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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934**

For The Fiscal Year Ended June 30, 2004

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

For the transition period to

Commission File Number

NATURAL GAS SYSTEMS, INC.

(Exact name of registrant as specified in charter)

Nevada	**41-1781991**
(State of incorporation)	(I.R.S. employer identification number)

820 Gessner, Suite 1340, Houston, Texas 77024
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: **(713) 935-0122**

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

Securities registered pursuant to Section 12(g) of the Exchange Act:
Common Stock, $.001 Par Value

(Title of class and shares outstanding)

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

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 o

Issuer's revenues for its most recent fiscal year: $118,158

As of August 31, 2004, the aggregate market value of common stock held by non-affiliates of the registrant was approximately $19,530,703, assuming solely for purposes of this calculation that all directors and executive officers of the registrant and all stockholders beneficially owning more than 10% of the registrant's common stock are "affiliates." This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of common stock outstanding on August 31, 2004 was 23,145,406 shares.

DOCUMENTS INCORPORATED BY REFERENCE into Part III hereof Portions of the Proxy Statement to be filed with the Commission in connection with the Company's 2004 Annual Meeting.

Transitional Small Business Format (Check One): Yes o No ☒

Glossary of Selected Petroleum Terms

The following abbreviations and definitions are terms commonly used in the oil and natural gas industry and throughout this report on Form 10-KSB:

"BBL" A standard measure of volume for crude oil and liquid petroleum products. One barrel equals 42 U.S. gallons.

"BCF" Billion cubic feet of natural gas.

"BOE" Barrels of oil equivalent. Calculated by converting 6 MCF of natural gas to 1 BBL of oil.

"BTU" or "British Thermal Unit" The standard unit of measure of energy equal to the amount of heat required to raise the temperature of one pound of water 1 degree Fahrenheit. One BBL of crude is typically 5.8 MMBTU, and one standard MCF is typically 1 MMBTU.

"Field" An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geologic structural feature and/or stratigraphic feature.

"gross well" The total number of wells participated in, regardless of the amount of working interest owned. (See net wells).

"MBOE" One thousand barrels of oil equivalent.

"MCF" One thousand cubic feet of natural gas at standard conditions, being approximately sea level pressure and 60 degrees Fahrenheit temperature. Standard pressure in the state of Louisiana is deemed to be 15.025 psi by regulation but varies in other states.

"MMBTU" One million British thermal units (BTU's).

"MMCF" One million cubic feet of natural gas.

"net wells" The aggregate fractional working interests owned, e.g., a 20% working interest in each of 5 gross wells equals one net well. (See Gross Well).

"NGL" Natural gas liquids, being the combination of ethane, propane, butane and natural gasolines that can be removed from natural gas through processing, typically through refrigeration plants that utilize low temperatures, or through J-T plants that utilize compression, temperature reduction and expansion to a lower pressure.

"NYMEX" New York Mercantile Exchange.

"permeability" The measure of ease with which petroleum can move through a reservoir.

"porosity" (of sand or sandstone) The relative volume of the pore space compared to the total bulk volume of the reservoir.

"royalty or royalty interest" The mineral owner's share of oil or gas production (typically $^1/8$, $^1/6$ or $^1/4$), free of costs, but subject to severance taxes unless the lessor is a government. In certain circumstances, the royalty owner bears a proportionate share of the costs of making the natural gas saleable, such as processing, compression and gathering.

"psi" pounds per square inch, a measure of pressure.

"shut-in well" A well that is not on production, but has not been plugged and abandoned. Wells may be shut-in in anticipation of future utility as a producing well, plugging and abandonment or other use.

"Standardized measure" The standardized measure is an estimate of future net reserves from a property, and is calculated in the same exact same fashion as a PV-10 value, except that the projected revenue stream is adjusted to account for the estimated amount of federal income tax that must be paid.

"working interest" The interest in the oil and gas in place which is burdened with the cost of development and operation of the property. Also called the operating interest.

"work-over" A remedial operation on a completed well to restore, maintain or improve the well's production.

PART I.

ITEM 1. BUSINESS

General

Natural Gas Systems, Inc. ("NGS", the "Company", "we", "us" or "our") is a development stage company formed to acquire established crude oil and natural gas properties and exploit them through the application of conventional and specialized technology, with the objective of increasing production, ultimate recoveries, or both. At June 30, 2004, NGS conducted operations through its 100% working interest in the Delhi Field. The Company currently operates its properties in the State of Louisiana, with three full time employees and a small number of independent contractors and service providers administered from its Houston office.

NGS is a Nevada corporation with its corporate headquarters in Houston, Texas. Its telephone number is 713-935-0122.

Corporate History

Reality Interactive, Inc. ("Reality"), a Nevada corporation, was incorporated on May 24, 1994 for the purpose of developing technology-based knowledge solutions for the industrial marketplace. On April 30, 1999, this company ceased business operations, sold substantially all of its assets and terminated all of its employees. Subsequent to ceasing operations, Reality explored potential business opportunities to acquire or merge with an entity with existing operations, while continuing to file reports with the SEC.

On May 26, 2004, Natural Gas Systems, Inc., a privately owned Delaware corporation formed in September 2003 ("Old NGS"), was merged into a wholly owned subsidiary of Reality. Reality was thereafter renamed Natural Gas Systems, Inc. and adopted a June 30 fiscal year end. As part of the merger, the officers and directors of Reality resigned and the officers and directors of Old NGS became the officers and directors of the Company. Immediately prior to the merger, Reality did not conduct any operations and had minimal assets and liabilities.

The stock of NGS is quoted on the OTC Bulletin Board under the new symbol of NGSY.OB.

All regulatory filings and other historical information including stock prices prior to June 30, 2004 that applied to Reality continue to apply to the Company after the merger.

Business Activities

NGS is a development stage company that seeks to acquire majority working interests of oil and gas resources in established fields and redevelop those fields through the application of capital and technology to convert the oil and gas resources into producing reserves. We focus on established fields with long-lived production from shallow reservoirs, particularly those reservoirs with low permeability. We believe this provides us with the following advantages:

- By limiting our focus to established fields, we believe we are likely to incur less exposure to the risk of whether resources are present. We also reduce the amount of capital expenditures necessary for infrastructure, such as roads, water handling facilities and pipelines.

- We prefer to acquire long-lived properties in order to reduce risk from short-term oil and gas price volatility.

- We focus on shallow reservoirs in order to reduce technical and operational risks associated with higher pressures, temperatures and their attenuate costs on deeper wells.

- We seek to own majority working interests in order to maintain full control of operations and development.

- We are particularly interested in applying lateral drilling technology, especially to opportunities with low permeability, thin bed reservoirs.

Old NGS purchased its first property in September 2003 through the acquisition of a 100% working interest in the Delhi Unit in northeastern Louisiana (see Properties section below). The purchase included six producing wells, one salt water disposal well and 37 shut-in wells with aggregate average production of approximately 18 barrels of oil per day ("**BOPD**") and no gas sales. The Delhi Unit encompasses approximately 13,636 acres. We own rights to the top of the Massive Anhydride Formation, less and except the Mengel Reservoir, which is being produced by another operator in a small number of wells.

In late 2003, we executed an agreement with Verdisys, Inc., the holder of the U.S. license rights to a patented lateral drilling technology. Under the license agreement, Verdisys has agreed to provide us with lateral drilling services based on our projected needs, subject only to adequate advance notice, at a fixed price not to exceed the lowest price offered to any other customer for similar services. Although we may find the Verdisys technology useful, our business plan does not rely on it. To date, we have used the Verdisys technology in only two wells, the results of which were inconclusive.

Markets and Customers

Marketing of oil and natural gas production is influenced by many factors that are beyond our control, the exact effect of which is difficult to predict. These factors include changes in supply and demand, market prices, government regulation and actions of major foreign producers.

Over the past 20 years, crude oil price fluctuations have been extremely volatile, with oil prices varying from $8.50, to in excess of $40 per barrel. Worldwide factors such as geopolitical, macroeconomic, supply and demand, refining capacity, petrochemical production and derivatives trading, among others, influence prices for crude oil. Localized influences include regulation and transportation issues unique to certain producing regions.

In the domestic U.S. market where we operate, crude oil and condensate production are readily transportable and marketable. We sell all of our oil production from the Delhi Field to Genesis Petroleum, LLC, a crude oil purchaser, at competitive spot field prices. We believe that other crude purchasers are readily available.

Similarly over the last 20 years, domestic natural gas prices have been volatile, ranging from $1 to $9 per MCF. The spot market for natural gas, changes in supply and demand, derivatives trading, pipeline availability, BTU content of the gas and weather patterns, among others, cause natural gas prices to be subject to significant fluctuations. Due to the practical difficulties in transporting natural gas, price influences tend to be more localized for natural gas than for crude oil.

All of our current natural gas production is located in northeastern Louisiana. There is only one gas pipeline sales point readily available, which reduces our leverage in negotiating a more favorable transportation charge and sales price. The current gas sales line is also a delivery line to customers, downstream of the pipeline's processing and treating facilities, thus making the pipeline very sensitive to the quality of gas sold into our point of interconnection.

We presently sell all of our gas under a short-term contract with a gas marketer. We believe that other gas marketers are readily available. The sales price is typically based on either a daily price average or a monthly "spot" (Index) price for the applicable production region. Title to the gas passes to the purchaser at the metered interconnection to the transportation pipeline, where the Index price is reduced by certain pipeline charges. Gas sold from the Delhi Field incurs a $0.25 per MMBTU deduction from the Henry Hub price, the primary pricing market for natural gas futures, less an additional $0.085 per MCF charge for transportation. These costs, along with the costs for gas processing and transportation prior to delivery to the sales point, are deducted from the gas sales receipts before calculation and distribution of royalties.

Competition and Regulation

The oil and gas industry is highly competitive. As a small independent, we must compete against companies with substantially larger financial and other resources in all aspects of their businesses.

Oil and gas drilling and production operations are regulated by various Federal, state and local agencies. These agencies issue binding rules and regulations that carry penalties, often substantial, for failure to comply. We anticipate the aggregate burden of Federal, state and local regulation will continue to increase, including in the area of rapidly changing environmental laws and regulations. We also believe that our present operations substantially comply with applicable regulations. To date, such regulations have not had a material effect on our operations, or the costs thereof. There are no known environmental or other regulatory matters related to our operations that are reasonably expected to result in material liability to us that have not been recognized in our financial statements or their footnotes. We do not believe that capital expenditures related to environmental control facilities or other regulatory matters will be material in the near term. NGS cannot predict what subsequent legislation or regulations may be enacted or what affect it will have on our operations or business.

RISK FACTORS

Risks related to the Company

Need for additional financing.

We currently do not have sufficient capital reserves to satisfy our obligations and continue operations through the end of 2004, and therefore have an immediate need for capital. While we are exploring various capital raising avenues, there can be no assurance that we will be able to obtain the sufficient short-term capital needed to sustain operations. Further, we are incurring losses from operating activities. Our current capital reserves will not be sufficient to allow us to fully execute our business plan within the time frame projected and take advantage of available business opportunities during fiscal year 2005. The full and timely development and implementation of our business plan and growth strategy will require significant additional resources. We may not be able to obtain the working capital necessary to implement our growth strategy. Furthermore, our growth strategy may not produce material revenue even if successfully funded. Management intends to explore a number of options to secure alternative sources of capital, including the issuance of secured debt, volumetric production payments, subordinated debt, or additional equity, including preferred equity securities or other equity securities. We might not succeed, however, in raising additional equity capital or in negotiating and obtaining additional and acceptable financing when we need it. Our ability to obtain additional capital will also depend on market conditions, national and global economies and other factors beyond our control. Even if we are able to obtain the short-term capital necessary to sustain our operations, if adequate capital is not available or is not available on acceptable terms at a time when we needed it, our ability to close acquisitions, execute our growth plans, develop or enhance our services or respond to competitive pressures will be significantly impaired. There are no assurances that we will be able to implement or capitalize on various financing alternatives or otherwise obtain required working capital, the need for which is substantial given our operating loss history. (See Liquidity and Capital Resources, Item 6, for further discussion.)

We have a limited operating history.

We are a development stage company with a limited operating history, and we face all the risks common to companies in their early stages of development, including undercapitalization and uncertainty of funding sources, high initial expenditure levels and uncertain revenue streams, an unproven business model, and difficulties in managing growth. Our prospects must be considered in light of the risks, expenses, delays and difficulties frequently encountered in establishing a new business. Any forward-looking statements in this report do not reflect any adjustments that might result from the outcome of these types of uncertainty. Since inception, we have incurred significant losses. No assurance can be given that we will be successful. While our management has previously carried out or been involved with acquisition and production activities in the oil and gas industry while employed by other companies, there can be no assurance that our intended acquisition targets and development plans will lead to the successful development of oil and gas production revenue.

We may incur unforeseen costs and we may need to raise capital in addition to that required by our business plan.

We are currently operating at a loss and intend to increase our operating expenses significantly as we expand our acquisitions and oil and gas production. Our current cash reserves are only sufficient to fund short-term operations, excluding debt service. Additionally, we may encounter unforeseen costs that could also require us to seek additional capital. We currently do not have any permanent arrangements or credit facilities in place as a source of funds should this need arise, and there can be no assurance that we will be able to raise sufficient additional capital on acceptable terms, if at all. Any additional financing may result in significant dilution to our existing stockholders.

We utilize licensed technology from third parties in certain aspects of our operations.

We utilize a variety of technologies in the oil and gas development and drilling process. We do not have any patents or copyrights for the technology we utilize. Instead, we license or outsource most of the technology integral to our business from third parties. Our commercial success will depend in part on this licensed technology not infringing on the propriety rights of others and not breaching technology licenses that cover the technology we use in our business. It is uncertain whether any third party patents will require us to utilize or develop alternative technology or to alter our business plan, obtain additional licenses, or cease activities that infringe on third-parties' intellectual property rights. Our inability to acquire any third-party licenses, or to integrate the related third-party products into our business plan, could result in delays in development unless and until equivalent products can be identified, licensed, and integrated. Existing or future licenses may not continue to be available to us on commercially reasonable terms. Litigation, which could result in substantial cost to us, may be necessary to enforce any patents licensed to us or to determine the scope and validity of third-party obligations.

Regulatory and accounting requirements may require substantial reductions in proven reserves and limitations of hedging.

We review on a periodic basis the carrying value of our oil and natural gas properties under the applicable rules of the various regulatory agencies, including the SEC. Under these rules, the carrying value of proved oil and natural gas properties may not exceed the present value of estimated future net after-tax cash flows from proved reserves, discounted at 10%. Application of this "ceiling" test generally requires pricing future revenue at the unescalated prices in effect as of the end the fiscal year and requires a write down for accounting purposes if the ceiling is exceeded, even if prices declined for only a short period of time. We may in the future be required to write down the carrying value of our oil and natural gas properties when oil and natural gas prices are depressed or unusually volatile. Whether we will be required to take such a charge will depend on the prices for oil and natural gas at the end of any fiscal year and the effect of reserve additions or revisions and capital expenditures during such period. If a write down is required, it would result in a charge to earnings but would not impact cash flow from operating activities.

In order to reduce our exposure to short-term fluctuations in the price of oil and natural gas, we may periodically enter into hedging arrangements. Our hedging arrangements would apply to only a portion of our production and provide only partial price protection against declines in oil and natural gas prices. Such hedging arrangements may expose us to risk of financial loss in certain circumstances, including instances where production is less than expected, our customers fail to purchase contracted quantities of oil or natural gas or a sudden, unexpected event materially impacts oil or natural gas prices. In addition, our hedging arrangements may limit the benefit to us of increases in the price of oil and natural gas.

Maintaining reserves and revenue in the future depends on successful development and acquisitions.

In general, the volume of production from oil and natural gas properties declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. Except to the extent we acquire properties containing proved reserves or conduct successful development activities, or both, our proved reserves will decline. Our future oil and natural gas production is, therefore, highly dependent upon our level of success in finding or acquiring additional reserves.

We are subject to substantial operating risks.

The oil and natural gas business involves certain operating hazards such as well blowouts, mechanical failures, explosions, uncontrollable flows of oil, natural gas or well fluids, fires, formations with abnormal pressures, hurricanes, pollution, releases of toxic gas and other environmental hazards and risks. We could suffer substantial losses as a result of any of these events. While we carry general liability, control of well, and operator's extra expense coverage typical in our industry, we are not fully insured against all risks incident to our business.

We may not always be the operator of some of our wells. As a result, our operating risks for those wells and our ability to influence the operations for these wells will be less subject to our control. Operators of these wells may act in ways that are not in our best interests.

The loss of key personnel could adversely affect us.

We depend to a large extent on the services of certain key management personnel, including our executive officers, the loss of any of which could have a material adverse effect on our operations. We do not maintain key-man life insurance with respect to any of our employees.

We depend on skilled technical personnel.

We depend to a large extent on the services of skilled technical personnel to operate and maintain our oil and gas fields. Additionally, as our production increases, so does our need for such services. Except for our agreement with Verdisys, we do not have long-term agreements with our drilling and maintenance service providers. Accordingly, there is a risk that any of our service providers could discontinue servicing our oil and gas fields for any reason. Although we believe that we could establish alternative sources for most of our operation and maintenance needs, any delay in locating, establishing relationships, and training our sources could result in production shortages and maintenance problems, with a resulting loss of revenue to us. We also rely on third-party carriers for the transportation and distribution of our recovered reserves, the loss of any of which could have a material adverse effect on our operations.

Our operations have significant capital requirements.

We have experienced and expect to continue to experience substantial working capital needs due to our active development and acquisition programs. Even if we are able to obtain the short-term capital necessary to maintain our operations, additional financing will be required in the future to fund our growth and operations. No assurances can be given as to the availability or terms of any such additional financing that may be required or that financing will continue to be available under new credit facilities. In the event such capital resources are not available to us, our drilling and other activities would be curtailed.

We may have difficulty managing future growth and the related demands on our resources and may have difficulty in achieving future growth.

We expect to experience rapid growth through acquisitions and development activity for the foreseeable future. Any future growth may place a significant strain on our financial, technical, operational and administrative resources. Our ability to grow will depend upon a number of factors, including our ability to identify and acquire new development or acquisition prospects, our ability to develop existing properties, our ability to continue to retain and attract skilled personnel, the results of our drilling program and acquisition efforts, the success of our technology, hydrocarbon prices and access to capital. There can be no assurance that we will be successful in achieving growth or any other aspect of our business strategy.

We face strong competition from larger oil and natural gas companies.

Our competitors include major integrated oil and natural gas companies and numerous independent oil and natural gas companies, individuals and drilling and income programs. Many of our competitors are large, well-established companies with substantially larger operating staffs and greater capital resources than us. We may not be able to successfully conduct our operations, evaluate and select suitable properties and consummate transactions in this highly competitive environment. Specifically, these larger competitors may be able to pay more for development projects and productive oil and natural gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. In addition, such companies may be able to expend greater resources on the existing and changing technologies that we believe are and will be increasingly important to attaining success in the industry.

The oil and natural gas reserve data included in or incorporated by reference in this report are only estimates and may prove to be inaccurate.

There are numerous uncertainties inherent in estimating oil and natural gas reserves and their estimated values. The reserves in this report are only estimates that may prove to be inaccurate because of these uncertainties. Reservoir engineering is a subjective and inexact process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner. Estimates of economically recoverable oil and natural gas reserves depend upon a number of variable factors, such as historical production from the area compared with production from other producing areas and assumptions concerning effects of regulations by governmental agencies, future oil and natural gas prices, future operating costs, severance and excise taxes, development costs and work-over and remedial costs. Some or all of these assumptions may in fact vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities of oil and natural gas attributable to any particular group of properties, classifications of such reserves based on risk of recovery, and estimates of the future net cash flows expected therefrom prepared by different engineers or by the same engineers but at different times may vary substantially. Accordingly, reserve estimates may be subject to downward or upward adjustment. Actual production, revenue and expenditures with respect to our reserves will likely vary from estimates, and such variances may be material. The information regarding discounted future net cash flows included in this report should not be considered as the current market value of the estimated oil and natural gas reserves attributable to our properties. As required by the SEC, the estimated discounted future net cash flows from proved reserves are based on prices and costs as of the date of the estimate, while actual future prices and costs may be materially higher or lower. Actual future net cash flows also will be affected by factors such as the amount and timing of actual production, supply and demand for oil and natural gas, increases or decreases in consumption, and changes in governmental regulations or taxation. In addition, the 10% discount factor, which is required by the SEC to be used in calculating discounted future net cash flows for reporting purposes, is not necessarily the most appropriate discount factor based on interest rates in effect from time to time and risks associated with us or the oil and natural gas industry in general.

Any anticipated credit facility may include substantial operating restrictions and financial covenants and we may have difficulty obtaining such credit facility.

We plan to attempt to put in place a credit facility. There can be no assurance that, in the future, commodity prices will not decline, we will not increase our borrowings or the borrowing base will not be adjusted downward. Any anticipated credit facility will likely be secured by a pledge of substantially all of our assets and have covenants that limit additional borrowings, sales of assets and the distributions of cash or properties and that prohibit the payment of dividends and the incurrence of liens. The revolving credit facility also may require that specified financial ratios be maintained. The restrictions of such credit facility and the difficulty in obtaining additional debt financing may have adverse consequences on our operations and financial results, including our ability to obtain financing for working capital, capital expenditures, our drilling program, purchases of new technology or other purposes may be impaired or such financing may be on terms unfavorable to us; we may be required to use a substantial portion of our cash flow to make debt service payments, which will reduce the funds that would otherwise be available for operations and future business opportunities; a substantial decrease in our operating cash flow or an increase in our expenses could make it difficult for us to meet debt service requirements and require us to modify operations; and we may become more vulnerable to downturns in our business or the economy generally.

Our ability to obtain and service indebtedness will depend on our future performance, including our ability to manage cash flow and working capital, which are in turn subject to a variety of factors beyond our control. Our business may not generate cash flow at or above anticipated levels or we may not be able to borrow funds in amounts sufficient to enable us to service indebtedness, make anticipated capital expenditures or finance our drilling program. If we are unable to generate sufficient cash flow from operations or to borrow sufficient funds in the future to service our debt, we may be required to curtail portions of our drilling program, sell assets, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing. We may not be able to refinance our debt or obtain additional financing, particularly in view of current industry conditions, any restrictions on our ability to incur debt under our existing debt or installment purchase arrangements, and the fact that some or all of our assets are currently pledged to secure obligations under our existing debt or installment purchase arrangements.

Our acquisition program may be unsuccessful, particularly in light of our recent formation and limited history of acquisitions.

Some of our personnel have had significant acquisition experience prior to joining the Company. However, because we have purchased only two properties to date under the Natural Gas Systems name or organization, we may not be in as good a position as our more experienced competitors to execute a successful acquisition program or close additional future transactions.. The successful acquisition of producing properties requires an assessment of recoverable reserves, future oil and natural gas prices, operating costs, potential environmental and other liabilities and other factors. Such assessments, even when performed by experienced personnel, are necessarily inexact and their accuracy inherently uncertain. Our review of subject properties, which generally includes on-site inspections and the review of reports filed with various regulatory entities, will not reveal all existing or potential problems, deficiencies and capabilities. We may not always perform inspections on every well, and may not be able to observe structural and environmental problems even when we undertake an inspection. Even when problems are identified, the seller may be unwilling or unable to provide effective contractual protection against all or part of such problems. There can be no assurances that any acquisition of property interests by us will be successful and, if unsuccessful, that such failure will not have an adverse effect on our future results of operations and financial condition.

