 23,748</u>

For the three months ended March 31, 2023, we invested \$47.8 million in rental and property and other equipment by adding \$47.0 million in new equipment to our rental fleet and \$0.8 million primarily in vehicles as well as various other machinery and equipment. Our investment in rental equipment, property and other equipment also includes any changes to work-in-process related to our rental fleet jobs at the beginning of the period compared to the end of the period. Our rental work-in-process increased by \$28.6 million during the three months ended March 31, 2023. We financed our investment in rental equipment, property and other equipment with cash flow from operations, and borrowings under our Amended and Restated Credit Facility. We anticipate that our cash flows from operations as well as our borrowing capacity under our Amended and Restated Credit Agreement will provide adequate liquidity for our planned capital expenditures during the remainder of 2023. For any new capital expenditures in 2023 and beyond that exceeds our cash flow from operations and our

borrowing base under our Amended and Restated Credit Agreement, we anticipate that we would need to negotiate an expansion of our borrowing capacity under our Amended and Restated Credit Agreement or raise money in the capital markets through equity. While we control the timing and extent of our capital expenditures, there is no assurance that any such borrowing expansion would be granted. At March 31, 2023 we had approximately \$77 million available for borrowing under the Amended and Restated Credit Agreement, subject to borrowing base determination.

Cash flows

At March 31, 2023, we had cash and cash equivalents of \$7.4 million compared to \$3.4 million at December 31, 2022. Our cash flows from operating activities of \$18.2 million were offset by capital expenditures of \$47.8 million during the three months ended March 31, 2023. We had working capital of \$17.6 million at March 31, 2023 compared to \$23.7 million at December 31, 2022. We generated cash flows from operating activities of \$18.2 million during the first three months of 2023 compared to cash flows provided by operating activities of \$5.0 million for the first three months of 2022.

Strategy

For the remainder of 2023, 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 utilizing bank borrowing in line with market conditions. For the remainder of 2023, our forecasted capital expenditures are not anticipated to exceed our internally generated cash flows, cash on hand and borrowing availability under our Amended and Restated Credit Agreement. The majority of required capital will be for contracted, premium-priced additions to our compressor rental fleet and/or required service vehicles. We believe market conditions indicate significant demand growth for large horsepower compression in 2023 and beyond. While we believe that cash flows from operations, our current cash position and borrowing capacity under our Amended and Restated Credit Agreement will be sufficient to satisfy a portion of our capital activity, we may need to negotiate an expansion of our borrowing capacity under our Amended and Restated Credit Agreement to meet the capital expenditure requirements needed to meet anticipated additional demand.

Critical Accounting Policies and Practices

Our condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States. In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements in conformity with accounting principles generally accepted in the United States. Actual results could differ significantly from those estimates under different assumptions and conditions. Management has determined that our critical accounting policies are those that relate to revenue recognition, estimating the allowance for doubtful accounts, accounting for income taxes, accounting for long-lived assets and accounting for inventory.

There have been no changes in the critical accounting policies disclosed in the Company's Form 10-K for the year ended December 31, 2022.

Recently Issued Accounting Pronouncements

Please read Note 2, Summary of Significant Accounting Policies, Recently Issued Accounting Pronouncements in our condensed consolidated financial statements in this report.

Off-Balance Sheet Arrangements

From time-to-time, we enter into off-balance sheet arrangements and transactions that can give rise to off-balance sheet obligations. As of March 31, 2023, the off-balance sheet arrangements and transactions that we have entered into include purchase agreements. We do not believe that these arrangements are reasonably likely to materially affect our liquidity or availability of 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, 2022 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, 2022.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

Our management, including the Interim Chief Executive Officer and our Interim Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting ("ICFR"), as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements for external purposes in accordance with GAAP.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of March 31, 2023, based on the Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on the results of this evaluation, the Company's management concluded that internal control over financial reporting was not effective as of March 31, 2023, due to the material weakness listed below.

A material weakness is a deficiency, or a combination of deficiencies, in ICFR, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

Management identified a material weakness in its internal control over financial reporting at December 31, 2022, over our inventory process which still exists as of March 31, 2023. Specifically, we have identified issues related to: (i) the classification of inventory work in progress; (ii) year-end physical inventory count procedures, and (iii) the process to review and approve inventory adjusting journal entries.

After giving full consideration to this material weakness, and the additional analyses and other procedures that we performed to ensure that our condensed consolidated financial statements included herein were prepared in accordance with U.S. generally accepted accounting principles ("US GAAP"), our management has concluded that our condensed consolidated financial statements present fairly, in all material respects our financial position, results of operations and cash flows for the periods disclosed in conformity with US GAAP.

Remediation Plan for Material Weakness

In response to the material weakness, management, with oversight of the Audit Committee of the Board of Directors, has begun the process of, and is committed to, designing and implementing effective measures to strengthen our internal controls over financial reporting and remediate the material weakness.