We cannot market our production without the assistance of third parties.

The marketability of our production depends upon the proximity of our reserves to, and the capacity of, facilities and third party services, including oil and natural gas gathering systems, pipelines, trucking or terminal facilities, and processing facilities. The unavailability or lack of capacity of such services and facilities could result in the shut-in of producing wells or the delay or discontinuance of development plans for properties. A shut-in or delay or discontinuance could adversely affect our financial condition. In addition, federal and state regulation of oil and natural gas production and transportation affect our ability to produce and market our oil and natural gas on a profitable basis.

Risks Relating to the Oil and Gas Industry

Oil and Gas Drilling, re-completions and re-working are speculative activities and involve numerous risks and substantial and uncertain costs.

Our growth will be materially dependent upon the success of our future drilling and development program. Drilling for oil and gas and re-working existing wells involve numerous risks, including the risk that no commercially productive oil or natural gas reservoirs will be encountered. The cost of drilling, completing and operating wells is substantial and uncertain, and drilling operations may be curtailed, delayed or cancelled as a result of a variety of factors beyond our control, including unexpected drilling conditions, pressure or irregularities in formations, equipment failures or accidents, adverse weather conditions, compliance with governmental requirements and shortages or delays in the availability of drilling rigs or crews and the delivery of equipment. Although we believe that our focus on re-developing existing oil and gas field and advanced drilling technology should increase the probability of success of our wells and should reduce average finding costs through elimination of prospects that might otherwise be drilled using other traditional methods, drilling or reworking remains a speculative activity. Even when fully utilized, lateral drilling does not predetermine if hydrocarbons will in fact be present in such structures if they are drilled. Our future drilling activities may not be successful and, if unsuccessful, such failure will have an adverse effect on our future results of operations and financial condition. There can be no assurance that our overall drilling success rate or our drilling success rate for activity within a particular geographic area will not decline. Although we may discuss drilling prospects that we have identified or budgeted for, we may ultimately not lease or drill these prospects within the expected time frame, or at all. We may identify and develop prospects through a number of methods, some of which do not include horizontal drilling. The drilling and results for these prospects may be particularly uncertain. Our drilling schedule may vary from our capital budget. The final determination with respect to the drilling of any scheduled or budgeted wells will be dependent on a number of factors, including, but not limited to: (i) the results of previous development efforts and the acquisition, review and analysis of data; (ii) the availability of sufficient capital resources to us and the other participants for the drilling of the prospects; (iii) the approval of the prospects by other participants after additional data has been compiled; (iv) economic and industry conditions at the time of drilling, including prevailing and anticipated prices for oil and natural gas and the availability of drilling rigs and crews; (v) our financial resources and results; (vi) the availability of leases and permits on reasonable terms for the prospects; and (vii) the success of our drilling technology. There can be no assurance that these projects can be successfully developed or that the wells discussed will, if drilled, encounter reservoirs of commercially productive oil or natural gas. There are numerous uncertainties in estimating quantities of proved reserves, including many factors beyond our control.

Reliance on technological development and possible technological obsolescence.

Our business is dependent upon utilization of changing technology. As a result, our ability to adapt to evolving technologies, obtain new technology and maintain technological advantages will be important to our future success. We believe that our ability to utilize state of the art technologies will give us an advantage over many of our competitors. This advantage, however, is based in part upon technologies developed by others, and we may not be able to maintain this advantage. As new technologies develop, we may be placed at a competitive disadvantage, and competitive pressures may force us to implement such new technologies at substantial cost. There can be no assurance that we will be able to successfully utilize, or expend the financial resources necessary to acquire, new technology, or that others will not either achieve technological expertise comparable to or exceeding that of our Company or that others will not implement new technologies before us. One or more of the technologies we currently utilize by or implement may, in the future, become obsolete. In such case, our business, financial condition and results of operations could be materially adversely affected. If we are unable to utilize the most advanced commercially available technology, our business, financial condition and results of operations could be materially and adversely affected.

Oil and natural gas prices are highly volatile in general and low prices negatively affect our financial results.

Our revenue, profitability, cash flow, future growth and ability to borrow funds or obtain additional capital, as well as the carrying value of our properties, are substantially dependent upon prevailing prices of oil and natural gas. Lower oil and natural gas prices also may reduce the amount of oil and natural gas that we can produce economically. Historically, the markets for oil and natural gas have been volatile, and such markets are likely to continue to be volatile in the future. Prices for oil and natural gas are subject to wide fluctuation in response to relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and a variety of additional factors that are beyond our control. These factors include the level of consumer product demand, weather conditions, domestic and foreign governmental regulations, the price and availability of alternative fuels, political conditions, the foreign supply of oil and natural gas, the price of foreign imports and overall economic conditions. It is impossible to predict future oil and natural gas price movements with certainty. Declines in oil and natural gas prices may materially adversely affect our financial condition, liquidity, ability to finance planned capital expenditures and results of operations.

Government regulation and liability for environmental matters may adversely affect our business and results of operations.

Oil and natural gas operations are subject to extensive federal, state and local government regulations, which may be changed from time to time. Matters subject to regulation include discharge permits for drilling operations, drilling bonds, reports concerning operations, the spacing of wells, unitization and pooling of properties and taxation. From time to time, regulatory agencies have imposed price controls and limitations on production by restricting the rate of flow of oil and natural gas wells below actual production capacity in order to conserve supplies of oil and natural gas. There are federal, state and local laws and regulations primarily relating to protection of human health and the environment applicable to the development, production, handling, storage, transportation and disposal of oil and natural gas, by-products thereof and other substances and materials produced or used in connection with oil and natural gas operations. In addition, we may be liable for environmental damages caused by previous owners of property we purchase or lease. As a result, we may incur substantial liabilities to third parties or governmental entities. We are also subject to changing and extensive tax laws, the effects of which cannot be predicted. The implementation of new, or the modification of existing, laws or regulations could have a material adverse effect on us.

Risks Associated with Our Stock

Our stock price has been and may continue to be very volatile.

Our common stock is thinly traded and the market price has been, and is likely to continue to be, highly volatile. During the 12 months prior to June 30, 2004, our stock price as traded on the OTC Bulletin Board has ranged from $4.75 to $0.60. The variance in our share price makes it extremely difficult to forecast with any certainty the stock price at which you may be able to buy or sell shares of our common stock. The market price for our common stock could be subject to wide fluctuations to factors that our out of our control, such as:

- Actual or anticipated variations in our results of operations,
- Naked short selling of our common stock and stock price manipulation
- Changes or fluctuations in the commodity prices of oil and natural gas
- General conditions and trends in the oil and gas industry
- General economic, political and market conditions

Future sales of our common stock in the public market could adversely affect the price of our common stock.

Sales of substantial amounts of common stock in the public market that are not currently freely tradable, or even the potential for these sales, could have an adverse effect on the market price for the shares of our common stock. These shares include approximately 23.1 million shares purchased by founders and investors and 335,000 warrants at September 15, 2004. Unregistered shares may not be sold except in compliance with Rule 144 promulgated by the SEC, or some other exemption from registration. Rule 144 does not prohibit the sale of these shares but does place conditions and restrictions on their resale, which must be complied with before they can be resold.

Future sales of our common stock in the public market could limit our ability to raise capital.

Sales of substantial amounts of our common stock pursuant to Rule 144, upon exercise or conversion of derivative securities or otherwise, or even the potential of these sales, could also affect our ability to raise capital through the sale of equity securities.

The Company has never paid cash dividends on its common stock and does not intend to do so in the foreseeable future.

Present management and directors may control the election of our directors and all other matters submitted to the stockholders for approval.

Our executive officers and directors, in the aggregate, beneficially own approximately 40% of our outstanding common stock. Further, our Chairman of the Board, Mr. Laird Q. Cagan, Managing Director of Cagan McAfee Capital Partners, LLC ("CMCP"), directly or indirectly, currently owns or controls approximately 7.5 million shares, or approximately 32% of the currently outstanding Common Stock of the Company. Mr. Eric McAfee, also a Managing Director of CMCP, directly or indirectly, currently owns or controls approximately 5.7 million shares, or approximately 25% of the currently outstanding Common Stock of the Company. Collectively, these two managing directors of CMCP directly, or indirectly, currently own or control 13,200,000 shares, or approximately 57% of the currently outstanding Common Stock of the Company. As a result, these holders of our outstanding common stock are able to exercise control over all matters submitted to our stockholders for approval (including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets). Accordingly, this concentration of ownership may have the effect of delaying, deferring or preventing a change in control of the Company, impede a merger, consolidation, takeover or other business combination involving the Company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of the Company, which in turn could have an adverse effect on the market price of our common stock.

"Penny stock" regulations may impose certain restrictions on marketability of securities.

The SEC adopted regulations, which generally define "penny stock" to be an equity security that has a market price of less than $5.00 per share. Our common stock may be subject to rules that impose additional sales practice requirements on broker-dealers who sell these securities to persons other than established customers and accredited investors (generally those with assets in excess of $1,000,000, or annual incomes exceeding $200,000 or $300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of these securities and have received the purchaser's prior written consent to the transaction.

Additionally, for any transaction, other than exempt transactions, involving a penny stock, the rules require the delivery, prior to the transaction, of a risk disclosure document mandated by the SEC relating to the penny stock market. The broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market-maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the "penny stock" rules may restrict the ability of broker-dealers to sell our common stock and may affect the ability to sell our common stock in the secondary market.

The market for our Company's securities is limited and may not provide adequate liquidity.

Our common stock is currently traded on the OTC Bulletin Board ("OTCBB"), a regulated quotation service that displays real-time quotes, last-sale prices, and volume information in over-the-counter equity securities. As a result, an investor may find it more difficult to dispose of, or obtain accurate quotations as to the price of, our securities than if the securities were traded on the Nasdaq Stock market, or another national exchange. There are a limited number of active market makers of our common stock. In order to trade shares of our common stock you must use one of these market makers unless you trade your shares in a private transaction. In the twelve months prior to June 30, 2003, the actual trading volume ranged from a low of no shares of common stock to a high of over 341,000 shares of common stock with only 7 days exceeding a trading volume over 100,000 shares (as adjusted for a 40:1 stock split in February 2004). On most days, this trading volume means there is limited liquidity in our shares of common stock. Selling our shares is more difficult because smaller quantities of shares are bought and sold and news media coverage about us is limited. These factors result in a limited trading market for our common stock and therefore holders of our Company's stock may be unable to sell shares purchased should they desire to do so.

ITEM 2. PROPERTIES

Delhi Field.

In late September, 2003, Old NGS purchased a 100% working interest in the Delhi Field by paying $995,000 in cash, issuing non-interest bearing notes for $1,500,000 and assuming a plugging and abandonment reclamation liability in the amount of approximately $302,000, in exchange for the conveyance of all the underlying leasehold interests. The notes are collateralized by a first mortgage on the leasehold interests and are payable to the sellers in twelve equal monthly installments beginning on January 30, 2004. At June 30, 2004, $750,000 remained payable under the notes. In addition to the mortgage, the property is burdened by an aggregate 20% royalty interest.

The Delhi Field was discovered in the 1940's and had been extensively developed over the subsequent decades through the drilling and completion of approximately 450 wells. According to W. D. Von Gonten & Co., the third party reservoir engineering firm that audits our reserves, the field has produced more than 200 million barrels of oil to date, in addition to substantial amounts of gas. Much of the gas production was stripped of gas liquids and re-injected for pressure maintenance. Beginning in the late 1950's, the field was unitized to conduct a pressure maintenance water flood project. Unitization is the process of combining multiple leases into a single ownership entity in order to simplify operations and equitably distribute royalties when common operations are conducted over multiple leases. Drilling operations were completed on primarily 40-acre spacing across the unit's 13,636 acres. A few wells were drilled below the targeted Tuscaloosa sand stone, and many wells were not drilled below the first producing reservoir.

At that time of our acquisition in 2003, production at Delhi averaged approximately 18 BOPD, and no gas was being sold due to a lack of gas processing and transportation facilities. The best producing well, the 161-36, was immediately lost during a periodic sand wash work-over when water from a lower reservoir broke through along the casing and into the producing reservoir.

Currently, at September 15, 2004, the gross productive rate of the field was approximately 58 BOPD, 600 MCFD of gas and 7 BLPD. Current gas sales have been approximately 500 MCFD, as a portion of the produced gas is utilized as compressor, dehydrator and pump engine fuel on site.

The Company has performed, or is planning to perform in the near term, the following significant development work.

Well	BOPD Before	BOPD After	MCFD After	Action
183-3	1	5	5	Re-completion
178-2	4	4	5	Laterally drilled
184-1	4	4	5	Laterally drilled
197-1	4	6	20	Mechanically repaired
197-2	0	65	- -65	Restored to production
204-2	0	0	200	Re-completion
198-1	0	0	0	Restore to production — shut-in
184-2	0	0	400	Re-completion from water injection status
210-2	0	Pending	Pending	Restore to production
215-17	0	Pending	Pending	Restore to production
180-1	0	Pending	Pending	Re-completion from water injection status
196-3	0	Pending	Pending	Re-completion of shut-in producer
225-1	0	Pending	Pending	Restore to production
87-2	0	Pending	Pending	Restore to production
203-2	0	Pending	Pending	Restore to production
161-36	10	0	0	Periodic sand wash led to water breakthrough
204-1	SI	0	0	Found collapsed casing

We occupy a leased headquarters containing 2,259 square feet in a modern high-rise office building located in the West Memorial area of Houston, Texas. In April 2003, we extended our lease for three years, without escalators. Other terms include an option for early termination after 18 months, and the right to use furniture and fixtures without cost.

In March of 2004, we installed a leased gas treating and compression facility under a one-year operating lease. The facility was necessary to begin sales of natural gas, which began in July of 2004, thus expanding our revenue base as contemplated by our original plan for the Delhi Field.

NGS maintains insurance on its properties and operations for risks and in amounts customary in the industry. Such insurance includes general liability, excess liability, control of well, operators extra expense and casualty coverage. Not all losses are insured, and the Company retains certain risks of loss through deductibles, limits and self-retentions. NGS does not carry lost profits coverage.

For more complete information regarding current year activities, including oil and gas production, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Significant Properties, Estimated Proved Oil and Gas Reserves, and Future Net Revenues

NGS engaged W. D. Von Gonten & Co. ("Von Gonten") to perform an independent review of our proved reserves located in the Delhi Field as of July 1, 2004. Von Gonten also previously performed an independent review of our proved reserves at January 1, 2004.

Estimates of reserve quantities and values must be viewed as being subject to significant change as more data about the properties becomes available. All of our existing wells are generally mature wells, originally drilled as many as 58 years ago. As such, they contain older down-hole equipment that is more subject to failure than new equipment. The failure of such equipment or other subsurface failure can result in the complete loss of a well.

At July 1, 2004, natural gas and associated liquids represented 27% and crude oil represented 73% of total proved reserves, denominated in equivalent barrels using a six MCF of gas to one barrel of oil conversion ratio.

The following table sets forth, as of July 1, 2004 and January 1, 2004, information regarding our proved reserves based on the assumptions set forth in Note 10 to the Consolidated Financial Statements where additional reserve information is provided. The average NYMEX prices used to calculate estimated future net revenues were $37.05 and $32.52 per barrel of oil and $6.16 and $6.19 per MMBTU of gas as of June 30, 2004 and December 31, 2003, respectively. The average NYMEX prices used were adjusted for transportation, market differentials and BTU content of gas produced. Amounts do not include estimates of future Federal and State income taxes.

	Oil (bbls)	Gas (Mcf)	Estimated Future Net Revenues	Estimated Future Net Revenues Discounted at 10%
Jul 1, 2004	238,904	508,556*	$ 8,121,711	$ 6,320,754
Jan 1, 2004	240,362	778,700	$ 10,065,493	$ 8,119,670

* NGL reserves of 5,000 bbls are included in the above gas volumes, at a 6:1 ratio.

Proved Developed reserves total 59% of Total Proved reserves, the balance consisting of Proved Behind Pipe reserves.

The reduction in proved reserves from January 1, 2004 to July 1, 2004 is primarily a result of the reclassification of proved behind pipe reserves associated with the 208-1 well to an other-than-proved category, offset by the addition of proved reserves for the 204-2 and 184-2 wells and increase in proved reserves assigned to the 87-2 well. The reclassification of the 208-1 reserves resulted from review of previously unavailable information that lowered the probability of recovery below the threshold required for proved reserves.

Production, Average Sales Prices and Average Production Costs

Our net production quantities and average price realizations per unit for the fiscal periods set forth below. There were no hedging gains or losses.

	6 months ended June 30, 2004		3 months ended December 31, 2003	
Product	Volume	Price	Volume	Price
Gas (Mcf)	123	5.28	—	—
Oil (bbls)	3,180	$ 36.95	857	$ 28.27

Average production costs, including production taxes, per unit of production (using a six to one conversion ratio of MCF's to barrels) were $38.90 and $92.54 per barrel for the six months ended

June 30, 2004 and the three month period ended December 31, 2003, respectively. The high production costs per barrel are a result of substantial expenses related to general field repair.

Productive Wells and Developed Acreage

Developed acreage at June 30, 2004 totaled 13,636.55 net and gross acres held by a unitization agreement. At June 30, 2004, we owned working interests in 44 net and gross wells consisting of 6 oil wells, 1 gas well, 1 water disposal well and 36 shut-in wells. Subsequent to June 30, we converted two shut-in wells to producing status.

Undeveloped Acreage

All working interest acreage owned by the Company is held by production through a unitization agreement and is previously developed.

Drilling

During fiscal the fiscal year ended June 30, 2004, the Company drilled no new wells.

Subsequent Events

Since June 30, 2004:

- We have placed on production two additional wells that were previously shut-in in the Delhi Field.

- We purchased a second property, comprising a 100% working interest in approximately 81 producing oil wells, 8 salt water disposal wells and 54 shut-in wells located in Louisiana, producing approximately 62 BOPD with opportunities for increased production.

See Item 8B, Other Information, for a further discussion.

ITEM 3. LEGAL PROCEEDINGS

We are not a party to any material pending legal proceedings. No such proceedings have been threatened and none are contemplated by NGS.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted during the fourth quarter of the fiscal year covered by this report to a vote of security holders through the solicitation of proxies or otherwise.

PART II.

ITEM 5. MARKET FOR THE COMPANY'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the OTC Bulletin Board National Association of Securities Dealers Automated Quotation System under the symbol "NGSY" and its predecessor symbol "RLYI". Market quotations shown below were reported by Media General Financial Services and represent prices between dealers, excluding retail mark-up or commissions, and adjusted for the 40:1 stock split that occurred on February 5, 2004.

	Calendar: 2004		2003	
Quarter Ended	High	Low	High	Low
December 31	na	na	$ 1.60	$ 0.64
September 30	na	na	$ 2.60	$ 1.20
June 30	$ 4.75	$ 0.91	$ 1.80	$ 0.60
March 31	$ 3.25	$ 0.65	$ 1.80	$ 0.20

At August 31, 2004, NGS had 241 shareholders of record. We have never paid a cash dividend and we do not expect to pay any cash dividends in the foreseeable future. Earnings, if any, are expected to be reinvested in business activities. No stock has been repurchased since the inception of the Company.

Securities authorized for issuance under equity compensation plans

On August 3, 2004, shareholders approved the adoption of our 2004 Stock Option Plan. No options have been granted under this plan. The purpose of the 2004 Plan is to grant stock options to purchase our common stock to our employees and key consultants

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	600,000(1)	$ 0.1048	3,400,000
Equity compensation plans not approved by security holders	319,932(2)	$ 1.00	—
Total	**931,932**	**$ 0.4161**	**3,400,000**

(1) On May 26, 2004, we, as Reality Interactive, Inc., executed an Agreement and Plan of Merger with Natural Gas Systems, Inc., a Delaware corporation (the "Merger"). In connection with the Merger, we assumed the obligations of 600,000 stock options under our newly acquired subsidiary's 2003 Stock Option Plan. No further shares shall be issued under the 2003 Stock Option Plan.

(2) In addition to assuming certain obligations listed in footnote 1 above, in connection with the Merger we also assumed outstanding warrants to purchase 300,000 shares of common stock at an exercise price of $1.00, with a seven year term (warrants). We issued 240,000 of these warrants to CMCP in connection with arranging the merger and 60,000 were issued to CMCP in the placement of 750,000 shares. Subsequently, we issued 19,932 warrants to CMCP in connection with capital raising services on the same terms as the warrants in the preceding sentence.

Recent Sales of Unregistered Securities

On May 26, 2004, we, as Reality Interactive, Inc., executed an Agreement and Plan of Merger with Natural Gas Systems, Inc., a private Delaware corporation ("Old NGS"), whereby the shareholders of Old NGS received 21,749,478 shares of our common stock in exchange for all of the 21,749,748 shares of Old NGS common stock then outstanding. The operations and management of Old NGS became our own, and we changed our name to Natural Gas Systems, Inc. The shares of stock that were issued in the transaction we believe to be exempt from registration under Regulation D promulgated under Section 4(2) of the Securities Act. The issuances were a share for share exchange resulting in a similar investment to that originally contemplated due to the continuation of management and business plan; the recipients in the exchange were accredited investors as defined in Rule 501 of Regulation D promulgated under Section 4(2) of the Securities Act, and took their shares for investment purposes without a view to distribution; they had access to information concerning our Company and our business prospects; there was no general solicitation or advertising for the purchase of our shares; there were no commissions paid; and the securities are restricted pursuant to Rule 144.

In June of 2004, we sold 249,667 shares of our common stock at a price of $1.00 per share (net of warrants exercised at $0.01 per share) in a private offering we believe to be exempt from registration under Regulation D promulgated under Section 4(2) of the Securities Act. These shares were subject to certain registration rights. The sales of stock was to an entity that was an accredited investor, as that term is defined in Rule 501 of Regulation D promulgated under Section 4(2) of the Securities Act and had adequate access to information pertaining to our Company. Furthermore, no advertisements were made and the securities are restricted pursuant to Rule 144. Offering costs consisted of 19,973 warrants exercisable at $1.00 per share until June 2011, and fees of $20,000, both payable to the placement agent.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

As used herein, the term "three months ended December 31, 2003" refers to our inception date, September 23, 2003, through December 31, 2003.

Liquidity and Capital Resources

As of June 30, 2004, we had $367,831 of unrestricted cash and negative working capital of $383,352. We incurred losses for the six months period ended June 30, 2004 and three months period ended December 31, 2003 of $1,027,682 and $336,905, respectively. Our negative working capital of $383,352 was adversely impacted by $732,806 of short-term mortgage notes we owe on the Delhi Field, payable in approximately equal monthly installments through December 30, 2004 (the "Delhi Notes" See Note 7 to the financial statements for a further description). Although our cash flow from operations currently approximates our recurring overhead, our cash flow has been, and continues to be, insufficient to cover the Delhi Note payments. Although we are current in our payments on the Delhi Notes, we have relied on additional funding sources to meet these payments since the beginning of 2004. At September 24, 2004, we owed four remaining monthly payments of $125,000 each on the Delhi Notes. At that date, we had cash balances of approximately $256,000 and approximately $176,000 of accounts payable due (excluding deferred fees due CMCP).

Our negative working capital and cash position, as well as our ongoing operating losses, raise concerns about our ability to meet future obligations and fund future operations. Accordingly, management has and continues to expend considerable time and effort to deal with this issue as discussed below. Subsequent to June 30, 2004, we have been working to improve our liquidity using three strategies:

1. **Additional Sales of Common Stock:** From June 30 through September 24, 2004 we received $544,734 of additional gross cash proceeds from the private sale of our common stock, before

commissions. We plan to raise funds through additional sales of equity securities in private transactions. Because there can be no assurance that we will be able to do so, we are pursuing borrowing arrangements as discussed below.

2. **Borrowing:** On August 11, 2004, we borrowed $475,000 under a short-term secured promissory note (the "Bridge") held by Laird Q. Cagan, the Company's Chairman and major stockholder, secured by a pledge of all of our assets. The loan was earmarked as partial bridge financing for our purchase of the Tullos Urania Field properties for $732,000 on September 3, 2004. The Bridge loan with Mr. Cagan has been amended to delay the repayment until the earlier of (a) July 1, 2005, or (b) the date on which the cumulative gross equity funding after August 14, 2004 reaches $1 million. Terms of the mandatory prepayment have also been amended as more fully described in the original documents filed or incorporated by reference herein. Mr. Cagan is a founding Managing Partner of Cagan McAfee Capital Partners, the financial advisor to the Company that is arranging private equity fundings. If additional funds are not raised, we may not have sufficient funds to repay the Bridge loan or complete our capital expenditure program as currently contemplated.

   Since the beginning of 2004, we also began developing relations with at least three commercial banks and several private equity sources that specialize in making loans or investing in oil and gas producers. We believe that our Delhi and Tullos properties could provide sufficient collateral to repay the remaining Delhi Notes in full, as well as providing us with additional development capital aimed at increasing our production from our existing wells according to our original plan. In the event that the collateral is not sufficient to also repay the Bridge loan above, we would likely be required to negotiate those terms further.

3. **Increased Production:** We continue to work on increasing cash flow from operations through our Delhi Field and additional acquisition candidates, thereby spreading our overhead, including significant expenses of being a public company, over a larger revenue base. On September 3, 2004, we closed the purchase of producing properties in the Tullos Urania Field, located close to our Delhi Field operations in Northern Louisiana. We believe that net cash flow from operations at our Tullos property currently exceeds $30,000 per month. We also believe that opportunities exist to increase Tullos production with relatively small amounts of additional capital expenditures.

   We are pursuing additional acquisition candidates meeting our targeted requirements.

Because earnings, if any, are anticipated to be reinvested in operations, cash dividends are not expected to be paid in the foreseeable future. Commitments for future capital expenditures were not material at year-end. The Company has no defined benefit plans and no obligations for post retirement employee benefits.

Product Prices and Production

Refer to Item 1, "Markets and Customers", for discussion of oil and gas prices and marketing.

Although product prices are key to our ability to operate profitably and to budget capital expenditures, they are beyond the Company's control and are difficult to predict. Although we have not entered into any product price hedges, we may do so. Gas sales are completed on a BTU basis and the gas pipeline measures the BTU content at the delivery point. The gas produced at the Delhi Field is high BTU, with over 1100 BTU per cubic foot of gas from the dry gas wells, and over 1300 BTU in gas associated with the oil wells. Due to the low initial production volumes, the Company utilizes a J-T gas processing unit that strips out most of the heavier liquids, in accordance with the sales pipeline criteria. However, the J-T unit is not as efficient as more costly methods such as cryogenic separation, thus the sales gas heat content of 1117 BTU per cubic foot (actual determination for the month of August, 2004) currently is being delivered to the gas sales pipeline is a higher BTU content than the standard of 1000 BTU per cubic foot. When gas production volume increases to a sufficient level, we may switch to a more efficient processing unit.

Our net production for the three month period ended December 31, 2003 was 857 BBLs, and, the average price received was $28.27 per BBL. For the six month period ended June 30, 2004, our net production was 3,180 BBLs and 123 MCF of natural gas, with average prices received of $36.95 per BBL and $5.28 per MCF. Increases in oil and natural gas volumes for the six months period ended June 30, 2004 over those for the three months ended December 31, 2003 were a result of more months in the period and the successful work-over and restoration to production of several wells.

Refer to Item 2, "Properties", for disclosures regarding reserve values.

Oil and Gas Activities

General

Reserves

Refer to Item 2, "Properties, General, Estimated Proved Oil and Gas Reserves and Future Net Reserves", for information regarding oil and gas reserves.

Results of Operations

During the six months period ended June 30, 2004, we generated revenues of $118,158. Revenues for the three months period ended December 31, 2003 were $24,229. Average daily production increased from 9 BOEPD (857 BOE total) for the three months period ended December 31, 2004, to 21 BOEPD (3,831 BOE total) during the 6 months period ended June 30, 2004. The increase in production is primarily a result of adding the 197-2 well to production. Prior to June 30, 2004, the 197-2 well was limited in rate due to restrictions on the amount of associated gas that could be vented, combined with down time caused by repeated workovers due to sand production. Subsequent to June 30, 2004, the pump was raised 300' and the well has been producing at a more consistent rate without sand problems.

Also subsequent to June 30, 2004, we began daily sales of gas through the refurbished gas gathering pipeline and gas treating and processing facility, allowing full production of oil wells and full production of the 204-2 well, a dry gas producer. Since gas sales began, the 204-2 well has been producing in excess of 150 MCFD. Please see Note 10, Subsequent Events, for wells placed on production subsequent to June 30, 2004.

Operating expenses were $79,305 or $92.54 per BOE, for the three months ended December 31, 2003 and $149,001 or $38.90 per BOE, for the six months ended June 30, 2004. Operating expenses for both periods are high due to the unusual level of workovers needed to control sand production in the 197-2 well (now believed to be corrected) and due to well upsets resulting from frequent production shut-ins caused by the three month process of getting the gas treating facilities working.

General and Administrative costs were $239,093 for the three months ended December 31, 2003 and $542,761 for the six months ended June 30, 2004. The costs included the addition of a second executive officer late in 2003 and the expensing of stock-based compensation in the amount of $50,400 for the three months ended December 31, 2003, and $108,614 for the six months ended June 30, 2004.

Merger fees and expenses related to the merger of Old NGS into a subsidiary of Reality were estimated to be $370,000 for the six month period ended June 30, 2004.

Critical Accounting Policies and Estimates

Accounting for Oil and Gas Property Costs. As more fully discussed in Note 3 to the consolidated financial statements, the Company (i) follows the full cost method of accounting for the costs of its oil and gas properties, (ii) amortizes such costs using the units of production method, and (iii) applies a quarterly full cost ceiling test. Adverse changes in conditions (primarily oil or gas price declines) could result in permanent write-downs in the carrying value of oil and gas properties as well as non-cash charges to operations, but would not affect cash flows.

Estimates of Proved Oil and Gas Reserves. An independent petroleum engineer annually estimates 100% of our proved reserves. Reserve engineering is a subjective process that is dependent upon the quality of available data and the interpretation thereof. In addition, subsequent physical and economic factors such as the results of drilling, testing, production and product prices may justify revision of such estimates. Therefore, actual quantities, production timing, and the value of reserves may differ substantially from estimates. A reduction in proved reserves would result in an increase in depreciation, depletion and amortization ("DD&A") expense.

Estimates of Asset Retirement Obligations. In accordance with SFAS No 143, we make estimates of future costs and the timing thereof in connection with recording our future obligations to plug and abandon wells. Estimated abandonment dates will be revised in the future based on changes to related economic lives, which vary with product prices and production costs. Estimated plugging costs may also be adjusted to reflect changing industry experience. Increases in operating costs and decreases in product prices would increase the estimated amount of the obligation and increase DD&A expense. Cash flows would not be affected until costs to plug and abandon were actually incurred.

This Form 10-KSB includes certain statements that may be deemed to be "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-KSB, other than statements of historical facts, address matters that the Company reasonably expects, believes or anticipates will or may occur in the future. Such statements are subject to various assumptions, risks and uncertainties, many of which are beyond the control of the Company. Investors are cautioned that any such statements are not guarantees of future performance and that actual results or developments may differ materially from those described in the forward-looking statements. The Company bases its forward-looking statements on information currently available and it undertakes no obligation to update them.

ITEM 7. FINANCIAL STATEMENTS

Index to Consolidated Financial Statements

NATURAL GAS SYSTEMS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	June 30, 2004	December 31, 2003
ASSETS		
Current Assets		
Cash and short-term investments	$ 367,831	$ 830,312
Receivables	24,387	56,837
Inventories	115,859	109,216
Prepaid expenses	69,067	25,930
Retainers and deposits	5,000	210,000
Total current assets	582,144	1,232,295
Oil and gas properties being amortized (full cost method)	3,075,438	2,971,468
Oil and gas properties not being amortized	105,225	—
Less: accumulated amortization	(55,509)	(13,960)
Net oil and gas properties	3,125,154	2,957,508
Furniture, fixtures and equipment, at cost	3,091	3,091
Less: accumulated depreciation	(1,159)	(386)
Net furniture, fixtures and equipment	1,932	2,705
Other assets (cash balances earmarked for bonding requirements)	301,835	301,835
Total Assets	$ 4,011,065	$ 4,494,343
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 139,188	$ 114,188
Accrued liabilities	50,073	41,118
Notes payable	776,235	1,437,073
Production taxes payable	—	665
Total current liabilities	965,496	1,593,044
Deferred plugging and abandonment liabilities	311,442	305,004
Stockholders' equity:		
Common stock, par value $0.001 per share; 100,000,000 shares authorized, 22,945,406 and 21,772,362 shares issued and outstanding as of June 30, 2004 and December 31, 2003, respectively	22,945	21,772
Additional paid-in capital	4,453,905	3,398,178
Deferred stock based compensation	(378,136)	(486,750)
Accumulated deficit	(1,364,587)	(336,905)
Total stockholders' equity	2,734,127	2,596,295
Total liabilities and stockholders' equity	$ 4,011,065	$ 4,494,343

See accompanying notes to consolidated financial statements.

NATURAL GAS SYSTEMS, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

	Six Months Ended June 30, 2004	For the Period From September 23, 2003 (Inception) to December 31, 2003
Revenues:		
Oil sales	$ 117,509	$ 24,229
Gas sales	649	—
Total revenues	118,158	24,229
Expenses:		
Operating costs	134,420	76,303
Production taxes	14,581	3,002
Depletion	41,549	13,960
Reverse-merger fees and expenses	370,000	—
General and administrative	542,761	239,093
Total expenses	1,103,311	332,358
Loss from operations	(985,153)	(308,129)
Other revenues and expenses:		
Interest income	4,093	1,148
Interest expense	(46,622)	(29,924)
Total other revenues and expenses	(42,529)	(28,776)
Net loss	$ (1,027,682)	$ (336,905)
Income (loss) per common share:		
Basic and diluted	$ (0.05)	$ (0.02)
Weighted average number of common shares, basic and diluted	22,057,614	20,091,720

See accompanying notes to consolidated financial statements.

NATURAL GAS SYSTEMS, INC. AND SUBIDIARIES

Consolidated Statements of Changes in Stockholders' Equity

For the Period From September 23, 2003 (Inception) to June 30, 2004

	Shares	Dollars	Additional Paid-in Capital	Deferred	Accumulated Deficit	Total Stockholders' Equity
Balances, September 23, 2003	—	$ —	$ —	$ —	$ —	
Sales of common stock	21,772,362	21,772	2,861,028	—	—	2,882,800
Stock-based compensation	—	—	537,150	(486,750)	—	50,400
Net loss	—	—	—	—	(336,905)	(336,905)
Balances, December 31, 2003	21,772,362	21,772	3,398,178	(486,750)	(336,905)	2,596,295
Sales of common stock before merger	923,377	923	825,977	—	—	826,900
Sales of common stock after merger	249,667	250	229,750	—	—	230,000
Deferred compensation	—	—	—	108,614	—	108,614
Net loss	—	—	—	—	(1,027,682)	(1,027,682)
Balances, June 30, 2004	22,945,406	$ 22,945	$ 4,453,905	$ (378,136)	$ (1,364,587)	$ 2,734,127

See accompanying notes to consolidated financial statements.

NATURAL GAS SYSTEMS, INC. AND SUBIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months ended June 30, 2004	For the Period From September 23, 2003 (Inception) to December 31, 2003
Operating activities:		
Net loss	$ (1,027,682)	$ (336,905)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depletion	41,549	13,960
Depreciation	773	386
Stock-based compensation expense	108,614	50,400
Accretion of debt discount	—	29,924
Changes in assets and liabilities:		
Accretion of deferred plugging and abandonment Liability	6,438	3,169
Accounts receivable	32,450	(28,762)
Inventories	(6,643)	(109,216)
Accounts payable	24,999	114,188
Other current liabilities	8,289	41,783
Prepaid expenses	(43,137)	(25,930)
Retainers and deposits	205,000	(210,000)
Net cash used by operating activities	(649,350)	(457,003)
Investing activities:		
Capital expenditures for oil and gas properties	(209,194)	(1,290,560)
Capital expenditures for furniture, fixtures, and equipment	—	(3,090)
Cash restricted for Delhi bonding requirements	—	(301,835)
Net cash used in investing activities	(209,194)	(1,595,485)
Financing activities:		
Payments on notes payable	(710,327)	—
Proceeds from notes payable	49,490	—
Proceeds from issuance of common stock	1,056,900	2,882,800
Net cash provided by financing activities	396,063	2,882,800
Net (decrease) increase in cash	(462,481)	830,312
Cash and cash equivalents, beginning of period	830,312	—
Cash and cash equivalents, end of period	$ 367,831	$ 830,312
Supplemental Cash Flow Information:		
Interest paid	$ 46,622	—
Taxes paid	—	—
Non-cash transactions:		
Seller note issued to acquire properties, net of discount	—	$ 1,407,049
Assumption of plugging and abandonment liability	—	$ 301,835

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2004

NATURAL GAS SYSTEMS, INC. AND SUBSIDIARIES

1. Company's Business

Reality Interactive, Inc. ("**Reality**"), a Nevada corporation that traded on the OTC Bulletin Board under the symbol RLYI.OB, and the predecessor of Natural Gas Systems, Inc., was incorporated on May 24, 1994 for the purpose of developing technology-based knowledge solutions for the industrial marketplace. On April 30, 1999, Reality ceased business operations, sold substantially all of its assets and terminated all of its employees. Subsequent to ceasing operations, Reality explored other potential business opportunities to acquire or merge with another entity, while continuing to file reports with the SEC. During the most recent two years, Reality represented that it had not conducted any operations and had minimal assets and liabilities.

On May 26, 2004, Natural Gas Systems, Inc., a privately owned Delaware corporation formed in September of 2003 ("**Old NGS**"), was merged into a wholly owned subsidiary of Reality and Reality changed its name to Natural Gas Systems, Inc. On the effective date of the merger, Laird Q. Cagan was elected as Chairman of the Board of Directors of Reality and Robert S. Herlin and Sterling H. McDonald, the CEO and CFO of Old NGS, were elected CEO and CFO of Reality, respectively. The corporation was renamed Natural Gas Systems, Inc. (the "**Company**" or "**NGS**") and adopted a June 30 fiscal year end.

Headquartered in Houston, Texas, Natural Gas Systems, Inc. is a development stage petroleum company engaged primarily in the acquisition, exploitation and development of properties for the production of crude oil and natural gas from underground reservoirs. NGS acquires established oil and gas properties and exploits them through the application of conventional and specialized technology to increase production, ultimate recoveries, or both. At June 30, 2004, NGS conducted operations through its 100% working interest in the Delhi Field in Louisiana.

All regulatory filings and other historical information including stock prices prior to May 26, 2004 apply to Reality, the predecessor of the Company. NGS trades on the OTC Bulletin Board under the symbol NGSY.OB. All stock information is adjusted to reflect Reality's 40:1 reverse stock split effected prior to the merger with NGS.

2. Significant Risks and Uncertainties

Preparation of the Company's financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and contingencies as of the balance sheet date, and the reported amount of revenues and expenses during the reporting period. On an ongoing basis, management reviews its estimates, including those related to litigation, environmental liabilities, income taxes, abandonment costs and the determination of proved reserves. Changes in circumstances may result in revised estimates and actual results may differ from those estimates.

The Company's business makes it vulnerable to changes in crude oil and natural gas prices. Such prices have been volatile in the past and can be expected to be volatile in the future. This volatility can dramatically affect cash flows and proved reserves, since price declines reduce the estimated quantity of proved reserves and increase annual amortization expense (which is based on proved reserves). Other risks related to proved reserves, revenues, and cash flows include the Company's current reliance on the concentration of a few wells. The reserve report dated July 1, 2004, identified six wells that make up approximately 60% of the Company's future net cash flows, discounted at 10% per annum. At July 31, 2004, approximately 85% of the Company's production was derived from three wells.

3. Summary of Significant Accounting Policies

Principles of Consolidation—The consolidated financial statements include the Company and its subsidiaries. All material intercompany accounts and transactions have been eliminated.

Oil and Gas Properties and Furniture, Fixtures and Equipment—The Company follows the full cost method of accounting for its investments in oil and natural gas properties. All costs incurred in the acquisition, exploration and development of oil and natural gas properties, including unproductive wells, are capitalized. Included in capitalized costs are general and administrative costs that are directly related to acquisition, exploration and development activities. Proceeds from the sale of oil and natural gas properties are credited to the full cost pool, unless the sale involves a significant quantity of reserves, in which case a gain or loss is recognized. Under the rules of the Securities and Exchange Commission ("SEC") for the full cost method of accounting, the net carrying value of oil and natural gas properties, reduced by the asset retirement obligation, is limited to the sum of the present value (10% discount rate) of the estimated future net cash flows from proved reserves, based on the current prices, plus the lower of cost or estimated fair market value of unproved properties adjusted for related income tax effects.

Capitalized costs of proved oil and natural gas properties are depleted on a unit of production method using proved oil and natural gas reserves. Costs depleted include net capitalized costs subject to depletion and estimated future dismantlement, restoration and abandonment costs.

Equipment, which includes computer equipment, hardware and software and furniture and fixtures, is recorded at cost and is generally depreciated on a straight-line basis over the estimated useful lives of the assets, which range from two to seven years.

Repairs and maintenance are charged to expense as incurred.

Statement of Cash Flows—For purposes of the statements of cash flows, cash equivalents include highly liquid financial instruments with maturities of three months or less as of the date of purchase.

Concentrations of Credit Risk—All of the Company's trade receivables are due from one purchaser. Accounts receivable are not collateralized.

Revenue Recognition—The Company recognizes oil and natural gas revenue from its interests in producing wells as oil and natural gas is sold.

Accounting for Reverse Merger—The Company accounts for its reverse-merger in accordance with Staff Accounting Bulletin ("SAB") Topic 2A. Generally, the staff of the Division of Corporate Finance considers reverse-mergers into public shells to be capital transactions in substance, rather than business combinations. That is, the transaction is equivalent to the issuance of stock by the private company for the net monetary assets of the shell corporation, accompanied by a recapitalization.

Under this treatment, post reverse-acquisition comparative historical financial statements are those of the "legal acquiree" (*i.e.*, the "accounting acquirer"), with appropriate disclosure concerning the change in the capital structure effected at the acquisition date. In the Company's case, the historical financial statements are those of the oil and gas operations of Old NGS, except that the Consolidated Statement of Changes in Stockholder's Equity reflect the activity of Old NGS prior to the merger. All share and per share amounts have been adjusted to reflect the conversion ratio of shares exchanged between Reality and Old NGS.

Also, in accordance with SAB Topic 2A, transaction costs incurred for the reverse-merger, such as legal fees, investment banking fees and the like, may be charged directly to equity only to the extent of the cash received, while all costs in excess of cash received should be charged to expense. Accordingly, since no cash was received, $370,000 in transaction fees were expensed in the Company's accompanying financial statements.

Stock Options—As permitted by SFAS No. 123, "Accounting for Stock Based Compensation," the Company follows the accounting requirements for stock options and stock-based awards contained in Accounting Principles Board Opinion No. 25, "Accounting for stock Issued to Employees," and related Interpretations and consensus of the Emerging Issues Task Force in terms of measuring compensation expense.

SFAS 123, "Accounting for Stock-Based Compensation," as amended by SFAS 148, "Accounting for Stock-Based Compensation—Transition and Disclosure," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25").

Fair Value of Financial Instruments—Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and seller notes. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the highly liquid nature of these short-term instruments. The fair values of the seller notes approximates their carrying amounts as of June 30, 2004, based upon interest rates currently available to us for borrowings with similar terms.

New Accounting Pronouncements—During December 2003, the FASB issued Interpretation No. 46R, "Consolidation of Variable Interest Entities" ("FIN 46"), which requires the consolidation of certain entities that are determined to be variable interest entities ("VIE's"). An entity is considered to be a VIE when either (i) the entity lacks sufficient equity to carry on its principal operations, (ii) the equity owners of the entity cannot make decisions about the entity's activities or (iii) the entity's equity neither absorbs losses or benefits from gains. NGS owns no interest in variable interest entities, and therefore this new interpretation has not affected the Company's consolidated financial statements.

4. Acquisitions

In September 2003, Old NGS completed the acquisition of a 100% working interest in the Delhi Field. The acquisition closed on September 25, 2003, whereby Old NGS paid $995,000 in cash, issued a purchase money mortgage for $1,500,000 (See Note 7, Notes Payable, for a description of the mortgage) and assumed a plugging and abandonment reclamation liability in the amount of approximately $302,000 (see Note 5, Asset Retirement Obligations), in exchange for the conveyance of all the underlying leasehold interests. In addition to the mortgage, the property is burdened by an aggregate 20% royalty interest.

On May 26, 2004, Reality Interactive, Inc., a publicly traded Nevada corporation ("Reality"), executed an Agreement and Plan of Merger with Natural Gas Systems, Inc., a private Delaware corporation

("Old NGS"), whereby the shareholders of Old NGS received 21,749,478 shares of common stock of Reality, in exchange for all of the 21,749,748 shares of Old NGS common stock then outstanding. The operations and management of Old NGS became our own, and Reality's name was changed to Natural Gas Systems, Inc., a Nevada corporation (the "Company" or "NGS"). Immediately prior to the closing of the merger, Reality had virtually no operations, assets or liabilities.

5. Asset Retirement Obligations

When an oil or gas property ceases economic production, the Company dismantles and removes all surface equipment, plugs the wells and restores the property's surface in accordance with various regulations and agreements before abandoning the property. The state of Louisiana requires operators of oil and gas properties to secure plugging, abandonment and reclamation liabilities with financial collateral in favor of the state. In the case of the Delhi Field, the previous owner had established a Site Specific Trust Fund (SSTA Account) that is considered a fully funded liability by the state of Louisiana. Pursuant to the Company's agreement to purchase the Delhi Field in September of 2003, NGS agreed to replace the seller's collateral on the SSTA Account within 120 days of closing. During the six months ended June 30, 2004, NGS replaced the seller's collateral by posting a letter of credit in the face amount of $301,835, fully collateralized by a certificate of deposit issued on Wells Fargo Bank. These restricted cash equivalents are carried as "Other Assets" in the Company's balance sheet.

In accordance with FAS 143, the Company has recorded an estimated asset retirement obligation ("ARO") for its Delhi Field of approximately $302,000, of which $274,000 relates to the Company's wells and $28,000 relates to wells operated by the Company for a third party. Accordingly, the Company has recorded an asset retirement obligation in the amount of $302,000, with an offsetting $274,000 charge to the full cost pool and a $28,000 receivable due from the 3rd party at December 31, 2003. The receivable was collected during the six months ended June 30, 2004.