Our planned internal control remediation efforts, which are underway, include:

- We intend to update and implement accounting policies and procedures related to work in process inventory. These will include modifying our financial reporting account consolidation procedures.
- We intend to improve and enforce our formalized inventory count and inventory adjustment processes which includes taking steps to reinforce the inventory taking procedures, proper training and supervision of warehouse staff and strengthening review and approval requirements for any inventory adjustments.
- We have engaged a third-party consultant to conduct a full assessment of our controls and procedures.
- We intend to continue efforts to ensure our employees understand the ongoing importance of internal controls and compliance with corporate policies and procedures.

While these actions and planned actions are subject to ongoing management evaluation and will require validation and testing of the design and operating effectiveness of internal controls over a sustained period of financial reporting cycles, we are committed to the continuous improvement of our internal control over financial reporting and will continue to diligently review 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 flows. We are not currently a party to any material legal proceedings.

Item 1A. Risk Factors

Please refer to and read Item 1A, Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2022 for a discussion of the risks associated with our Company and industry.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None

Item 6. Exhibits

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

Exhibit No.	Description
3.1	Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3.1 of the 10-QSB filed and dated November 10, 2004.)
3.2	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 February 10, 2021.)
4.1	Description of Securities (Incorporated by reference to the Registrant's Registration Statement on Form 8-A, filed with the SEC on October 27, 2008.)
4.2	Form of Senior Indenture (Incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form S-3 (No. 333-261091) and filed on November 16, 2021.)
4.3	Form of Subordinated Indenture (Incorporated by reference to Exhibit 4.4 of the Registrant's Registration Statement on Form S-3 (No. 333-261091) and filed on November 16, 2021.)
10.1†	2019 Equity Incentive Plan, as amended (Incorporated by reference to Exhibit 4.3 of the Registrant's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on July 12, 2022.)
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†	Retirement Agreement dated May 17, 2022 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 May 19, 2022.)
10.4†	Severance Agreement and Release Between Natural Gas Services Group, Inc. and John W. Chisholm dated December 21, 2022 (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 December 28, 2022.)
10.5†	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.)

10.6†	Letter Agreement between Natural Gas Services Group, Inc. and James D. Faircloth dated February 8, 2023 (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 February 13, 2023.)
10.7	Amended and Restated Credit Agreement dated February 28, 2023, among Natural Gas Services Group, Inc., the other Loan Parties thereto, Texas Capital Bank, in its capacity as Administrative Agent and the Lenders party thereto (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 March 6, 2023.)
10.8	Amended and Restated Pledge and Security Agreement dated February 28, 2023, among Natural Gas Services Group, Inc., the Grantors thereto, Texas Capital Bank, in its capacity as Administrative Agent, for the Lenders and other Secured Parties (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 March 6, 2023.)
10.9	A Cooperation Agreement, dated April 28, 2023, between Natural Gas Services Group, Inc. and Mill Road Capital III, L.P., a Cayman Islands exempted limited partnership, and Mill Road Capital III GP LLC, a Cayman Islands limited liability company, pursuant to which the Company agreed to appoint Justin C. Jacobs and Donald J. Tringali to the Company's Board of Directors. In connection with the Agreement, on April 28, 2023, Leslie A. Beyer resigned from the Company's Board of Directors (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 28, 2023).
31.1*	Certification of Interim 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 Interim 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.

† Indicates a management contract or compensatory plan or arrangement

SIGNATURES

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

NATURAL GAS SERVICES GROUP, INC.

/s/ Stephen C. Taylor

Stephen C. Taylor

Interim President and Chief Executive Officer
(Principal Executive Officer)

May 15, 2023

/s/ James D. Faircloth

James D. Faircloth

Interim Chief Financial Officer
(Principal Accounting Officer)

May 15, 2023

Certifications

I, Stephen C. Taylor, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Natural Gas Services Group, Inc;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
1. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 15, 2023

Natural Gas Services Group, Inc.

By: /s/ Stephen C. Taylor

Stephen C. Taylor
Interim President and Chief Executive Officer
(Principal Executive Officer)

Certifications

I, James D. Faircloth, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Natural Gas Services Group, Inc;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 15, 2023

Natural Gas Services Group, Inc.

By: /s/James D. Faircloth

James D. Faircloth

Interim Chief Financial Officer
(Principal Accounting Officer)

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Natural Gas Services Group, Inc. (the “Company”) on Form 10-Q for the period ended March 31, 2023 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Stephen C. Taylor, Interim Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 15, 2023

Natural Gas Services Group, Inc.

By: /s/ Stephen C. Taylor

Stephen C. Taylor
Interim President and Chief Executive Officer
(Principal Executive Officer)

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Natural Gas Services Group, Inc. (the “Company”) on Form 10-Q for the period ended March 31, 2023 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, James D. Faircloth, Interim Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 15, 2023

Natural Gas Services Group, Inc.

By: /s/ James D. Faircloth

James D. Faircloth
Interim Chief Financial Officer
(Principal Accounting Officer)

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.