Also in accordance with FAS 143, the Company provides accretion expense on all ARO liabilities. For the Delhi Field, NGS uses the 10-year constant maturity Treasury yield of 4.27% available at September 30, 2003, which equates to 1.05% per quarter.

The following table describes the change in the Company's asset retirement obligations for the period from September 23, 2003 (inception) to June 30, 2004:

Asset retirement obligation at September 23, 2003	$	301,835
Accretion expense for 2003		3,169
Asset retirement obligation at December 31, 2003		305,004
Accretion expense for 2004		6,438
Asset retirement obligation at June 30, 2004	$	311,442

6. Oil and Gas Properties

Depletion expense for the period from September 23, 2003 (inception) to December 31, 2003 and for the six months ended June 30, 2004 totaled $13,960 and $41,549, respectively.

During 2003, no costs were excluded from amortization. For the six months ended June 30, 2004, $105,225 of costs were not being amortized, pending the closing or abandonment of property acquisitions under active consideration.

7. Notes Payable

In September 2003, the Company issued $1,500,000 of notes payable in connection with its acquisition of the Delhi Field. The notes were collateralized by a first mortgage on the Company's Delhi field and are payable to the sellers in twelve equal monthly installments beginning on January 30, 2004. Although the notes bear no interest, the Company has imputed interest at 8% per annum, thus resulting in an initial recorded principal amount of $1,407,049. At December 31, 2003, the balance of the notes payable was $1,436,973, including $29,924 of imputed interest. At June 30, 2004, the principal balance outstanding was $732,807.

In May 2004, the Company borrowed $49,490 to finance 70% of its Director and Officer's liability insurance premiums. The note requires eight level mortgage-amortizing payments in the amount of $5,350 per month, including 7% interest per annum, with the first payment due on June 25, 2004. At June 30, 2004, the principal outstanding balance of the note was $43,429.

8. Common Stock and Stock Options

Common Stock

At December 31, 2003, Reality had issued and outstanding 256,598 shares of its $0.001 par value common stock. From January 1, 2004, up to, but not including, the merger closing on May 26, 2004, Reality issued 689,663 of its $0.001 par value common shares, net of cancellations and redemptions. At the closing of the merger on May 26, 2004, Reality issued 21,749,478 of its $0.001 par value common shares in exchange for all of the 21,749,478 issued and outstanding $0.001 par value common shares of Old NGS.

During 2003, Old NGS issued 18,000,000 common shares as founder's capital at $0.001 per share, and sold 2,864,600 of its $0.001 par value common shares at $1.00 per share through a private equity offering to accredited investors. Prior to the merger closing in 2004, Old NGS sold an additional 884,878 of its $0.001 par value common shares to accredited investors for $886,900 gross proceeds, less $60,000 in commissions equal to 8% of the gross cash proceeds and the issuance of 7 year term warrants equal to 8% of the shares issued, for the account of Chadbourn Securities, Inc. and Laird Q. Cagan, an affiliate of the Company as described in Footnote 9 on Related Party Transactions.

Since the merger closing through June 30, 2004, the Company sold 249,667 shares of its $0.001 par value common shares for gross proceeds of $250,000, less $30,000 in commissions and the same warrant structure described above for the account of Chadbourn Securities, Inc. and Laird Q. Cagan.

At June 30, 2004, the Company had 22,945,406 issued and outstanding shares of common stock.

See Note 11, Subsequent Events, for information on additional sales of common stock since June 30, 2004.

Options

Old NGS adopted a stock option plan in 2003 (the "2003 Plan"). The purpose of the 2003 Plan was to offer selected individuals an opportunity to acquire a proprietary interest in the success of Old NGS, or to increase such interest, by purchasing shares of the Old NGS' common stock. The 2003 Plan provided both for the direct award or sale of shares and for the grant of options to purchase shares in an aggregate amount not to exceed 4,000,000 shares. Options granted under the Plan included nonstatutory options as well as incentive stock options intended to qualify under Section 422 of the Code. Options granted under the 2003 Plan were assumed by Reality Interactive, Inc., predecessor to the Company. No further shares will be granted under the 2003 Stock Option Plan.

At June 30, 2004, options totaling 600,000 shares of the Company's stock had were outstanding, having been granted in 2003 by Old NGS and assumed in 2004 by the Company, subject to various vesting requirements. Options to purchase 250,000, 250,000 and 100,000 shares were granted to Messrs. Herlin, McDonald and Lee (counsel to the Company), respectively. Mr. Herlin's options are committed for subsequent cancellation and re-issuance as warrants to Tatum Partners, in consideration of its services agreement with the Company. These options were accounted for under APB 25, with respect to Messrs. Herlin and McDonald, and under FASB 123 with respect to Messrs. Lee, and gave rise to $537,150 of Company expense to be recognized over the respective vesting periods of the options.

On August 3, 2004, the Company adopted its 2004 Stock Option Plan (the "2004 Plan"). The purpose of the 2004 Plan is to offer selected individuals an opportunity to acquire a proprietary interest in the success of the Company, or to increase such interest, by purchasing shares of the Company's common stock. The 2004 Plan provides both for the direct award or sale of shares and for the grant of options to purchase shares in an aggregate amount not to exceed 4,000,000 shares. Options granted under the 2004 Plan may include nonstatutory options as well as incentive stock options intended to qualify under Section 422 of the Code.

No options were issued during the six months ended June 30, 2004. However, 200,000 options have been authorized, but not issued, to two members of the Board of Directors of the Company.

A reconciliation of reported loss as if the Company used the fair value method of accounting for stock-based compensation has not been provided as the fair value of options computed under FASB 123 was essentially the same as the amount determined in accordance with APB 25.

Fair value was estimated at the date of grant using the Black-Scholes options pricing model with the following weighted average assumptions: risk-free interest rate of approximately 2.5%; dividend yield of 0%; volatility factor of 1.31; and a weighted-average expected life of three years. These assumptions resulted in a weighted average grant date fair value of $.99. For purposes of the pro forma disclosures, the estimated fair value is amortized to expense over the awards' vesting period.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a single measure of the fair value of its employee stock options. At June 30, 2004, 3,400,000 shares were available for grant under the plans. A summary of options transactions for the period from September 23, 2003 (inception) to June 30, 2004 follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding at September 23, 2003		$ —
Granted	600,000	0.10
Exercised	—	—
Canceled	—	—
Outstanding at December 2003	600,000	$ 0.10
Granted	—	—
Exercised	—	—
Canceled	—	—
Outstanding at June 30, 2004	600,000	$ 0.10
Shares exercisable at June 30, 2004	153,122	$ 0.05

	Options Outstanding		
Range of Exercisable Prices	Outstanding at June 30, 2004	Weighted Average Exercise Price	Exercisable June 30, 2004
.001	350,000	.001	121,872
.25	250,000	.25	31,250

The weighted average remaining contractual life of options outstanding at June 30, 2004, was approximately 38 months. The weighted average grants date fair value of the options granted in 2003 was $.89 per share. The options vest as follows: 2004 - 150,000; 2005 - 150,000; 2006 - 150,000; and 2007 - 150,000.

Warrants

At June 30, 2004, outstanding warrants to purchase the Company's $0.001 par value common shares were as follows:

	Warrants Outstanding		
Holder	Range of Exercisable Prices	Outstanding at June 30, 2004	Exercisable June 30, 2004 Thru 2011
Cagan McAfee Capital Partners, LLC	$ 1.00	240,000	240,000
Laird Q. Cagan	$ 1.00	75,935	75,935
Chadbourn Securities, Inc.	$ 1.00	3,997	3,997
Total		**319,932**	**319,932**

The warrants above were issued for services rendered for the merger and the sale of the Company's common shares. Laird Q. Cagan and Cagan McAfee Capital Partners ("CMCP") are affiliates of the Company. We issued 240,000 of these warrants to CMCP in connection with arranging the merger. We issued 79,932 to Laird Q. Cagan and Chadbourn Securities, Inc., in connection with capital raising services.

9. Related Party Transactions

Laird Cagan, Chairman of the Board of the Company, is a Managing Director of Cagan McAfee Capital Partners, LLC ("CMCP"). CMCP performs financial advisory services to the Company pursuant to a written agreement and is paid a monthly retainer of $15,000. In addition, Mr. Cagan is a registered representative of Chadbourn Securities, Inc. ("Chadbourn"), the Company's placement agent in private equity financings. Pursuant to the Agreement between the Company, Mr. Cagan, and Chadbourn, the Company pays a cash fee equal to 8% of gross equity proceeds and warrants equal to 8% of the shares purchased. During 2003, the Company expensed and paid CMCP $32,500 for monthly retainers.

In connection with the founding of the Company, 18,000,000 shares of NGS common stock were directly and indirectly purchased by various parties as founder's shares, including, 1,000,000 shares by Robert S. Herlin as an incentive to perform as the Company's President and CEO; 1,000,000 shares by Liviakis Financial Communications, Inc., the Company's investor relations firm; 7,500,000 shares by Laird Q. Cagan, the Company's Chairman and Managing Director of CMCP; and 5,700,000 by Eric M. McAfee, Managing Director of CMCP, and 450,000 by John Pimentel, a member of the Company's Board of Directors.

During the six months ended June 30, 2004 the Company has expensed $90,000 in monthly retainers, $60,000 of which remains unpaid at June 30, 2004, and charged $80,000 to stockholder's equity as a reduction of the proceeds from common stock sales in the amount of $1,000,000. The $80,000 paid to Chadbourn Securities and Laird Q. Cagan was for commissions from the sale of the common stock. Also during the six months ended June 30. 2004 NGS issued warrants to purchase 319,932 shares of Common Stock to CMCP, Chadbourn Securities and Laird Q. Cagan in connection with arranging the merger, (240,000 warrants) and placement of 999,145 common shares (79,932 warrants). These warrants have a $1.00 exercise price and a seven year term.

Eric McAfee, also a Managing Director of Cagan McAfee Capital Partners, has served as Vice Chairman of the Board of Verdisys, Inc., the provider of certain horizontal drilling services to the Company. Subsequently in 2004, Mr. McAfee resigned from the Board of Directors of Verdisys, but continues to hold shares in both companies. Mr. McAfee has represented to the Company that he is also a 50% owner of Berg McAfee Companies, LLC, which owns approximately 30% of Verdisys, Inc. NGS paid $130,000 to Verdisys during 2003 and $25,960 during 2004 for horizontal drilling services.

Subsequent to June 30, 2004, Laird Cagan, Chairman of the Board of the Company, loaned the Company $475,000 as partial bridge financing for the acquisition of the Tullos Urania Field. See Footnote 11, Subsequent Events, for a further explanation.

10. Supplemental Oil and Gas Disclosures (unaudited)

Costs Incurred in Oil and Gas Producing Activities

	Six Months Ended June 30, 2004	For the Period From September 23, 2003 (Inception) to December 31, 2003
Property acquisition costs:		
Proved	$ 6,855	$ 2,363,716
P&A liability assumed	—	273,760
Unproved	105,225	—
Exploration costs	—	—
Development costs	97,114	333,992
Total Property Acquisition Costs	$ 209,194	$ 2,971,468

Results of Operations for Oil and Gas Producing Activities

	Six Months Ended June 30, 2004	For the Period From September 23, 2003 (Inception) to December 31, 2003
Oil and gas sales	$ 118,158	$ 24,229
Production costs	(134,420)	(76,303)
Production taxes	(14,581)	(3,002)
Depletion	(41,549)	(13,960)
Results of operations for oil and gas producing activities (excluding corporate overhead and financing costs)	$ (72,392)	$ (69,036)

Proved Developed and Undeveloped Reserves
prepared by W.D. Von Gonten & Co. Petroleum Engineers

The following table sets forth the net proved reserves of the Company as of July 1, 2004, and the changes therein for the period from September 23, 2003 (inception) to July 1, 2004. The reserve information was reviewed by W.D. Von Gonten & Co., independent petroleum engineers. All of the Company's oil and gas producing activities are located in the United States.

	Oil (bbls)	Gas (mcf)
September 23, 2003	—	—
Purchases of minerals in place	241,219	778,700
Extensions and discoveries	—	—
Production	(857)	—
Sales of minerals in place	—	—
December 31, 2003	240,362	778,700
Purchases of minerals in place		
Extensions, discoveries and revisions	2,352	(270,021)
Production	(3,810)	(123)
Sales of minerals in place	—	—
July 1, 2004	238,904	508,556*
Proved developed reserves:		
December 31, 2003	240,400	778,700
July 1, 2004	238,900	508,556*

* Includes 5,000 BBL of NGL's converted at 6 BBLs / MCF

Standardized Measure of Discounted Future Net Cash Flows
at December 31, 2003 and June 30, 2004

The information that follows has been developed pursuant to SFAS No. 69 and utilizes reserve and production data prepared or reviewed by independent petroleum consultants. Reserve estimates are inherently imprecise and estimates of new discoveries are less precise than those of producing oil and natural gas properties. Accordingly, these estimates are expected to change as future information becomes available.

The estimated discounted future net cash flows from estimated proved reserves are based on prices and costs as of the date of the estimate unless such prices or costs are contractually determined at such date. Actual future prices and costs may be materially higher or lower. Actual future net revenues also will be affected by factors such as actual production, supply and demand for oil and natural gas, curtailments or increases in consumption by natural gas purchasers, changes in governmental regulations or taxation and the impact of inflation on costs. Future income tax expense has been reduced for the effect of available net operating loss carryforwards.

	Six Months Ended June 30, 2004	For the Period From September 23, 2003 (Inception) to December 31, 2003
Future cash inflows	$ 11,549,850	$ 13,318,169
Future production costs	(2,978,139)	(2,895,677)
Future development costs	(450,000)	(357,000)
Future income taxes	(1,465,000)	(2,412,000)
Future Net Cash Flows	6,656,711	7,653,492
10% annual discount	(1,476,100)	(1,479,544)
Standardized Measure	$ 5,180,611	$ 6,173,948

Changes in Standardized Measure

The following table sets forth the changes in standardized measure of discounted future net cash flows for the period from September 23, 2003 (inception) to December 31, 2003 and for the six months ended June 30, 2004:

	Six Months Ended June 30, 2004	For the Period From September 23, 2003 (Inception) to December 31, 2003
Standardized Measure, beginning	$ 6,173,948	$ —
Net change in income taxes	737,006	(1,945,721)
Oil and gas sales, net of costs	30,843	51,065
Purchase of minerals in place	—	8,068,605
Changes in prices and costs	82,230	—
Change in developments costs	(84,042)	—
Accretion of discount	308,697	—
Revisions of estimates	(2,131,318)	—
Other	64,246	—
Standardized Measure, ending	$ 5,180,611	$ 6,173,948

11. Subsequent Events

Subsequent to June 30, 2004, the Company received $475,000 under a short-term secured promissory note (the "Note") held by Laird Q. Cagan, the Company's Chairman and major stockholder, for the purpose of bridge financing part of the purchase price of the Tullos Urania Field. Under the terms of the Note, all net revenue derived from the Company's Tullos Urania Field, less operating expenses and development costs, must be applied toward repayment of the Note. The Note bears interest at 10% per annum, is secured by a pledge of all of the Company's assets and is due in full by February 10, 2005. Since the origination of the loan, the Company and Mr. Cagan agreed to amend the repayment terms of the loan by delaying the repayment until the earlier of (a) July 1, 2005, or (b) the date on which the cumulative gross equity funding after August 14, 2004 reaches $1 million. Also amended are the terms of the Note which delays the mandatory prepayment until all net revenue derived from the Company's Tullos Urania Field, less operating expenses and capital costs accruing after February 5, 2005 and 50% of the net proceeds of any related third party financings of any kind conducted by the Company after the date of this Note.

From July 1, 2004 through September 24, 2004, NGS raised gross proceeds from the sale of common stock in the amount of $544,734.

On September 2, 2004, NGS purchased its second property comprising a 100% working interest in approximately 81 producing oil wells, 8 salt water disposal wells and 54 shut-in wells located in La Salle and Winn Parishes, Louisiana. Fourteen of the shut-in wells will require a new lease prior to restoration of production. The purchase included leases covering 386.04 gross and net acres, and fee ownership of 2.33 acres around certain of the wells. NGS intends to initiate a program of restoring the shut-in wells to production, increasing overall production per well by addition of incremental water disposal capacity and utilizing gas production to replace purchased power for pumps. NGS will file at a later date a Form 8-K to further describe the purchased assets.

12. Income Taxes

The tax effect of significant temporary differences representing deferred tax assets and liabilities at December 31, 2003 and June 30, 2004 are as follows:

	June 30, 2004	December 31, 2003
Oil and gas properties	$ (69,389)	$ (113,558)
Net operating loss carryforwards	366,425	228,043
Valuation Allowance	(297,036)	(114,485)
Net deferred tax asset	$ —	$ —

The increase in the valuation allowance during fiscal 2003 and 2004 of $114,485 and $182,551; respectively, is the result of additional net tax losses incurred during the year.

As of June 30, 2004, the Company has net operating loss carryforwards of approximately $1,078,000 that will expire in 2023 and 2024. Future utilization of the net operating loss carryforwards and other tax attributes may be limited by changes in the ownership of the Company in May 2004 under section 382 of the Internal Revenue Code.

The following is a reconciliation of the Company's expected income tax expense (benefit) based on statutory rates to the actual expense (benefit):

	Six Months Ended June 30, 2004	For the Period From September 23, 2003 (Inception) to December 31, 2003
Income taxes (benefit) at US statutory rate	$ (349,412)	$ (114,548)
Non-deductible amortization and expenses	165,141	62
Deferred tax asset valuation allowance adjustment	182,551	114,485
Net operating losses	—	—
Other	$ 1.720	1
	$ —	$ —

13. Liquidity

As of June 30, 2004, we had $367,831 of unrestricted cash and negative working capital of $383,352. We incurred losses for the six months period ended June 30, 2004 and three months period ended December 31, 2003 of $1,027,682 and $336,905, respectively. Our negative working capital of $383,352 was adversely impacted by $732,806 of short-term mortgage notes we owe on the Delhi Field, payable in approximately equal monthly installments through December 30, 2004 (the "Delhi Notes" See Note 7 to the financial statements for a further description). Although our cash flow from operations currently approximates our recurring overhead, our cash flow has been, and continues to be, insufficient to cover the Delhi Note payments. Although we are current in our payments on the Delhi Notes, we have relied on additional funding sources to meet these payments since the beginning of 2004. At September 24, 2004, we owed four remaining monthly payments of $125,000 each on the Delhi Notes. At that date, we had cash balances of approximately $256,000 and approximately $176,000 of accounts payable due (excluding deferred fees due CMCP).

Our negative working capital and cash position, as well as our ongoing operating losses, raise concerns about our ability to meet future obligations and fund future operations. Accordingly, management has and continues to expend considerable time and effort to deal with this issue as discussed below. Subsequent to June 30, 2004, we have been working to improve our liquidity using three strategies:

1. **Additional Sales of Common Stock:** From June 30 through September 24, 2004 we received $544,734 of additional gross cash proceeds from the private sale of our common stock, before commissions. We plan to raise funds through additional sales of equity securities in private transactions. Because there can be no assurance that we will be able to do so, we are pursuing borrowing arrangements as discussed below.

2. **Borrowing:** On August 11, 2004, we borrowed $475,000 under a short-term secured promissory note (the "Bridge") held by Laird Q. Cagan, the Company's Chairman and major stockholder, secured by a pledge of all of our assets. The loan was earmarked as partial bridge financing for our purchase of the Tullos Urania Field properties for $732,000 on September 3, 2004. The Bridge loan with Mr. Cagan has been amended to delay the repayment until the earlier of (a) July 1, 2005, or (b) the date on which the cumulative gross equity funding after August 14, 2004 reaches $1 million. Terms of the mandatory prepayment have also been amended as more fully described in the original documents filed or incorporated by reference herein. Mr. Cagan is a founding Managing Partner of Cagan McAfee Capital Partners, the financial advisor to the Company that is arranging private equity fundings. If additional funds

are not raised, we may not have sufficient funds to repay the Bridge loan or complete our capital expenditure program as currently contemplated.

Since the beginning of 2004, we also began developing relations with at least three commercial banks and several private equity sources that specialize in making loans or investing in oil and gas producers. We believe that our Delhi and Tullos properties could provide sufficient collateral to repay the remaining Delhi Notes in full, as well as providing us with additional development capital aimed at increasing our production from our existing wells according to our original plan. In the event that the collateral is not sufficient to also repay the Bridge loan above, we would likely be required to negotiate those terms further.

3. **Increased Production:** We continue to work on increasing cash flow from operations through our Delhi Field and additional acquisition candidates, thereby spreading our overhead, including significant expenses of being a public company, over a larger revenue base. On September 3, 2004, we closed the purchase of producing properties in the Tullos Urania Field, located close to our Delhi Field operations in Northern Louisiana. We believe that net cash flow from operations at our Tullos property currently exceeds $30,000 per month. We also believe that opportunities exist to increase Tullos production with relatively small amounts of additional capital expenditures.

   We are pursuing additional acquisition candidates meeting our targeted requirements.

14. Leases

The Company is obligated for operating lease payments related to the Company's headquarters in Houston, Texas, and a gas processing plant servicing the Company's Delhi Field. Minimum lease payments are:

Fiscal 2005:	$	101,772
Fiscal 2006:		12,516
Total	$	114,288

Lease expense was $44,770 for the six months ended June 30, 2004 and $8,541 for the three months ended December 31, 2003.

15. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	Six Months Ended June 30, 2004	For the Period From September 23, 2003 (Inception) to December 31, 2003
Numerator:		
Net loss applicable to common stockholders	$ (1,027,682)	$ (336,905)
Plus income impact of assumed conversions:		
Preferred stock dividends	N/A	N/A
Interest on convertible subordinated notes	N/A	N/A
Net loss applicable to common stockholders plus assumed Conversions	(1,027,682)	(336,905)
Denominator:		
	22,057,614	20,091,720
Affect of potentially dilutive common shares:		
Warrants	N/A	N/A
Employee and director stock options	N/A	N/A
Convertible preferred stock	N/A	N/A
Convertible subordinated notes	N/A	N/A
Redeemable preferred stock	N/A	N/A
Denominator for dilutive earnings per share—weighted-average shares		
Outstanding and assumed conversions	22,057,614	20,091,720
Loss per common share:		
Basic and diluted	$ (0.05)	$ (0.02)

INDEPENDENT AUDITORS' REPORT

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Natural Gas Systems, Inc.
Houston, Texas

We have audited the accompanying consolidated balance sheets of Natural Gas Systems, Inc. as of June 30, 2004 and December 31, 2003 and the related consolidated statements of operations, stockholders' equity, and cash flows for the six months period ended June 30, 2004 and the period from September 23, 2003 (inception) to December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Natural Gas Systems, Inc. and subsidiaries as of June 30, 2004 and December 31, 2003, and the results of their operations and their cash flows for each of the periods then ended, in conformity with accounting principles generally accepted in the United States of America.

HEIN & ASSOCIATES LLP

Houston, Texas
September 28, 2004

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 8A. CONTROLS AND PROCEDURES

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures, as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 8B. OTHER INFORMATION

Subsequent Events

Subsequent to June 30, 2004, the Company and Laird Cagan, Chairman of the Company, agreed to amend the repayment terms of the outstanding bridge loan provided by Cagan to the Company in the amount of $475,000. Terms of the original loan and the amendment are discussed in Item 6, Management's Discussion and Analysis and are available herein or incorporated by reference in the exhibits hereto.

In September 2004, we placed on production two additional wells that were previously shut-in. The 184-2 well was recompleted into a stray gas sand and initially tested at a rate of 500 mcfd and 1120 psig flowing tubing pressure. Initial shut-in tubing pressure was 1350 psig with a perforated depth of 3,170-78'. The 210-2 well was placed back into production and initially made 5 BOPD while unloading wash water.

On September 2, 2004, we purchased our second property comprising a 100% working interest in approximately 81 producing oil wells, 8 salt water disposal wells and 54 shut-in wells located in La Salle and Winn Parishes, Louisiana. We purchased the property for $725,000, plus post closing adjustments, in cash. Fourteen of the shut-in wells will require a new lease prior to restoration of production. The production rate aggregates approximately 62 BOPD plus a small amount of associated gas that is not sold currently. The purchase included leases covering 386.04 gross and net acres, and fee ownership of 2.33 acres around certain of the wells. NGS intends to initiate a program of restoring the shut-in wells to production, increasing overall production per well by addition of incremental water disposal capacity and utilizing gas production to replace purchased power for pumps. We will file at a later date a Form 8-K to further describe the purchased assets including audited proved reserves and financial statements.

PART III.

ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS

Incorporated by reference to the Company's Proxy Statement to be filed with the Commission pursuant to Regulation 14A within 120 days of the end of the Company's year 2004.

ITEM 10. EXECUTIVE COMPENSATION

Incorporated by reference to the Company's Proxy Statement to be filed with the Commission pursuant to Regulation 14A within 120 days of the end of the Company's year 2004.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Incorporated by reference to the Company's Proxy Statement to be filed with the Commission pursuant to Regulation 14A within 120 days of the end of the Company's year 2004.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Incorporated by reference to the Company's Proxy Statement to be filed with the Commission pursuant to Regulation 14A within 120 days of the end of the Company's year 2004.

ITEM 13. EXHIBITS AND REPORTS

Index of Exhibits

2.1	Asset Purchase Agreement for Delhi Field, dated September 24, 2003.	Included
2.2	Asset Purchase Agreement for Tullos Field, dated September 3, 2004.	Previously Filed
3(i)	Articles of Incorporation.	Previously Filed
3(ii)	Bylaws.	Previously Filed
10.1	Employment Agreement — Robert S. Herlin, dated September 23, 2003.	Included
10.2	Employment Agreement — Sterling McDonald, dated November 10, 2003.	Included
10.3	Engagement Agreement — Cagan McAfee Capital Partners, LLC, dated September 23, 2003.	Included
10.4	Addendum to Engagement Agreement — Cagan McAfee Capital Partners, LLC dated May 5 ,2004.	Included
10.5	Lateral Drilling Services Agreement — Verdisys, Inc., January 27, 2004.	Included
10.6	Secured Promissory Note — Laird Q. Cagan, dated August 10, 2004.	Previously Filed
16.1	Letter, dated June 2, 2004, from Chishold, Bierwolf & Nilson, LLC concerning the change in accountants.	Previously Filed
21.1	List of all subsidiaries of the Company.	Included
31.1	Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.	Included
31.2	Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.	Included
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Included
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Included

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Incorporated by reference to the Company's Proxy Statement to be filed with the Commission pursuant to Regulation 14A within 120 days of the end of the Company's year 2004.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NATURAL GAS SYSTEMS, INC.

By: /s/ ROBERT S. HERLIN

Robert S. Herlin
Chief Executive Officer
(Principal Executive Officer)

By: /s/ STERLING H. MCDONALD

Sterling H. McDonald
Vice President and
Chief Financial Officer
(Principal Financial and
Accounting Officer)

Date: September , 2004

In accordance with the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date	Signature	Title
September , 2004	/s/ E. J. DIPAOLO E. J. DiPaolo	Director
September , 2004	/s/ GENE STOEVER Gene Stoever	Director
September , 2004	/s/ JOHN PIMENTEL John Pimentel	Director
September , 2004	/s/ LAIRD CAGAN Laird Cagan	Chairman of the Board

QuickLinks

Exhibit 2.1

A true copy of original Filed for Record this the 30th day of Sept., 2003
File No. 323645
Core Book 436 Folio
Diane Huff
Clerk of Court
Richland Parish, LA

ASSIGNMENT, CONVEYANCE AND BILL OF SALE

STATE OF LOUISIANA

PARISHES OF RICHLAND, MADISON and FRANKLIN

KNOWN ALL MEN BY THESE PRESENTS:

WHEREAS, **DELTA EXPLORATION AND DEVELOPMENT COMPANY, INC.**, tax ID #____________, and **CAMARK PRODUCTION CO.**, tax ID #75-307742 (successors to MWP NORTH LOUISIANA, LLC, successor to McGowan Working Partners) have acquired certain oil and gas leasehold and equipment interests in and to the Delhi Field Unit by virtue of Assignments from MWT North Louisiana, L.L.C., filed June 23, 2000, recorded in Book 419, DR#310944, Records of Richland Parish, Louisiana, out of Delhi Package I, LTD and Eland Energy, Inc., recorded in Book 318, File No. 280940, dated April 15, 1996, Deed Records of Franklin Parish, Louisiana; Munoco Company, L.C., recorded in Book 402, File No. 297789, dated February 14, 1997, Deed Records of Richland Parish, Louisiana; Murphy Exploration and Production Company recorded in Book 164, File 92951, dated January 28, 1997, Deed Records of Madison Parish, Louisiana; Richland Oil Company recorded in Book 170, File No. 94740, dated October 23, 1997, Deed Records of Madison Parish, Louisiana, and mense assignments in and to the Delhi Field Unit, located in Madison, Richland, and Franklin Parishes, Louisiana.

NOW, THEREFORE, DELTA EXPLORATION AND DEVELOPMENT COMPANY, INC., whose address is 105 East Shore Drive, Monroe, Louisiana 71201, and CAMARK PRODUCTION CO., P.O. Box B, Camden, Arkansas 71711-0120, hereinafter collectively referred to as "Assignors", for and in consideration of the sum of Ten Dollars ($10.00) and other valuable considerations paid, receipt of which is hereby acknowledged, does hereby grand, sell, convey, assign and transfer unto **NGS Sub. Corp.** Tax ID #80-0076903, a foreign corporation domiciled in the State of Delaware, whose principal business address is 3 Raydon Lane, Houston, Texas 77024, represented herein by its duly authorized President, Robert Herlin, hereinafter said corporation referred to as "Assignee", EIGHTY (80.0%) PERCENT NET REVENUE INTEREST, representing ONE-HUNDRED (100.0%) PERCENT WORKING INTEREST, of Assignors' leasehold interests and ONE-HUNDRED (100%) of the equipment interests along with all applicable contracts, rights of ways, burdens, reservations, exceptions and obligations within the geographical confines of the Delhi Field Unit, said unit boundaries being more accurately described in that certain Unitization Agreement dated August 5, 1952, recorded in Book 81, File No. 129, Deed Records, Franklin Parish, Louisiana, and all subsequent amendments, subject to the following and subject to the terms and conditions specified and outlined on Exhibit "A" attached hereto and made a part hereof, including but not limited to the following, it specifically excluding the retained assets described on Exhibit "A":

(i) the oil, gas and mineral leases, mineral servitude interests and other interests, the leasehold estates or other interests in oil and gas created thereby, including operating rights, and all rights and privileges appurtenant thereto, as well as any mineral rights or interests, overriding royalty interests, royalty interests or other interests lying in, on, or under or affecting production from the leases and/or lands;

(ii) any unit affecting the interests described in subsection (i) above and/or the lands, including, but not limited to, all rights derived from any unitization, pooling, operating, communitization or other agreement or from any declaration or order of any governmental authority;

(iii) all oil, condensate or gas wells, water sources and water and other injection or disposal wells located on the leases and/or lands or lands utilized or pooled therewith; and all fixtures, equipment, material, facilities and other personal property used or useful in connection with the production, gathering, storing, measuring, treating, operation, maintenance, or marketing of production from any of the properties described herein;

(iv) all contracts and contractual rights and interests pertaining to the leases and/or lands and the personal property described herein, including, but not limited to, unit agreements, farmouts agreements, farmin agreements, operating agreements and production sales contracts, excluding the exception and reservations hereinafter specifically set forth;

(v) all easements, rights-of-ways, servitudes, franchises, licenses, permits and similar interests applicable to our used in connection with the leases and/or lands or the personal property described herein; and

(vi) copies of lease, contract and well files (excluding any of Assignor's internal valuation or interpretive data or documentation) relating to the leases and/or lands or the personal property described herein. Assignor will keep division order files and will notify Assignee of changes to division order as received by Assignor.

For the same consideration as first hereinafter recited, the Assignor does hereby bargain, grant, sell, convey and transfer unto Assignee the above-mentioned percentage of Assignor's rights, title and interest in and to the wells located on the lands, together with that same percentage of all material, equipment, easements and properties of any kind located therein and thereon and used solely in connection therewith.

Assignee acknowledges and represents that prior to accepting this Agreement, Conveyance and Bill of Sale, it conducted such inspection of the properties as it deemed reasonably prudent, made itself familiar with the operations previously conducted thereon and satisfied itself as to the risks and obligations assumed hereunder.

Assignee agrees to comply with all laws and with all rules, regulations and orders of all municipal, state and federal agencies and regulatory bodies in the conduct of all operations by Assignee in and on, the lands covered hereby, including, but not by way of limitation, the proper plugging of any well(s) on the said lands, the proper disposal or treatment of wastes and the transfer or assumption of applicable permits, bonds, approvals and licenses.

Subject to the provisions of the following paragraphs, the following shall govern the rights and obligations of the parties hereto:

(i) Assignors shall be entitled to all rights of ownership (including, without limitation, the right to all proceeds attributable to the Properties) and shall be subject to the duties and obligations of such ownership attributable to the Properties for the period of time prior to the Effective Date;

(ii) Assignee shall be entitled to 100.0% of all of the rights of working interest ownership (including, without limitation, the right to 80% of all proceeds attributable to the Properties) and shall be subject to the duties and obligations of such ownership (including, without limitation, the duties and obligations assumed herein), attributable to the Properties for the period of time from and after the Effective Date;

(iii) Assignee shall indemnify and hold Assignors harmless from any claims and liabilities arising out of the ownership and operation of the Properties (including without limitation, any oil or gas produced therefrom and any claims with respect thereto for any reimbursement or other compensation in respect of the sale thereof) from and after the Effective Date, to the extent of Assignee's percentage ownership interest; and

(iv) As used in this paragraph, "claims" shall include claims, demands, causes of action, liabilities, damages, penalties and judgments of any kind or character and all costs and fees in connection therewith. Nothing in this paragraph shall limit, expand or enlarge the warranty of title contained elsewhere herein.

Assignee acknowledges that it has had the opportunity to inspect the Properties and test it as Assignee deems fit, and that the Properties and any personality, materials or fixtures thereon are purchased WHERE IS, AS IS. Assignee exclusively waives any claims against Assignor for indemnity or contribution which it may have under civil law, common law or statute arising from or relating to the condition of the Properties, including, without limitation, claims resulting from environmental damage or pollution and the existence of Naturally Occurring Radioactive Material (NORM) on the Properties, fixtures and equipment which are the subject of this Agreement, together with any related fines, penalties and cleanup expenses, whether incident for such claim occurred prior to or after the Effective Date.

It is expressly understood by the parties hereto that Assignors do not make any representations or warranties, express or implied, as the condition and state of repair of the Properties, its value, quality, merchantability, suitability or fitness for any uses or purposes, nor as to the current volume, nature, quality, classification, or value of the oil, gas or other mineral reserves thereunder or covered thereby, nor with respect to any appurtenances thereto belonging or in any way appertaining to said Properties or otherwise. Assignors have advised Assignee and Assignee has acknowledged that certain spills of oil and chemicals from oil and gas exploration, development, or production (regulated or under the jurisdiction of the applicable commission, department or other governmental authority of the State of Louisiana) have occurred, or may have occurred, upon the property, which could have resulted in contamination of the soil, water, ground water or improvements on the Properties; however, Assignors know of no other wastes or other contaminants upon the Property which Assignee cannot discover by prudent examination and inspection of the Properties, nor of any violation of any federal or state laws, rules or regulations, concerning environmental acts or hazards. Furthermore, Assignors have cautioned Assignee to thoroughly examine and inspect the Properties for any such conditions or violations and generally as to the condition of the Properties and its improvements, and Assignee hereby acknowledges such obligations and assumes all liabilities associated therewith to the extent of Assignee's working interest ownership percentage.

Furthermore, Assignee certifies that said Property (including, but not limited to, any oil, gas or other mineral reserves underlying said Property) has been carefully inspected by Assignee, that Assignee is familiar with its condition and value thereof, and the improvements and appurtenances (including electric wiring and machinery installed thereon) located on the Property, inclusive of any hydrocarbons, other soil contaminants or waste substances, whether similar or dissimilar, that may be present in the soil, water and groundwater, that Assignee has engaged such contractors or consultants as Assignee deems prudent for tests and surveys of the soil, water, groundwater, Wells and Equipment, and improvements on the Property, and that Assignee assumes any and all obligations, risks and liabilities associated therewith to the extent of Assignee's working interest ownership. Assignee acknowledges that the Property has been or may have been used in connection with oil, gas and other mineral exploration, development and operations, as well as with respect to processing and refining operations, and, as such, equipment, appurtenances, processing and other facilities, plants, buildings, structures, improvements, abandoned and other tanks and piping (including above ground and underground tanks and piping), storage facilities, gathering and distribution lines, wells and other petroleum production facilities and appurtenances which have not been excepted and excluded from this conveyance may be located thereon. Assignee further accepts said Property (including, but not limited to, any oil, gas or other minerals and/or mineral reserves underlying said Property) AS IS, WHERE IS, IN ITS PRESENT CONDITION AND STATE OF REPAIR AND WITHOUT ANY REPRESENTATIONS, GUARANTIES, OR WARRANTIES, EXPRESS OR IMPLIED, AS TO ITS TITLE, VALUE, QUALITY, MERCHANTABILITY, OR ITS SUITABILITY OR FITNESS FOR ASSIGNEE'S INTENDED USE, OR FOR ANY USES OR PURPOSES WHATSOEVER, OR THAT SAID PROPERTY HAS BEEN RENDERED FREE FROM ANY DEFECTS, HAZARDS OR DANGEROUS CONDITIONS.

Indemnification

Notwithstanding any other terms in this assignment to the contrary, assignors shall indemnify assignee for any environmental damages arising out of operation of the properties only during or from the period of time that the properties were operated by Arkla Petroleum, LLC, beginning with Arkla Petroleum, LLC's operations in 2002, through today's date.

This agreement and any disputes arising out of it will be governed by the Laws of the State of Louisiana.

Without limiting the generality of the foregoing but in furtherance of same, Assignee accepts the Properties in its "as is, where is" condition. Assignors disclaim any and all liability arising in connection with any environmental matters, including, without limitation, any presence of Naturally Occurring Radioactive Material (NORM) on the Property. In addition, there are no warranties or representations, express or implied, as to the accuracy or completeness of any data, information or materials heretofore or hereafter furnished in connection with the Properties as to the quality or quantity of the hydrocarbon and any other mineral reserves, if any, attributable to the interest conveyed herein or the ability of the Property to produce hydrocarbons or any other minerals, and any and all data, information and material furnished by Assignor is provided as a convenience only and any reliance on or use of the same is at Assignee's sole risk.

Other than as set out above in the indemnification clause for the operation period of Arkla Petroleum, LLC, Assignee hereby waives and releases Assignors of and from any claims, actions, causes of action, demands, rights, damages, costs, expenses or compensation whatsoever, direct or indirect, known or unknown, foreseen or unforeseen, which Assignee now has or which may arise in the future on account of or in any way growing out of or connected with the physical or environmental condition of the property or any law or regulation applicable to it, including, but not limited to the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. Section 9601 *et seq* or similar state statutes, whether such claim, action, etc. arose from events occurring before or after effective date of this conveyance, except as to the extent of Assignor's retained working interest.

This Assignment, Conveyance and Bill of Sale supercedes the provisions and conditions contained in that certain Letter Agreement with Assignors dated August 25, 2003.

Assignors reserve the right to have access, and at Assignor's expense, the right to copy, excerpt from, or reproduce any records to the extent necessary for:

a. federal, local or state regulatory or tax matters affecting Assignors.

b. the resolution of any existing disputes or contract compliance issues affecting Assignors and related to the Properties, or

c. other matters or disputes relating to Assignors' prior ownership of or liability with respect to the said leases and lands.

The reservation herein made and the provisions and covenants contained herein shall attach to and run with the leases assigned and the lands herein described or referred to and shall be binding upon and inure to the benefit of Assignors and Assignee and their respective heirs, administrators, executors, devisees, trustees, successors and assigns.

This Assignment, Conveyance and Bill of Sale shall be effective for all purposes as of the 26 day of September, 2003 at 7:00 P.M., Central Standard Time.

TO HAVE AND TO HOLD the same unto the said Assignee, its successors and assigns according to the terms and conditions of the Oil and Gas Leases, the said Assignee to perform all of the conditions, obligations, and covenants thereof and the terms hereof.

THIS ASSIGNMENT, CONVEYANCE AND BILL OF SALE IS MADE WITHOUT WARRANTY TO TITLE OF ANY KIND, EXPRESS OR IMPLIED, AS TO ALL WELLS, MATERIALS AND EQUIPMENT COVERED HEREBY, THIS ASSIGNMENT, CONVEYANCE AND BILL OF SALE IS MADE WITHOUT WARRANTY, EXPRESS OR IMPLIED, AS TO MERCHANTABILITY AND FITNESS FOR PARTICULAR PURPOSE, AND ASSIGNEE ACCEPTS SUCH WELLS, MATERIALS AND EQUIPMENT "AS IS".

NGS Sub. Corp. (Assignee) agrees to provide within 120 days of the effective date—at Assignee's expense—a performance surety bond or Bank Letter of Credit approved by Assignor, in favor of Assignors in the amount of $301,835.00 to secure the obligations of Assignee under this Assignment, Conveyance and Bill of Sale, including—but not limited to—plugging, clean up and other environmental obligations under this Assignment, the subject leases, State and Federal regulations and any applicable law.

Assignee agrees that it will provide to Assignors evidence of annual renewal of said letter of credit or bond 30 days prior to the expiration thereof so long as said obligations continue. Failure to do so shall constitute default under this agreement and under the Mortgage between the parties of this same date. Approval of the Bond or Bank Letter of Credit by Assignors shall not be unreasonably withheld; however, if it is withheld, Assignors shall notify Assignee of the reason for the disapproval and Assignee shall have the opportunity and a reasonable time to correct the situation before being in default under this agreement and under the mortgage between the parties.

Assignors agree to reduce amount of said bond required at the annual renewal dates in the amount of $5,000.00 for each well location which Assignee plugs and abandons and restores to the satisfaction of Assignors. A reduction in an agreed amount shall be allowed for clean up work performed on part or all of the Station #4 Saltwater Disposal Facility and the LACT Facility #3. Assignee agrees to provide documentation that the wells and/or facilities have been plugged/restored in accordance with landowner and lease requirements, and State and Federal requirements.

Venue for any disputes arising out of this assignment shall be Richland Parish, Louisiana.

Ad Valorem taxes will be prorated as of the effective date of this sale.

IN WITNESS WHEREOF, the said DELTA EXPLORATION AND DEVELOPMENT COMPANY, INC., and CAMARK PRODUCTION CO., as Assignors, and NGS SUB. CORP., as Assignee, have caused their names to be affixed to this, in triplicate originals, as of this 25th day of September, 2003.

WITNESSES:

/s/ [ILLEGIBLE]	DELTA EXPLORATION AND DEVELOPMENT COMPANY, INC.
/s/ [ILLEGIBLE]	By: /s/ JAMES H. JONES
	James H. Jones, President

STATE OF LOUISIANA
PARISH OF OUACHITA

THIS DAY personally appeared before me, the undersigned authority in and for said Parish and State, the within named James H. Jones, President of Delta Exploration and Development Company, Inc., a Louisiana Domestic Corporation, who acknowledged that he signed and delivered the within and foregoing instrument on the day and year therein mentioned, as the act and deed of said Corporation, being first thereunto duly authorized so to do.

/s/ [ILLEGIBLE]

NOTARY PUBLIC

/s/ [ILLEGIBLE]

/s/ [ILLEGIBLE]

CAMARK PRODUCTION CO.

By: /s/ H.M. BERG, JR., PRESIDENT

H.M. Berg, Jr., President

STATE OF LOUISIANA
PARISH OF OUACHITA

THIS DAY personally appeared before me, the undersigned authority in and for said Parish and State, the within named H.M. Berg, Jr., President of Camark Production Co., a Foreign Corporation, who acknowledged that he signed and delivered the within and foregoing instrument on the day and year therein mentioned, as the act and deed of said Corporation, being first thereunto duly authorized so to do.

/s/ [ILLEGIBLE]

NOTARY PUBLIC

/s/ [ILLEGIBLE]

/s/ [ILLEGIBLE]

NGS SUB. CORP.

By: /s/ ROBERT HERLIN

Robert Herlin, President

STATE OF LOUISIANA
PARISH OF OUACHITA

THIS DAY personally appeared before me, the undersigned authority in and for said Parish and State, the within named Robert Herlin, President of NGS Sub Corp., a Foreign Corporation, who acknowledged that he signed and delivered the within and foregoing instrument on the day and year therein mentioned, as the act and deed of said Corporation, being first thereunto duly authorized so to do.

/s/ [ILLEGIBLE]

NOTARY PUBLIC

EXHIBIT "A"

Attached hereto and made a part hereof that certain Assignment, Conveyance and Bill of Sale, and Mortgage, by and between Delta Exploration and Development Company, Inc., Camark Production Co., and NGS Sub. Corp., effective September 25, 2003.

Delta Exploration and Development Company, Inc. and Camark Production Co. convey 100.0% of its **working interest** leasehold rights and well bores and equipment in the Delhi Field, with James H. Jones, Individually, retaining this 4.86% overriding royalty interest, carried free and clear of any production costs; and the conveyance to NGS Sub. Corp. is less and except the following:

1. The production sand known as the Mengel Sand, further described and encountered at the depths between 3117' - 3172' as indicated on Sun Exploration and Production Company's electrical log of Delhi Unit 203-3 well, Section 35, Township 17 North, Range 8 East, Richland Parish, Louisiana.

2. Well bores as listed below are not conveyed.

3. Holt Bryant Sand from those well bores listed below under "McGowan Holt Bryant Producers".

4. MWP North Louisiana, L.L.C., saltwater disposal wells and system identified below.

5. Pipelines and surface facilities currently utilized by Assignor or others in connection with the retained and/or unassigned assets.

6. Any and all rights of way, surface easements, and surface leases and any other servitudes in place as needed by Assignors to operate retained and/or unassigned assets.

WELLS NOT CONVEYED, TO BE OPERATED BY
MCGOWAN WORKING PARTNERS OR OTHERS:
Holt Bryant Producers:
164-2
177-2
195-2
177-4(TA)

Mengel Well bores:

Producers	SWD	TA	Others
175-39	182-1	187-16	177-1
182-2	188-14	188-12	170-1
196-2	189-2	201-19	
203-3	195-1	202-3	
209-2	230-23		
215-5	231-5		
222-18			
223-2			

WELLS ASSIGNED TO NGS SUB. CORP. AND NOT EXCEPTED:

87-2	—	189-1	204-2
102-5	178-1	190-1	208-1
102-7	178-2	191-1	209-1
154-1	179-1	196-1	210-1
158-3	179-2	196-3	210-2
161-36	180-1	197-1	215-1
166-1	181-2	197-2	215-17
167-1	183-1	198-1	216-8
168-1	183-3	199-2	225-1
170-2	184-1	203-1	
176-1	184-2	203-2	
176-2	184-5	204-1	

QuickLinks

Exhibit 2.1

Exhibit 10.1

Natural Gas Systems, Inc.
EMPLOYMENT AGREEMENT

ROBERT HERLIN
President & Chief Executive Officer

This Employment Agreement ("**Agreement**") is made and effective as of September 23, 2003 (the "**Effective Date**") by and between Natural Gas Systems, Inc. ("**NGS**" or the "**Company**"), and Mr. Robert Herlin ("Herlin") to serve as President and Chief Executive Officer of the Company.

NOW, THEREFORE, the parties hereto agree as follows:

1. Employment.

NGS hereby agrees to employ Herlin as its President and Chief Executive Officer. Herlin hereby accepts such employment in accordance with the terms of this Agreement and the terms of employment applicable to regular employees of NGS. In the event of any conflict or ambiguity between the terms of this Agreement and terms of employment applicable to regular employees, the terms of this Agreement shall control. Election or appointment of Herlin to another office or position, regardless of whether such office or position is inferior to Herlin's initial office or position, shall not be a breach of this Agreement.

2. Duties.

The duties of Herlin shall include the performance of all of the duties typical of the office held by President & CEO as described in the bylaws of NGS and such other duties and projects as may be assigned by a superior officer of NGS, if any, or the board of directors (the "**Board**") of the Company. Herlin shall devote essentially all of his normal work time, ability and attention to the business of the NGS, except as provided below, and shall perform all duties in a professional, ethical and businesslike manner. Herlin will not, during the term of this Agreement, directly or indirectly engage in any other business, either as an employee, employer, consultant, principal, officer, director, advisor, or in any other capacity, either with or without compensation, without the prior written consent of the Board. NGS hereby acknowledges and consents to Herlin serving as a member of the board of directors of Boots and Coots Group, a publicly-owned oilfield service company, and similar service for Intercontinental Tower Corporation, a private company, which activities Herlin agrees shall not substantially impair his provision of the above services to NGS.

3. Compensation.

Herlin will be paid compensation during this Agreement as follows:

A. *Base Salary*. A base salary of ONE HUNDRED EIGHTY THOUSAND ($180,000) per year, payable in installments on the 15th and last day of each month in arrears according to NGS' regular payroll schedule. The amount of the base salary is net the $3,000 per month paid to Tatum Partners pursuant to the Resources Agreement referenced herein.

B. *Variable Compensation*. A Management By Objectives (MBO) plan will be established by the Company and approved by the Board, with a bonus of up to $100,000 per year based upon meeting or exceeding objectives. Twenty five percent (25%) of this variable compensation is subject to assignment or payment to a third party pursuant to the Resources Agreement referenced herein.

C. *Common Stock Purchase*. Herlin shall enter into the Common Stock Purchase Agreement, attached hereto as **Exhibit** A (the "**Common Stock Purchase Agreement**")**,** for the purchase of 1,000,000 shares of common stock upon execution of this Agreement. This Common Stock Purchase Agreement is not subject to assignment or payment under the Resources Agreement referenced herein.

D. *Stock Option Agreement*. Herlin shall further be granted an incentive stock option ("**Option**") pursuant to a Stock Option Agreement ("**Stock Option Agreement**"), entitling him to purchase up to 250,000 shares of common stock at the current fair market value, as determined by the Company's Board of Directors. Such Option shall be subject to the terms and conditions of the Company's Stock Option Plan and Stock Option Agreement. The vesting requirements shall be as follows: 1/8th of the shares shall vest on the six month anniversary of this Agreement. and then 1/16th thereafter shall vest at the end of each successive three month period until the Option is fully vested at the end of four years. All of stock granted under this Stock Option Agreement is subject to assignment or payment to a third party pursuant to the Resources Agreement referenced herein

4. Benefits.

A. *Holidays*. Herlin will be entitled to 10 paid holidays each calendar year and 5 personal days. Such holidays must be taken during the calendar year and cannot be carried forward into the next year.

B. *Vacation*. Herlin shall be entitled to 15 days paid vacation each year, accruing if not used to a maximum of 30 days over the period of this contract.

C. *Sick Leave*. Herlin shall be entitled to sick leave and emergency leave according to the regular policies and procedures of NGS. Additional sick leave or emergency leave over and above paid leave provided by the NGS, if any, shall be unpaid and shall be granted at the discretion of the board of directors.

D. *Medical and Group Life Insurance*. NGS agrees to include Herlin in the group medical and hospital plan of NGS, to the extent the Company has one. Herlin shall be responsible for payment of any federal or state income tax imposed upon these benefits.

E. *Pension and Profit Sharing Plans*. Herlin shall be entitled to participate in any pension or profit sharing plan or other type of plan adopted by NGS for the benefit of its officers and/or regular employees.

F. *Expense Reimbursement*. Herlin shall be entitled to reimbursement for all reasonable expenses, including travel and entertainment, incurred by Herlin in the performance of Herlin' duties. Herlin will maintain records and written receipts as required by the NGS expense policy and reasonably requested by the board of directors to substantiate such expenses.

5. Term and Termination.

A. *Trial Period*. This Agreement shall commence Effective Date and shall be subject to immediate termination, with or without Cause, by either party during a trial period ending on December 31, 2003 ("**Trial Period**"). No further compensation of any kind shall become due and payable to Herlin upon separation of employment for any reason during the Trial Period, except that all wages, salary and accrued vacation earned as of the last day of employment shall be paid to Herlin by NGS.

B. *Termination without Cause*. After Trial Period of this Agreement, Herlin's employment may be terminated at NGS' discretion without Cause, provided that NGS shall pay Herlin an amount equal to Herlin's base salary rate for six months on a monthly basis after such termination and all Options then vested shall be exerciseable during the six month period after termination (and afterward such Options shall terminate).

B. *Termination by Herlin*. This Agreement may be terminated at any time by Herlin at Herlin's discretion by providing at least thirty (30) days prior written notice to NGS. In the event of termination by Herlin pursuant to this subsection, NGS may immediately relieve Herlin of all duties and immediately terminate this Agreement, provided that NGS shall pay Herlin at the then applicable base salary rate up to an and including the date of termination, and Herlin shall not be paid any incentive salary payments or other compensation, prorated or otherwise, and all Options then vested shall be exercisable during the 30 day period after termination (afterward all such options shall terminate).

C. *For Cause Termination.* In the event that Herlin is in breach of any material obligation owed NGS in this Agreement, habitually neglects the duties to be performed under this Agreement, engages in any conduct which is dishonest, damages the reputation or standing of NGS, or is convicted of any criminal act or engages in any act of moral turpitude, then NGS may terminate this Agreement for cause ("**Cause**") upon fifteen (15) days notice to Herlin, provided that such breach is not cured by Herlin during the notice period. In event of termination of the Agreement pursuant to this subsection, Herlin shall be paid only at the then applicable base salary rate up to and including the date of termination. Herlin shall not be paid any incentive salary payments or other compensation, prorated or otherwise, and all Options then vested shall be exercisable during the 30 day period after termination (afterward all such options shall terminate).

D. In the event that NGS is acquired, is the non-surviving party in a merger, or sells all or substantially all of its assets, this Agreement shall not be terminated and NGS agrees to use its commercially reasonable efforts to ensure that the transferee or surviving entity is bound by the provisions of this Agreement.

E. Herlin understands and hereby acknowledges that his employment with the Company constitutes "at will" employment and may be terminated at any time, prior to, during, or after that Trial Period, with or without good cause or for any reason or for no Cause, and with or without notice, subject to the rights and compensation upon termination described in this Section 5 of this Agreement.

6. Restrictive Covenants.

A. *Confidential Information*.

(i) During Herlin's employment and at all times thereafter, Herlin shall not, without the prior express written consent of the Board (except as may be required in connection with any judicial or administrative proceeding or inquiry) disclose to any person, other than an officer or director of the Company or a person to whom disclosure is reasonably necessary or appropriate in connection with the performance by Herlin of his duties as CEO and President, any confidential information with respect to the business and affairs of the Company or any of its subsidiaries.

(ii) Herlin acknowledges that he has and will have access to proprietary information, trade secrets, and confidential material (including lists of key personnel, customers, clients, vendors, suppliers, distributors or consultants) of the Company (the "**Confidential Information**"). Herlin agrees, without limitation in time or until such information shall become public other than by the Executive's unauthorized disclosure, to maintain the confidentiality of the Confidential Information and refrain from divulging, disclosing, or otherwise using in any respect the Confidential Information to the detriment of the Company and any of its subsidiaries, Affiliates, successors or assigns, or for any other purpose or no purpose.

B. *No Solicitation*. For a period of one (1) year after he ceases to be employed by the Company, Herlin agrees that he will not, directly or indirectly, for his benefit or for the benefit of any other person, firm or entity, do any of the following:

(i) solicit from any client doing business with the Company as of Herlin's termination, business of the same or of a similar nature to the business of the Company with such client;

(ii) solicit from any known potential client of the Company business of the same or of a similar nature to that which has been the subject of a known written or oral bid, offer or proposal by the Company, or of substantial preparation with a view to making such a bid, proposal or offer, within six (6) months prior to Herlin's termination;

(iii) solicit the employment or services of, or hire, any person who was known to be employed by the Company upon termination of Herlin's employment, or within six (6) months prior thereto, other than Herlin's personal secretary; or

(iv) otherwise knowingly interfere with the business or accounts of the Company.

C. *Covenant Not to Compete*. During the Term and for a period of one (1) year following the termination of this Agreement, Herlin shall not directly or indirectly engage in, or own any interest in any business which engages in, (i) the business of the Company or any of its subsidiaries as of the date of this Agreement or (ii) any other business which the Company or any of its subsidiaries shall have acquired by purchase, merger or otherwise prior to the Date of Termination, in any state or foreign country in which the Company or any of its subsidiaries does business; *provided*, *however*, that this sentence shall not prohibit Herlin's ownership of not more than five (5) percent of the voting stock of any publicly held corporation.

D. *Survival*. The covenants contained in this Section 6 shall survive any termination of Executive's employment.

7. Resource Agreement.

NGS agrees to enter into the Resource Agreement, attached hereto as Exhibit B **(the "Resource Agreement")**, by and between NGS and Tatum Partners, wherein Tatum shall provide certain services to NGS through Herlin and shall be compensated directly by NGS in the amount specified in the Resources Agreement. NGS and Herlin agree that any stock or options due Tatum Partners as a result of the stock or options awarded to Herlin pursuant to Section 3 shall reduce the amounts due Herlin by NGS.

8. Notices.

Any notice required by this Agreement or given in connection with it, shall be in writing and shall be given to the appropriate party by personal delivery or by certified mail, postage prepaid, or recognized overnight delivery services;

If to NGS:	If to Herlin:
Natural Gas Systems, Inc. 10600 N. De Anza, #250 Cupertino, CA 95014	Robert Herlin 3 Raydon Lane Houston, Texas 77024

9. Final Agreement.

This Agreement, the Resource Agreement referenced in Section 7 hereof, and the Common Stock Purchase Agreement and the Stock Option Agreement referenced in Section 3 hereof, terminate and supersede all prior understandings or agreements on the subject matter hereof. This Agreement may be modified only by a further writing that is duly executed by both parties.

10. Governing Law.

This Agreement shall be construed and enforced in accordance with the laws of the State of Texas.

11. Headings and Counterparts.

Headings used in this Agreement are provided for convenience only and shall not be used to construe meaning or intent. This Agreement may be signed in one or more counterparts, each of which shall be deemed an original and all of which constitute one instrument.

12. No Assignment.

The Company may assign this Agreement without Herlin's consent. Neither this Agreement nor any or interest in this Agreement may be assigned by Herlin without the prior express written approval of NGS, which may be withheld by NGS at NGS' absolute discretion.

13. Severability.

If any term of this Agreement is held by a court of competent jurisdiction to be invalid or unenforceable, then this Agreement, including all of the remaining terms, will remain in full force and effect as if such invalid or unenforceable term had never been included.

14. Arbitration.

The parties agree that they will use their best efforts to amicably resolve any dispute arising out of or relating to this Agreement. Any controversy, claim or dispute that cannot be so resolved shall be settled by final binding arbitration in accordance with the rules of the American Arbitration Association and judgment upon the award rendered by the arbitrator or arbitrators may be entered in any court having jurisdiction thereof. Any such arbitration shall be conducted in Texas, or such other place as may be mutually agreed upon by the parties. Within fifteen (15) days after the commencement of the arbitration, each party shall select one person to act arbitrator, and the two arbitrators so selected shall select a third arbitrator within ten (10) days of their appointment. Each party shall bear its own costs and expenses and an equal share of the arbitrator's expenses and administrative fees of arbitration.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first above written.

Natural Gas Systems, Inc.	**Robert S. Herlin**
______________________________	______________________________
By: Laird Q. Cagan, Chairman	Robert S. Herlin

EXHIBT A

STOCK PURCHASE AGREEMENT

EXHIBIT B

RESOURCES AGREEMENT

Exhibit 10.2

Natural Gas Systems, Inc.
Employment Agreement

THIS AGREEMENT ("*Agreement*")is entered into as of November 10, 2003, by and between **Sterling McDonald** (the "*Employee*") and **Natural Gas Systems, Inc.**, a Delaware corporation (the "*Company*").

1. **Duties and Scope of Employment**.

(a) **Position**. For the term of his employment under this Agreement (the "*Employment*"), the Company agrees to employ the Employee in the position of Chief Financial Officer. The Employee shall report to the Company's CEO and Board of Directors, or to such other person as the Company subsequently may determine.

(b) **Obligations to the Company**. During the term of employment under this Agreement, Employee shall devote his/her full business efforts and time to the Company. The foregoing shall not preclude the Employee from engaging in appropriate civic, charitable or religious activities or from devoting a reasonable amount of time to private investments or from serving on the boards of directors of other entities, as long as such activities and/or services do not interfere or conflict with his/her responsibilities to the Company. Employee may provide material work for companies or third parties, if and only if such work is disclosed in writing and Employee receives consent from the Board at a duly-held meeting of the Board of Directors of the Company. The Employee shall comply with the Company's policies and rules, as they may be in effect from time to time during his Employment.

(c) **No Conflicting Obligations**. The Employee represents and warrants to the Company that he is under no obligations or commitments, whether contractual or otherwise, that are inconsistent with his obligations under this Agreement. The Employee represents and warrants that he will not use or disclose, in connection with his Employment, any trade secrets or other proprietary information or intellectual property in which the Employee or any other person has any right, title or interest and that his Employment will not infringe or violate the rights of any other person. The Employee represents and warrants to the Company that he has returned all property and confidential information belonging to any prior employer.

(d) **Commencement Date**. The Employee shall commence full-time Employment as soon as reasonably practicable and in no event later than November 11, 2003.

2. **Cash and Incentive Compensation.**

(a) **Salary**. The Company shall pay the Employee as compensation for his services an initial base salary at a gross annual rate of $120,000.00. Such salary shall be payable in accordance with the Company's standard payroll procedures. The annual compensation specified in this Subsection (a), together with any increases in such compensation that the Company may grant from time to time, is referred to in this Agreement as "*Base Salary*.")

(b) **Incentive Bonuses**. The Employee shall be eligible to be considered for an annual incentive bonus based on objective or subjective criteria established by the Company's Board of Directors (the "*Board*") or the Compensation Committee of the Board. The determinations of the Board or its Compensation Committee with respect to such bonus shall be final and binding. The Employee shall not be entitled to an incentive bonus if he is not employed by the Company on the date when such bonus is payable.

(c) **Stock Options**. Subject to the approval of the Board or the Compensation Committee of the Board, the Company shall grant the Employee a stock option covering 250,000 shares of the

Company's Common Stock. Such option shall be granted as soon as reasonably practicable after the date of this Agreement. The exercise price of such option shall be equal to the fair market value of such stock on the later of (i) the date of grant or (ii) the first day of the Employee's Employment. The term of such option shall be 10 years, subject to earlier expiration in the event of the termination of the Employee's Employment. The Employee shall vest in 1/8th of the option shares after the first six months of continuous service, and thereafter the remaining option shares shall vest in equal quarterly installments of 1/16th per quarter over the next forty-two months of continuous service. The grant of such option shall be subject to the other terms and conditions set forth in the Company's 2003 Stock Plan and in the Stock Option Agreement, attached hereto as Exhibits B and C, respectively.

3. **Vacation and Employee Benefits.** During his Employment, the Employee shall be eligible for paid vacations in accordance with the Company's vacation policy, as it may be amended from time to time. During his Employment, the Employee shall be eligible to participate in the employee benefit plans maintained by the Company, subject in each case to the generally applicable terms and conditions of the plan in question and to the determinations of any person or committee administering such plan.

4. **Business Expenses.** During his Employment, the Employee shall be authorized to incur necessary and reasonable travel, entertainment and other business expenses in connection with his duties hereunder. The Company shall reimburse the Employee for such expenses upon presentation of an itemized account and appropriate supporting documentation, all in accordance with the Company's generally applicable policies.

5. **Term of Employment.**

(a) **Termination of Employment**. The Company may terminate the Employee's Employment at any time and for any reason (or no reason), and with or without Cause, by giving the Employee ten day's notice in writing. The Employee may terminate his Employment by giving the Company ten days' advance notice in writing. The Employee's Employment shall terminate automatically in the event of his death. The termination of the Employee's Employment shall not limit or otherwise affect his obligations under Section 7.

(b) **Employment at Will**. The Employee's Employment with the Company shall be "at will," meaning that either the Employee or the Company shall be entitled to terminate the Employee's Employment at any time and for any reason, with or without Cause. Any contrary representations that may have been made to the Employee shall be superseded by this Agreement. This Agreement shall constitute the full and complete agreement between the Employee and the Company on the "at will" nature of the Employee's Employment, which may only be changed in an express written agreement signed by the Employee and a duly authorized officer of the Company.

(c) **Rights Upon Termination**. Except as expressly provided in Section 6, upon the termination of the Employee's Employment, the Employee shall only be entitled to the compensation, benefits and expense reimbursements that the Employee has earned under this Agreement before the effective date of the termination. The payments under this Agreement shall fully discharge all responsibilities of the Company to the Employee.

6. **Termination Benefits**.

(a) **General Release**. Any other provision of this Agreement notwithstanding, Subsections (b) and (c) below shall not apply unless the Employee (i) has executed a general release of all claims (in a form prescribed by the Company) and (ii) has returned all property of the Company in the Employee's possession.

(b) **Severance Pay**. If, after ninety days of Employee's continuous employment with the Company, the Company terminates the Employee's Employment for any reason other than Cause or Permanent Disability, then the Company shall pay the Employee his Base Salary for a period of one month following the termination of his Employment (the "*Continuation Period*"). The Continuation Period shall increase by one month for every six months of continuous service of Employee, for a maximum of six months (after thirty of continuous service). Such Base Salary shall be paid at the rate in effect at the time of the termination of Employment and in accordance with the Company's standard payroll procedures.

(c) **Definition of "Cause."** For all purposes under this Agreement, "*Cause*" shall mean:

(i) An unauthorized use or disclosure by the Employee of the Company's confidential information or trade secrets, which use or disclosure causes material harm to the Company;

(ii) A material breach by the Employee of any agreement between the Employee and the Company;

(iii) A material failure by the Employee to comply with the Company's written policies or rules;

(iv) The Employee's conviction of, or plea of "guilty" or "no contest" to, a felony under the laws of the United States or any state thereof;

(v) The Employee's gross negligence or willful misconduct; or

(vi) A continued failure by the Employee to perform assigned duties after receiving written notification of such failure from the Board of Directors.

(d) **Definition of "Permanent Disability."** For all purposes under this Agreement, "*Permanent Disability*" shall mean the Employee's inability to perform the essential functions of the Employee's position, with or without reasonable accommodation, for a period of at least 90 consecutive days because of a physical or mental impairment.

7. **Non-Solicitation and Non-Disclosure**.

(a) **Non-Solicitation**. During the period commencing on the date of this Agreement and continuing until the first anniversary of the date when the Employee's Employment terminated for any reason, the Employee shall not directly or indirectly, personally or through others, solicit or attempt to solicit (on the Employee's own behalf or on behalf of any other person or entity) either (i) the employment of any employee or consultant of the Company or any of the Company's affiliates or (ii) the business of any customer or working interest partner, or other oil and gas service provider with whom the Company is engaged in one or more projects or relationships.

(b) **Non-Disclosure**. The Employee has entered into a Proprietary Information and Inventions Agreement with the Company, attached hereto as **Exhibit A**, which is incorporated herein by this reference.

8. **Successors.**

(a) **Company's Successors**. This Agreement shall be binding upon any successor (whether direct or indirect and whether by purchase, lease, merger, consolidation, liquidation or otherwise) to all or substantially all of the Company's business and/or assets. For all purposes under this Agreement, the term "*Company*" shall include any successor to the Company's business and/or assets which becomes bound by this Agreement.

(e) **Employee's Successors**. This Agreement and all rights of the Employee hereunder shall inure to the benefit of, and be enforceable by, the Employee's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees.

9. **Arbitration**.

(a) **Scope of Arbitration Requirement**. The parties hereby waive their rights to a trial before a judge or jury and agree to arbitrate before a neutral arbitrator any and all claims or disputes arising out of this Agreement and any and all claims arising from or relating to the Employee's Employment, including (but not limited to) claims against any current or former employee, director or agent of the Company, claims of wrongful termination, retaliation, discrimination, harassment, breach of contract, breach of the covenant of good faith and fair dealing, defamation, invasion of privacy, fraud, misrepresentation, constructive discharge or failure to provide a leave of absence, or claims regarding commissions, stock options or bonuses, infliction of emotional distress or unfair business practices.

(b) **Procedure**. The arbitrator's decision shall be written and shall include the findings of fact and law that support the decision. The arbitrator's decision shall be final and binding on both parties, except to the extent applicable law allows for judicial review of arbitration awards. The arbitrator may award any remedies that would otherwise be available to the parties if they were to bring the dispute in court. The arbitration shall be conducted in accordance with the National Rules for the Resolution of Employment Disputes of the American Arbitration Association. The arbitration shall take place in Houston, Texas.

(c) **Costs**. The parties shall share the costs of arbitration equally. Both the Company and the Employee shall be responsible for their own attorneys' fees, and the arbitrator may not award attorneys' fees unless a statute or contract at issue specifically authorizes such an award.

(d) **Applicability**. This Section 9 shall not apply to (i) workers' compensation or unemployment insurance claims or (ii) claims concerning the validity, infringement or enforceability of any trade secret, patent right, copyright or any other trade secret or intellectual property held or sought by either the Employee or the Company (whether or not arising under the Proprietary Information and Inventions Agreement between the Employee and the Company).

10. **Miscellaneous Provisions**.

(a) **Notice**. Notices and all other communications contemplated by this Agreement shall be in writing and shall be deemed to have been duly given when personally delivered or when mailed by U.S. registered or certified mail, return receipt requested and postage prepaid. In the case of the Employee, mailed notices shall be addressed to him at the home address that he most recently communicated to the Company in writing. In the case of the Company, mailed notices shall be addressed to its corporate headquarters, and all notices shall be directed to the attention of its Secretary.

(b) **Modifications and Waivers**. No provision of this Agreement shall be modified, waived or discharged unless the modification, waiver or discharge is agreed to in writing and signed by the Employee and by an authorized officer of the Company (other than the Employee). No waiver by either party of any breach of, or of compliance with, any condition or provision of this Agreement by the other party shall be considered a waiver of any other condition or provision or of the same condition or provision at another time.

(c) **Whole Agreement**. This Agreement supersedes any previous offer letter. No other agreements, representations or understandings (whether oral or written and whether express or implied) which are not expressly set forth in this Agreement have been made or entered into by either party with respect to the subject matter hereof. This Agreement and the Proprietary Information and Inventions Agreement contain the entire understanding of the parties with respect to the subject matter hereof.

(d) **Withholding Taxes**. All payments made under this Agreement shall be subject to reduction to reflect taxes or other charges required to be withheld by law.

(e) **Choice of Law and Severability**. This Agreement shall be interpreted in accordance with the laws of the State of Texas (except their provisions governing the choice of law). If any provision of this Agreement becomes or is deemed invalid, illegal or unenforceable in any applicable jurisdiction by reason of the scope, extent or duration of its coverage, then such provision shall be deemed amended to the minimum extent necessary to conform to applicable law so as to be valid and enforceable or, if such provision cannot be so amended without materially altering the intention of the parties, then such provision shall be stricken and the remainder of this Agreement shall continue in full force and effect. If any provision of this Agreement is rendered illegal by any present or future statute, law, ordinance or regulation (collectively the "*Law*"), then such provision shall be curtailed or limited only to the minimum extent necessary to bring such provision into compliance with the Law. All the other terms and provisions of this Agreement shall continue in full force and effect without impairment or limitation.

(f) **No Assignment**. This Agreement and all rights and obligations of the Employee hereunder are personal to the Employee and may not be transferred or assigned by the Employee at any time. The Company may assign its rights under this Agreement to any entity that assumes the Company's obligations hereunder in connection with any sale or transfer of all or a substantial portion of the Company's assets to such entity.

(g) **Counterparts**. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

(h) **Indemnification.** As an officer of the Company, Employee will be protected by the indemnification provisions of Article IV of the Company's Certificate of Incorporation.

IN WITNESS WHEREOF, each of the parties has executed this employment Agreement, in the case of the Company by its duly authorized officer, as of the day and year first above written.

Employee

Natural Gas Systems, Inc.

By Robert S. Herlin
Title: CEO and President

EXHIBIT A
INVENTIONS ASSIGNMENT AGREEMENT

EXHIBIT A
STOCK OPTION PLAN

EXHIBIT C
STOCK OPTION AGREEMENT

QuickLinks

[Exhibit 10.2](#)

[CAGAN-MCAFEE LETTERHEAD]

Exhibit 10.3

September 23, 2003

Mr. Robert S. Herlin
Chief Executive Officer
NATURAL GAS SYSTEMS, INC.
3 Raydon Lane
Houston, TX 77024

Dear Bob,

We are pleased that Natural Gas Systems, Inc. (the "*Company*") desires to engage Cagan McAfee Capital Partners, LLC ("*CMCP*") as its financial advisor with respect to various matters involving the business of the Company (the "*Advisory Services").* We look forward to working with you and your management team, and have set forth below the agreed upon terms of our involvement.

1. ***Scope of Engagement***

As discussed, we will undertake certain services on behalf of the Company, including:

(a) Assisting management in preparing a private placement memorandum, executive summary, PowerPoint presentation and other presentation materials that describe the Company and its related businesses; and,

(b) Introducing and assisting in the negotiation of bank and finance company lines of credit and term loans;

(c) Providing financial advisory services and management consulting services to the Company;

(d) Introducing the Company to potential investors and public relations specialists; and

(d) Providing assistance to the Company in consummating merger or acquisition transactions with a public entity, including the assistance of negotiation of transactions and advisory work related to the documentation of acquisitions by the Company.

2. ***Fees and Expenses.***

For our services hereunder, the Company will pay to CMCP the following:

(a) A monthly advisory fee commencing November 1, 2003 (the "*Effective Date*") of $15,000 per month. Payments shall be made to the account of CMCP via bank transfer from the Company on the first day of each month during the term of this agreement;

(b) A merger and acquisitions advisory fee equal to: Three Hundred Thousand Dollars ($300,000) and a warrant to purchase 240,000 shares of the Company's Common Stock ("*Warrant*"). This Warrant shall have a seven year maturity, a cashless net exercise provision and an exercise price equal to $1.00. This fee and warrants shall be due and payable upon the successful execution of a merger agreement between the Company and a public entity introduced to the Company by CMCP; and

(c) An administrative expense reimbursement to CMCP for CFO support and other office and support staff in the amount of $2,500 per month, paid on the first day of each calendar month. This fee shall terminate December 1, 2003.

3. ***Use of Information; Financing Matters.***

(a) The Company recognizes and confirms that CMCP in acting pursuant to this engagement will be using publicly available information and information in reports and other materials provided by others, including, without limitation, information provided by or on behalf of the Company, and that CMCP does not assume responsibility for and may rely, without independent verification, on the accuracy and completeness of any such information. The Company agrees to furnish or cause to be furnished to CMCP all necessary or appropriate information for use in its engagement and hereby represents and warrants that any information relating to the Company or transaction that is furnished to CMCP by or on behalf of the Company will be true and correct in all material respects and not misleading. The Company and CMCP agree that any information or advice rendered by CMCP or any of our representatives and any information provided by Company to CMCP in connection with this engagement are for the confidential use of the receiving party and only as required to effect a transaction and the receiving party will not, and will not permit any third party to, use it for any other purpose or disclose or otherwise refer to such advice or information, or to the disclosing party, in any manner without prior written consent.

(b) Each of the Company and CMCP agrees to conduct any offering and sale of securities in any transaction in accordance with applicable federal and state securities laws, and neither the Company nor CMCP, nor any person acting on behalf of either of them, will offer or sell any securities in a transaction by any form of general solicitation, general advertising, or by any other means that would be deemed a public offering under applicable law without the express written approval by the Board of Directors of the Company and pursuant to applicable state and federal securities laws. CMCP has no obligation, express or implied, to purchase or underwrite any transaction or to itself provide any type of financing to the Company or be a party to any transaction, or to solicit investors outside the United States.

4. ***Certain Acknowledgements.***

The Company acknowledges that CMCP has been retained by the Company, and that the Company's engagement of CMCP is as an independent contractor. Neither this engagement, nor the delivery of any advice in connection with this engagement, is intended to confer rights upon any persons not a party hereto (including security holders, employees or creditors of the Company) as against CMCP or our affiliates or their respective directors, officers, agents and employees. Upon prior written consent of the Company (which consent will not be unreasonably withheld), CMCP may, at our own expense, place announcements or advertisements approved by the Company in financial newspapers and journals describing our services hereunder. The Company also acknowledges that CMCP may acquire free-trading or restricted shares or debt of the Company either prior to or after a merger with a public company. The Company also acknowledges that CMCP may also be a significant shareholder or retained advisor to entities that merge with the Company, and CMCP may make investments in or act as advisor to Companies that later become strategic partners or customers of the Company. Such relationships shall be disclosed to the Company in writing prior to initiation of such transaction(s).

5. ***Indemnity.***

CMCP and the Company have entered into a separate letter agreement, dated the date hereof, providing for the indemnification of CMCP by the Company in connection with CMCP's engagement hereunder, the terms of which are incorporated into this agreement in their entirety.

6. ***Term of Engagement.***

CMCP's engagement shall commence on the date hereof and shall continue until December 31, 2005 (the "*Minimum Term*"), and monthly thereafter unless terminated as provided below. CMCP may terminate this agreement at any time, with or without cause, and the Company may terminate this agreement after the Minimum Term, with or without cause, by giving not less than 30 days written notice to the other party; provided, however, that no such termination will affect the matters set out in this section or sections 3, 4, 5, or 7, or in the separate letter agreement relating to indemnification. It is expressly agreed that following the expiration or termination of this agreement, CMCP shall be entitled to receive any fees as described above that have accrued prior to such expiration or termination but are unpaid, as well as reimbursement for expenses as set forth herein.

It is also expressly agreed that if during a period of 24 months following termination of this agreement the Company executes a merger agreement with a public entity based introduced to the Company by CMCP, the Company will pay CMCP a fee and expense reimbursement equal to the fees and administrative expenses which would have been payable to CMCP pursuant to Section 2 as if the transaction had occurred during the term of this agreement. For clarification, CMCP shall only be paid the merger advisory fee described in Section 2(a) once.

7. ***Miscellaneous.***

This agreement is governed by the laws of the State of Texas, without regard to conflicts of law principles, and will be binding upon and inure to the benefit of the Company and CMCP and their respective successors and assigns. Neither this agreement nor any duties or obligations under this agreement may be assigned by CMCP without the prior written consent of the Company. The Company and CMCP agree to waive trial by jury in any action, proceeding or counterclaim brought by or on behalf of either party with respect to any matter whatsoever relating to or arising out of any actual or proposed transaction or the engagement of or performance by CMCP hereunder. The Company also hereby submits to the jurisdiction of the courts of the State of Texas in any proceeding arising out of or relating to this agreement, including federal district courts located in such state, agrees not to commence any suit, action or proceeding relating to thereto except in such courts, and waives, to the fullest extent permitted by law, the right to move to dismiss or transfer any action brought in such court on the basis of any objection to personal jurisdiction, venue or inconvenient forum. This agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, but all of which shall constitute one and the same agreement.

We are pleased to accept this engagement and look forward to working with you on this matter. Please confirm that the foregoing is in accordance with your understanding of our agreement by signing and returning to us a copy of this letter.

Very truly yours,

CAGAN MCAFEE CAPITAL PARTNERS, LLC

By:

Laird Q. Cagan
Managing Director

Accepted and agreed to as of the date set forth above:

NATURAL GAS SYSTEMS, INC.

By ______________________________

Robert S. Herlin
Chief Executive Officer

QuickLinks

Exhibit 10.3

[CAGAN-MCAFEE LETTERHEAD]

Exhibit 10.4

May 5, 2004

Mr. Robert S. Herlin
Chief Executive Officer
NATURAL GAS SYSTEMS, INC.
Two Memorial City Plaza
820 Gessner, Suite 1340
Houston, TX 77024
Fax: 713-935-0199

RE: Addendum I to CMCP Advisory Agreement

Dear Bob,

We are pleased that Natural Gas Systems, Inc. (the "Company") previously engaged Cagan McAfee Capital Partners, LLC ("CMCP"), pursuant to our engagement agreement, dated on September 23, 2003 (the "Engagement Agreement"), as its financial advisor with respect to various matters involving the business of the Company (the "Advisory Services"). We have enjoyed working with you and look forward to an expanded relationship with the Company as we continue in our efforts to raise capital and establish strategic relationships for the Company.

This Addendum I memorializes the previous verbal understanding of the partiers and expands the Advisory Services offered by CMCP to include the services of Laird Q. Cagan, as a registered representative of Chadbourn Securities, NASD broker-dealer.

The following supplemental provisions are hereby incorporated into the Engagement Agreement between the parties (all other paragraphs remain unchanged), effective as of April 15, 2004:

"1.(f) Engaging Laird Q. Cagan, registered representative of Chadbourn Securities, Inc., National Associates of Securities Dealers ("NASD") broker-dealer, in managing, identifying and/or assisting in the negotiation and placement of private equity for the Company, in one or more closings (the "*Equity Funding*"). In connection with Advisory Services related to Equity Funding, Laird Q. Cagan agrees to comply with all applicable laws and regulations of federal and state governmental and regulatory agencies, including, but not limited to, the Rules of Fair Practices of the NASD."

"2.(d) In consideration for the Advisory Services related to the raising of Equity Funding that is lead managed by Laird Q. Cagan, directly, or by a third party engaged by Laird Q. Cagan, the Company shall pay to Laird. Q. Cagan an advisory fee ("Advisory Fee") equal to eight percent (8%) of the Equity Funding; and warrants equal to 8% of the number of shares sold in the offering, such warrants to have a seven year maturity, a net exercise provision and an exercise price equal to the offering price of each respective offering by the Company."

"2.(e) The Company acknowledges and agrees that CMCP or Laird Q. Cagan may, in full compliance with NASD rules and applicable state and federal laws, delegate and/or assign certain Advisory Services to Chadbourn Securities, Inc., or other registered representative or broker dealers, or various finders."

We are pleased to accept this expanded engagement and look forward to continued work with you. Please confirm that the foregoing is in accordance with your understanding of our agreement by signing and returning to us a copy of this letter.

Respectfully,

CAGAN MCAFEE CAPITAL PARTNERS, LLC

By: ________________________

Laird Q. Cagan
Managing Director

Accepted and agreed to as of the date set forth above:

NATURAL GAS SYSTEMS, INC.

By: ________________________

Robert S. Herlin
Chief Executive Officer

QuickLinks

[Exhibit 10.4](#)

QuickLinks -- Click here to rapidly navigate through this document

Exhibit 10.5

THIS CONTRACT CONTAINS RELEASE AND INDEMNITY OBLIGATIONS

MASTER SERVICE CONTRACT

THIS AGREEMENT (this "Contract"), made and entered into and shall be effective as of this 27 day of January, 2004, by and between the parties herein designated as "Company" and "Contractor".

Company:	Natural Gas Systems Corporation, its subsidiaries and other affiliates.
Address:	820 Gessner, Suite 1340 Houston, Texas 77024
Contractor:	Verdisys, Inc., its subsidiaries, divisions and other affiliates
Address:	The individual, subsidiary, division or affiliate providing services shall be deemed Contractor with respect to such services and shall provide its address for notice purposes before commencing same.

WITNESSETH: THAT,

WHEREAS, Company in the course of such operations regularly and customarily enters into contracts with independent contractors for the performance of service relating thereto; and

WHEREAS, Company desires, as a matter of company policy, to establish and maintain an approved list of Contractors and to offer work or contracts only to those Contractors who are included on such approved list; and

WHEREAS, Contractor represents that it has adequate equipment in good working order and fully trained personnel capable of efficiently operating such equipment and performing services for Company.

NOW THEREFORE IN CONSIDERATION of the mutual promises, conditions and agreements herein contained, the sufficiency of which is hereby acknowledged, and the specifications and special provisions set forth in the exhibits attached hereto and made a part hereof, the parties mutually agree as follows:

1.0 AGREEMENT

Upon execution of this Contract, Company agrees that the name of Contractor shall be added to the Company's approved list of Contractors and this Contract shall remain in force and effect until canceled by either party by giving the other party thirty (30) days prior written notice at the respective address of either party. All work to be performed by the Contractor hereunder shall be conducted pursuant to a written Work Agreement executed by both parties. If current work extends past such thirty (30) day period, then cancellation shall not be effective until work is completed. This Contract shall control and govern all work performed by Contractor for Company, under subsequent verbal and/or written work orders. Agreement or stipulations in any such work order, delivery ticket, or other instrument, used by Contractor not in conformity with the terms and provisions hereof shall be null and void. No waiver by Company of any of the terms, provisions or conditions hereof shall be effective unless said waiver shall be in writing and signed by an authorized officer of Company and specifically referencing this Contract.

2.0 LABOR, WARRANTY, EQUIPMENT, MATERIALS, SUPPLIES AND SERVICES

2.1 When notified by Company by written Work Agreement of the services and/or equipment desired and upon acceptance of same, Contractor shall commence furnishing same at the agreed upon time, and continue such operations diligently and without delay, in strict conformity with the specifications and requirements contained herein and such work orders.

2.2 Contractor shall not employ in any work for Company any employee whose employment violates any labor, employment or other applicable laws. Contractor shall not employ in any work for Company any employee who is a minor.

2.3 All work or services rendered or performed by Contractor shall be done with due diligence in a good and workmanlike manner, using skilled, competent and experienced workmen and supervisors, and in accordance with good oilfield servicing practices.

(a) NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, THE TERMS OF THIS PARAGRAPH APPLY TO ANY SERVICES AND TO ANY EQUIPMENT RENTED OR LEASED WITH OR WITHOUT AN OPERATOR. Contractor uses its best efforts to ensure that all service personnel furnished are competent and rental equipment is in good condition. Contractor personnel will use best efforts to perform the work requested; however, because of the nature of the work to be accomplished and unpredictable conditions, the results of such services cannot be and are not guaranteed. Contractor warrants the services provided hereunder for a period of ninety (90) days. NO WARRANTY IS GIVEN WITH RESPECT TO ENGINEERING AND TECHNICAL INFORMATION FURNISHED BY CONTRACTOR OR WITH RESPECT TO THE RESULTS OF THE SERVICES PROVIDED BY CONTRACTOR. CONTRACTOR MAKES NO WARRANTY OR REPRESENTATION, EXPRESS OR IMPLIED, AS TO THE DESIGN, OPERATION, OR QUALITY OF THE MATERIAL OR WORKMANSHIP OF RENTAL EQUIPMENT USED TO SUPPLY THE SERVICES PROVIDED TO COMPANY HEREUNDER, AND CONTRACTOR MAKES NO WARRANTY OF MERCHANTABILITY OR FITNESS OF THE EQUIPMENT FOR ANY PARTICULAR PURPOSE OR ANY OTHER REPRESENTATION OR WARRANTY WHATSOEVER, EXCEPT FOR THE PROVISIONS OF THIS AGREEMENT.

(b) Contractor shall have no responsibility for any materials furnished and/or specified-by Company.

(c) With regard to materials or equipment furnished by third party vendors and/or suppliers, Contractor's liability therefore shall be limited to the assignment of such third party vendor's and/or supplier's warranty to Company, provided such warranties are assignable.

(d) NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, THE TERMS OF THIS PARAGRAPH APPLY TO THE SALE OF ANY EQUIPMENT TO COMPANY. Contractor warrants equipment sold pursuant hereto to be free of defects in material and workmanship for a period of one (1) year after the date equipment is delivered. The above warranty does not apply to (i) used equipment that has been repaired or worked over; (ii) equipment that has been modified or subject to improper handling, storage, installation, operation or maintenance by Company, including use of unauthorized replacement parts; (iii) component parts not manufactured by Contractor, whether purchased by Contractor or furnished by Company, such parts being subject to any applicable manufacturer's warranty; (iv) parts requiring replacement because of natural wear and tear; (v) the design on those jobs where Contractor prepared drawings or lists from designs furnished by others; and (vi) models or samples furnished to Company as illustrations only of general properties of equipment. Contractor's liability for breach of this warranty is expressly limited to the repair or replacement, at its sole option, of any equipment or parts of equipment which prove to be defective during the warranty period. THIS LIMITED EXPRESS WARRANTY, AND THE STATED REMEDIES FOR BREACH THEREOF, SHALL BE IN LIEU OF ANY AND ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING WITHOUT LIMITATION, WARRANTIES FOR MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE.

2.4 Contractor agrees to maintain his equipment in good operating condition at all times and shall use all reasonable means to control and prevent fires and blowouts, protect the hole, and protect Company's equipment.

2.5 Notwithstanding anything to the contrary contained herein, this paragraph shall apply to instances when work is provided by the Contractor on a **fixed rate basis**. Except when Contractor's equipment is lost or damaged as a result of the sole negligence of Company, the Company will not be responsible to the Contractor for Contractor's equipment that is lost or damaged. Contractor agrees to defend, indemnify and hold Company harmless from the loss of or damage to Contractor's tools or equipment occurring in the hole, or in the drill string below the level of the rotary table. In the event and only in the event that the loss of or damages to the Contractor's tools is caused by the sole negligence of the Company, the Company will replace such tools/equipment or reimburse Contractor with the depreciated current replacement cost. Should Company decide to replace lost or damaged tools/equipment, the replaced items should be purchased or obtained from a reputable manufacturer and should meet all original equipment manufacturer's specifications. Company agrees to reimburse Contractor for the cost of major repair to such tools and equipment that are damaged other than from normal wear-and-tear during the rental period, if such damage is as a result of the sole negligence of the Company. However, before any major repairs are made to damaged equipment, approval for such repairs must be secured from an authorized representative of Company.

2.6 Notwithstanding anything to the contrary contained herein, this paragraph shall apply to instances when work is provided by the Contractor on **non-fixed rate basis**, except when Contractor's equipment is lost or damaged as a result of the negligence of Contractor, Company agrees to defend, indemnify and hold Contractor harmless from the loss of or damage to Contractor's tools or equipment occurring in the hole, or in the drill string below the level of the rotary table if directly attributable to the negligence of Company. Company will replace such tools/equipment or reimburse Contractor with the depreciated current replacement cost. Should Company decide to replace lost or damaged tools/equipment, the replaced items should be purchased or obtained from a reputable manufacturer and should meet all original equipment manufacturer's specifications. Company agrees to reimburse Contractor for the cost of major repairs to such tools and equipment that are damaged other than from normal wear-and-tear during the rental period, if such damage is directly attributable to the negligence of the Company. However, before any major repairs are made to damaged equipment, approval for such repairs must be secured from an authorized representative of Company. Company shall not be responsible if Contractor's tools/equipment is damaged as a result of Contractor's negligent acts and/or omissions.

2.7 Notwithstanding anything to the contrary contained herein, it is expressly agreed and understood that in the event Contractor's equipment is leased or rented to Company pursuant to the Contract and is not returned or is damaged beyond repair, Company will replace such equipment or reimburse Contractor with the depreciated current replacement cost of such equipment. Should Company decide to replace lost or damaged assets, the replaced items should be purchased or obtained from a reputable manufacturer and should meet all original equipment manufacturer's specifications. Company agrees to reimburse Contractor for the cost of major repair to such tools and equipment that are damaged other than from normal wear-and-tear during the rental period. However, before any major repairs are made to damaged equipment, approval for such repairs must be secured from an authorized representative of Company. Company shall not be responsible to the extent that Contractor's equipment is damaged as a result of Contractor's negligent acts and/or omissions.

3.0 PAYMENT

3.1 Within thirty (30) days after receipt of an invoice, the Company shall pay Contractor at the rate stipulated in the work orders provided for herein, subject to same being accepted by Company as fully complying with all the terms, conditions, specifications and requirements of this Contract and such work orders. No payment is required until any dispute over the invoice is fully resolved.

3.2 Company shall have the right to audit Contractor's books and records relating to all invoices issued pursuant to this agreement. Contractor agrees to maintain such books and records for a period of two (2) years from the date such costs were incurred and to make such books and records available to Company at any time or times within such two (2) year period.

3.3 In the event that Company's account with Contractor becomes delinquent and after the Contractor has given the Company written notice of such delinquency with a ten (10) day period to cure any such delinquency, Contractor has the right to revoke any and all discounts from the listed price established in the service agreement and previously applied in arriving at the net invoice price. Upon revocation, the full invoice price without discount will become immediately due and owing and subject to collection. Notwithstanding anything herein to the contrary, Contractor may file liens if Company fails to pay Contractor's valid charges as required by this Contract or any court order, except during the pendency of any dispute.

4.0 REPORTS TO BE FURNISHED BY CONTRACTOR

4.1 The quantity, description and condition of the materials and supplies and/or services furnished shall be verified and checked by Contractor, and all delivery tickets shall be properly certified as to receipt by Contractor's representative. Contractor must obtain approval of Company's representative on the well site of delivery tickets for materials and supplies for which Contractor is to be reimbursed by Company.

4.2 Contractor shall immediately orally report to Company, as soon as practicable followed by an appropriate written report, all accidents or occurrences resulting in death or injuries to Contractor's employees, agents or third parties, or damage to property of Company or third parties arising out of or during the course of work to be performed hereunder. Contractor shall furnish Company with a copy (within ten days) of all records made available by Contractor to Contractor's insurer or governmental authorities or to others of such accidents and occurrences.

4.3 Contractor shall provide a written representation after completion of each well as to the results of the services provided specifying the number of laterals drilled and the lateral distance of each.

5.0 INDEPENDENT COMPANY RELATIONSHIP

In the performance of any work by Contractor for Company, Contractor shall be deemed to be an independent contractor, with the authority and right to direct and control all of the details of the work, Company being interested only in the results obtained. However, all work contemplated shall meet the approval of Company and shall be subjected to the general right of inspection. Company shall have no right or authority to supervise or give instructions to the employees, agents, or representative of Contractor, but such employees, agents or representatives at all times shall be under the direct and sole supervision and control of Contractor. Any suggestions or directions given by Company or its employees shall be given only to the superintendent or other person in charge of Contractor's crew, provided however, that in the event any employee of Company should give any order or instructions to the employees of Contractor (which employee of Company shall not in any event be authorized to do) and such order is not countermanded by Contractor's superintendent or other person in charge of Contractor's employees or crew, it shall be deemed that such orders or instructions are the orders or instructions of Contractor. It is the understanding and intention of the parties hereto that no relationship of master and servant or principal and agent shall exist between Company and the employees, agents, or representatives of Contractor, and that all work or services covered hereby shall be performed at the sole risk of Contractor.

6.0 INDEMNITY OBLIGATIONS

6.1 *Definitions.* The following terms shall have the designated definitions.

(a) *Company Group* includes, individually or in any combination, Company, its affiliates, contractors (other than Contractor) and entities for whom Company is performing services and each of their respective directors, officers agents, representatives, employees and invitees.

(b) *Contractor Group* includes, individually or in any combination, Contractor, and its affiliates and contractors, and each of their respective directors, officers, agents, representatives, employees and invitees.

(c) *Defend*—the obligation of the indemnitor (i) to defend the indemnitees at its sole expense, or at the indemnitees' election (ii) to reimburse the indemnitees for the indemnitees' reasonable expenses incurred in defending themselves. Notwithstanding the indemnitee's election of option (i) above, the indemnitee shall be entitled to participate in its defense at its sole cost.

(d) *Losses*—claims, demands, causes of action, losses, judgments, liabilities, indemnity obligations, costs, damages or expenses of any kind and character (including attorney's fees and other legal expenses).

6.2 *Contractor.* Contractor shall release, defend, indemnify, and hold harmless Company Group from and against any and all Losses arising out of bodily injury or death or property damage or loss (including patent or license infringement resulting from the use of the Contractor Group's property) suffered by any of the Contractor Group in connection with this Contract, REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR OTHER FAULT OF ANY MEMBER OF COMPANY GROUP.

6.3 *Company.* Company shall release, defend, indemnify, and hold harmless Contractor Group from and against all Losses arising out of bodily injury or death or property damage or loss (including patent or license infringement resulting from the use of the Company Group's property) suffered by any of the Company Group in connection with this Contract, REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR OTHER FAULT OF ANY MEMBER OF CONTRACTOR GROUP.

6.4 *Insurance Support/Limitation.* The mutual indemnity obligations in Sections 6.2 and 6.3 above shall be supported by insurance provided by the parties hereto in the amounts and the types described in Exhibit A. Notwithstanding anything in this Contract to the contrary, (i) in the event enforcement of Sections 6.2 and/or 6.3 above is governed by the Texas Anti-Indemnity Statute (Tex. Civ. Prac. & Rem. Code Ann. Secs. 127.001-127.007 (1986 & Supp. 1996) as amended) or similar statute in another jurisdiction, and (ii) to the extent the indemnified Losses under such Section 6.2 or 6.3, as applicable, result from the indemnitee's negligence, then the obligations of the indemnitor under such Section 6.2 or 6.3, as applicable, shall be limited to the extent of insurance required to be provided by both parties pursuant to this Section 6.4 (or any such greater amount allowed by law).

6.5 **NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED HEREIN, COMPANY HEREBY AGREES TO ASSUME THE ENTIRE RESPONSIBILITY AND LIABILITY FOR, AND AGREES TO RELEASE, DEFEND, INDEMNIFY AND HOLD CONTRACTOR HARMLESS FROM AND AGAINST ALL CLAIMS, LIABILITIES, DAMAGES AND EXPENSES (INCLUDING WITHOUT LIMITATION ATTORNEYS' FEES, COURT COSTS, EXPERT WITNESS FEES AND ANY OTHER COST OF DEFENSE) FOR AND ARISING OUT OF THE FOLLOWING SPECIFIED TYPES OF CLAIMS, LOSSES OR EVENTS:**

1. **LOSS OR LIABILITY FOR DAMAGES OR AN EXPENSE ARISING FROM PROPERTY INJURY THAT RESULTS FROM RESERVOIR OR UNDERGROUND DAMAGE, INCLUDING LOSS OF OIL, GAS, OTHER MINERAL SUBSTANCE, OR WATER OR THE WELLBORE ITSELF; OR**

2. **LOSS OR LIABILITY FOR DAMAGES OR ANY EXPENSE ARISING FROM COST OF CONTROL OF WILD WELL, UNDERGROUND OR ABOVE THE SURFACE.**

THIS OBLIGATION TO INDEMNIFY, DEFEND AND RELEASE SET FORTH IN THIS SECTION 6.5 APPLIES REGARDLESS OF WHETHER OR NOT THE CLAIM OR LOSS IS OCCASIONED BY OR RESULTS FROM THE ACTUAL OR ALLEGED NEGLIGENCE OF CONTRACTOR OR ANY OTHER PERSON, OR ENTITY, IN WHOLE OR IN PART, WHETHER SOLE, JOINT, ACTIVE OR PASSIVE, EXCEPT TO THE EXTENT THE CLAIM OR LOSS IS DUE TO CONTRACTOR'S SOLE NEGLIGENCE, GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.

6.6 **NOTWITHSTANDING THE FOREGOING, CONTRACTOR SHALL HAVE SOLE RESPONSIBILITY AND LIABILITY FOR THE CONTROL AND REMOVAL OF AND SHALL HOLD COMPANY HARMLESS FROM PROPERTY LOSS OR DAMAGE, FINES AND/OR PENALTIES FROM SUCH POLLUTION OR CONTAMINATION THAT RESULTS FROM SPILLS OF FUELS, LUBRICANT, MOTOR OILS, PIPEDOPE, PAINTS, SOLVENTS, BALLAST, BILGE, METALLIC OBJECTS AND GARBAGE IN CONTRACTOR'S SOLE POSSESSION AND CONTROL, REGARDLESS OF OWNERSHIP, REGARDLESS OF WHETHER OR NOT OCCASIONED BY OR RESULTING FROM THE NEGLIGENCE, STRICT LIABILITY, BREACH OF WARRANTY OR OTHER FAULT OF COMPANY, IN WHOLE OR IN PART, WHETHER SOLE, JOINT, ACTIVE OR PASSIVE. THE INITIATION OF CLEAN-UP OPERATIONS INCLUDING CONTROL, RESPONSE AND REMOVAL, BY EITHER PARTY SHALL NOT BE AN ADMISSION OF ASSUMPTION OF LIABILITY BY THE INITIATING PARTY OR PARTIES**.

6.7 *Indirect or Consequential Damages.* The parties hereto waive and release all claims against the other party for indirect, special, punitive or consequential damages arising out of this Contract, **REGARDLESS OF WHETHER CAUSED OR CONTRIBUTED TO BY THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (IN ANY AMOUNT), STRICT LIABILITY OR**

OTHER FAULT OF ANY OF THE OTHER PARTY. As used herein, "indirect or consequential damages" shall include, but not be limited to, loss of revenue, profit or use of capital, production delays, loss of product, reservoir loss or damage, losses resulting from failure to meet other contractual commitments or deadlines and downtime of facilities or vessels.

6.8 *No Limit.* Except as otherwise provided herein, the foregoing indemnity obligations shall not be limited to the amount of insurance of the parties.

6.9 The provisions of this Section shall extend to and be enforceable by and for the benefit of Contractor Group and Company Group.

6.10 During the term of this Contract, Contractor and its subcontractors or their officers, directors and employees may have occasion to be upon or about property, platforms, vessels, equipment or other premises belonging to or under the control of or in the possession of or under contract to Company while performing services for another company or while in transit between a vessel and another location. In such event, Contractor's and Company's indemnification rights and obligations under this Contract shall apply to the same extent as if Contractor had been employed at the request of or for the benefit or account of Company.

6.11 Should Louisiana law be applicable to this Contract and the activities performed hereunder, Contractor and Company agree to recognize Company as the statutory employer of employees of Contractor while such employees are performing services to be supplied by Contractor under this agreement. This provision is included for the sole purpose of establishing a statutory employer relationship to gain benefits expressed in La. Rev. Stat. 23:1031 (C-E) and La. Rev. Stat. 23:1061 (A) and is not intended to create an employer/employee relationship for any other purpose.

7.0 INSURANCE

Contractor shall carry insurance (with reliable insurance companies that are satisfactory to Company) in the amounts set forth in Exhibit A, such insurance to be effective prior to the commencement of any work under this Contract. In each such policy, to the extent of the liabilities agreed to be assumed by Contractor, Contractor shall cause (i) all deductibles to be for Contractor's account, (ii) the insurer to waive all rights of subrogation against Company Group, (iii) Company Group to be listed as additional insureds, and (iv) such policy to be primary as to any other existing valid and collectible insurance of Company Group or otherwise. Before engaging in any work hereunder, Contractor shall furnish Company an executed Certificate of Insurance (in form satisfactory to Company) evidencing the foregoing insurance. Contractor shall cause each insurer to agree to give Company at least thirty (30) days written notice of cancellation or expiration of any such policies or of any other changes that would materially reduce the limits of coverage of such policies. Notwithstanding any provision herein to the contrary, failure to secure the insurance coverage, or the failure to comply fully with any of the insurance provisions of this Contract, or the failure to secure such endorsements on the policies as may be necessary to carry out the terms and provisions of this Contract, (x) shall in no way act to relieve Contractor from the obligations of this Contract, and (y) shall constitute grounds for the immediate termination of this Contract by Company (in addition to any other rights or remedies available to the Company).

8.0 THIRD PARTY BENEFICIARIES

Except as provided in Section 6.9 above with regard to Company Group and Contractor Group, nothing herein shall be construed to confer any benefit on any third party not a party to this Contract nor to provide any rights to such third parties to enforce the provisions hereof.

9.0 TAXES AND CLAIMS

9.1 Contractor agrees to pay all taxes, licenses, and fees levied or assessed on Contractor in connection with or incident to the performance of this Contract by any governmental agency and unemployment compensation insurance, old age benefits, social security, or any other taxes upon the wages of Contractor, its agents, employees, and representatives. Contractor agrees to require the same agreements and be liable for any breach of such agreements by any of its sub-Contractors.

9.2 Contractor agrees to reimburse Company on demand for all such taxes or governmental charges, State or Federal that Company may be required or deem it necessary to pay on account of employees of Contractor or its sub-Contractors. Contractor agrees to furnish Company with the information required to enable it to make the necessary reports and pay such taxes or charges. At its election, Company is authorized to deduct all sums so paid for such taxes and governmental charges from such amounts as may be or become due to Contractor hereunder.

9.3 Contractor agrees to pay all claims for labor, materials, services, and supplies furnished to Contractor hereunder and agrees to allow no lien or charge to be fixed upon the rig, the lease, the well, the land on which the well is located, or other property of Company or the party for whom Company is performing services with respect to such claims. Contractor agrees to indemnify, protect, defend, and hold Company harmless from and against all such claims, charges, and liens. If Contractor shall fail or refuse to pay any claims or indebtedness incurred by Contractor in connection with the services provided hereunder, it is agreed that Company shall have the right to pay any such claims or indebtedness out of any money due or to become due to Contractor hereunder. Notwithstanding the foregoing, Company agrees that it will not pay any such claim or indebtedness as long as same is being actively contested by Contractor and Contractor has taken all actions necessary (including the posting of a bond when appropriate) to protect the property interests of Company or any other party affected by such claim or indebtedness.

9.4 Before payments are made by Company to Contractor, Company may require Contractor to furnish proof that there are no unsatisfied claims for labor, materials, equipment, and supplies or for injuries to persons or property not covered by insurance.

10.0 LAWS, RULES AND REGULATIONS

10.1 Company and Contractor respectively agree to comply with all laws, rules, and regulations which are now or may become applicable to operations covered by this Contract or arising out of the performance of such operations. If either party is required to pay any fine or penalty resulting from the other party's failure to comply with such laws, rules, or regulations, the party failing to comply shall immediately reimburse the other for any such payment.

10.2 In the event any provision of this Contract is inconsistent with or contrary to any applicable law, rule, or regulation, said provision shall be deemed to be modified to the extent required to comply with said law, rule, or regulation, and this Contract as so modified, shall remain in full force and effect.

10.3 This Contract shall be governed, construed and interpreted in accordance with the laws of Texas.

10.4 In the case of any dispute, claim, or controversy arising out of or relating to this Agreement, the parties shall first attempt in good faith to resolve any such disputes informally without the necessity of a formal proceeding. If the dispute is not resolve within sixty (60) days, then, upon written notice by either party to the other party, all disputes, claims, or causes of action arising under the Agreement, shall be submitted to mediation. The parties shall within thirty(30) days of receipt of notice that such matter shall be mediated, submit to the other party a list of five (5) persons to act as a mediator of said claim. All such mediators should be licensed to practice law in the State of Texas(in good standing), be a qualified mediator, and be knowledgeable about the subject matter of the dispute. If the parties are unable to agree on a mediator, then this matter will be submitted for administration by the American Arbitration Association, under its commercial mediation rules. In the event the parties are unable to fully and completely resolve any claims or causes of action in mediation, then all such disputes, claims, or controversies arising out of or relating to this Agreement, shall be submitted to binding non-appealable Arbitration to be administered by the American Arbitration Association under its Commercial Arbitration Rules. The parties further agree that any judgment awarded in arbitration shall be entered in any court of competent jurisdiction.

11.0 FORCE MAJEURE

Except for the duty to make payments hereunder when due, and the indemnification provisions under this Contract, neither Company nor Contractor shall be responsible to the other for any delay, damage or failure caused by or occasioned by a Force Majeure Event. As used in this Contract, "Force Majeure Event" includes, but is not limited to: acts of God, action of the elements, warlike action, insurrection, revolution or civil strife, piracy, civil war or hostile action, strikes, differences with workers, acts of public enemies, federal or state laws, rules and regulations of any governmental authorities having jurisdiction in the premises or of any other group, organization or informal association (whether or not formally recognized as a government), acute and unusual labor or material or equipment shortages, or any other causes (except financial) beyond the control of either party. Delays due to the above causes, or any of them, shall not be deemed to be a breach of or failure to perform under this Contract. Neither Company nor Contractor shall be required against its will to adjust any labor or similar disputes except in accordance with applicable law. Notwithstanding, the foregoing, any party relying on a Force Majeure Event, shall give the other party written notice within five (5) days of a Force Majeure Event. Failure to timely provide notice of a Force Majeure Event shall act as a waiver of the use of the Force Majeure provisions contained herein.

12.0 PATENTS

In addition to all other indemnity provisions contained herein, Contractor represents and warrants that the use or construction of any and all tools and equipment furnished by Contractor and used in the work provided for herein does not infringe on any license or patent issued or applied for, and Contractor agrees to indemnify and hold Company harmless from any and all claims, demands, and causes of action of every kind and character in favor of or made by an patentee, licensee, or claimant of any rights or priority to such tool or equipment, or the use or construction thereof, that may result from or arise out of furnishing or use of any such tool or equipment by Contractor in connection with the work.

13.0 ASSIGNMENTS

Company and Contractor agree that neither will assign or delegate this Contract or any of the work or services required hereunder, except for work normally performed by sub-contractors, and not to assign any sum that may accrue to Contractor hereunder, without prior written consent of the other party.

14.0 TERMINATION OF WORK

14.1 Company may, with 30 days written notification, in its sole discretion, terminate work covered by any work order, oral or written, issued hereunder, in which event Contractor shall be paid at the applicable rates stipulated in Contractor's Rate Schedule or Bid for services rendered up to the date of such termination. In no event shall Contractor be entitled to be paid prospectively for work unperformed by reason of such termination, nor shall Contractor be entitled to any other compensation or damages for loss of anticipated profits or otherwise. On notice of such termination, Contractor shall promptly remove its personnel, machinery, and equipment from the location and shall further cooperate with Company or its designee to ensure an orderly and expeditious transition and completion of the work.

14.2 The foregoing paragraph shall in no way limit (other than compensation for goods and/or services already provided) Company's right to terminate Contractor without additional compensation in the event of Contractor's breach of this Contract.

15.0 GIFTS AND GRATUITIES

It is considered to be in conflict with the Company's interest for its employees or any member of their immediate family to accept gifts, payments, extravagant entertainment, services, or loans in any form from anyone soliciting business, or who may already have established business relations with the Company. Gifts of nominal value and entertainment, meals, and social invitations that are customary and proper under the circumstances and do not place the recipient under obligation are acceptable. If any employee of the Company should solicit a gift or gratuity from the Contractor, Contractor hereby agrees to notify an officer of the Company of such act. It is agreed that the Company will hold such notification in confidence. It is further understood that failure by the Contractor to comply with the Company's policies regarding gifts and gratuities may, at the Company's option, result in the termination of this Contract and may further preclude any future dealings between the parties.

16.0 ILLEGAL DRUGS, ALCOHOL, AND FIREARMS

16.1 To help insure a safe, productive work environment, Company may establish a program designed to prohibit the use, transportation and possession of firearms, drugs and/or controlled substances, drug paraphernalia and alcoholic beverages on drilling locations, or Company's other premises. Illegal drugs include marijuana, amphetamines, barbiturates, opiates, cocaine, codeine, morphine, hallucinogenic substances (LSD) and any similar drugs and/or chemicals synthetics deemed hazardous by Company.

16.2 Such programs, if established, upon notice shall apply to Contractor's employees, agents, servants and Contractors.

16.3 Company specifically reserves the right to carry our reasonable searches of individuals, their personal effects, and vehicles when entering on and leaving Company's premises. The searches will be initiated by Company without prior announcement. Individuals found in violation will be removed from Company's premises immediately. Submission to such a search is strictly voluntary; however, refusal may be cause for not allowing that individual on the wellsite or Company's other premises. It is Contractor's responsibility to notify its employees of this prohibition and its enforcement.

17.0 GOVERNMENT REGULATIONS

The following regulations, where required by law, are incorporated in the agreement by reference as if fully set out.

(1) The Equal Opportunity Clause prescribed in 41CFR 60-1.4;

(2) The Affirmative Action Clause prescribed in 41 CFR 60-250.4 regarding veterans and veterans of the Vietnam era;

(3) The Affirmative Action Clause for handicapped workers prescribed in 41 CFR 60-741.4;

(4) The Certification of Compliance with Environmental Laws prescribed in 40 CFR 15.20.

18.0 SPECIAL PROVISIONS

This Contract sets forth the entire agreement between Company and Contractor with respect to its subject matter. All prior negotiations and dealings regarding the subject matter hereof are superseded by and merged into the Contract, including any existing Master Service Contracts and/or Drilling Service Contracts between the Company and Contractor. It is specifically stipulated and agreed between the Company and the Contractor that this Contract supersedes and replaces that certain Drilling Services Agreement dated September 29, 2003, together will all affiliated terms and invoices (hereinafter collectively referred to as the "Drilling Services Contract"), relating to services to be provided in the Delhi Field, and that neither party owes the other party any further obligations under said Drilling Services Agreement, and that all amounts owing between the parties thereunder have been paid in full or will be paid in full on or before February 2, 2004. If requested by the Company, Contractor agrees that it will assign, transfer, and convey to NGS Sub Corp. (a wholly owned subsidiary of the Company) all right, title and interest in any future, net profits, or contingent interests in the Delhi Field which the Contractor may have acquired pursuant to the terms of the Drilling Services Contract. No modification or amendment of this Contract shall be effective unless made in writing and signed by both parties.

19.0 NOTICES

Company: Natural Gas Systems Corporation
820 Gessner, Suite 1340
Houston, Texas 77024
Office: 713-935-0122
Fax: 713-935-0199

Contractor: Verdisys Inc.
25025 I-45, Suite 525
The Woodlands, Texas 77380
Office: 281-364-6999
Fax: 281-364-8007

20.0 ACCEPTANCE OF CONTRACT

IN WITNESS WHEREOF, the parties hereto have executed this Contract upon the date above shown in several counterparts, each of which shall be considered as an original.

COMPANY		**CONTRACTOR**	
By:		By:	
Title:	President	Title:	
Date:		Date:	

INSURANCE
Exhibit A

Contractor shall carry insurance (with reliable insurance companies that are satisfactory to Company) in the minimum amounts set forth below, such insurance to be effective prior to the commencement of any work under this Contract. In each such policy, to the extent of the liabilities agreed to be assumed by Contractor, Contractor shall cause (i) all deductibles to be for Contractor's account, (ii) the insurer to waive all rights of subrogation against Company Group, (iii) Company Group to be listed as additional insureds, and (iv) such policy to be primary as to any other existing valid and collectible insurance of Company Group or otherwise. Before engaging in any work hereunder, Contractor shall furnish Company an executed Certificate of Insurance (in form satisfactory to Company) evidencing the foregoing insurance. Contractor shall cause each insurer to agree to give Company at least thirty days written notice of cancellation or expiration of any such policies or of any other changes that would materially reduce the limits of coverage of such policies. Notwithstanding any provision herein to the contrary, failure to secure the insurance coverage, or the failure to comply fully with any of the insurance provisions of this Contract, or the failure to secure such endorsements on the policy as may be necessary to carry out the terms and provisions of this contract, (x) shall in no way act to relieve Contractor from the obligations of this Contract, and (y) shall constitute grounds for the immediate termination of this Contract by Company (in addition to any other rights or remedies available to the Company).

1. Workers' Compensation insurance to the full extent required by all laws applicable in any jurisdiction in which the Work is to be performed or the contracts of employment for Contractor's employees are made or expressed to be made. The Employer's Liability Insurance shall not be less than $1,000,000.

2. Comprehensive or Commercial General Liability insurance for any incidents or series of incidents covering the operations of the Contractor in the performance of the contract, in an amount of not less than $1,000,000.

3. Automobile Bodily Injury and Property Damage Liability Insurance extending to owned, non-owned, and hired automobiles used by Contractor in the performance of this Contract in the amount of not less than $1,000,000.

Excess Liability Insurance over and above the coverages listed above in the amount of not less than $2,000,000.

QuickLinks

Exhibit 10.5

QuickLinks -- Click here to rapidly navigate through this document

EXHIBIT 21.1

Subsidiaries of Natural Gas Systems, Inc.

Subsidiary	State of incorporation organization	Name under which entity does business
Natural Gas Systems, Inc.	Delaware	Natural Gas Systems
NGS Sub Corp.	Delaware	Natural Gas Systems
ARKLA Petroleum LLC	Louisiana	Arkla Petroleum LLC and Natural Gas Systems

Exhibit 31.1
CERTIFICATION PURSUANT TO RULE 15D-14 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Robert S. Herlin, Chief Executive Officer of Natural Gas Systems, Inc., certify that:

1. I have reviewed this annual report on Form 10-KSB of Natural Gas Systems, Inc.;

2. Based on my knowledge, this annual 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 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)) 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) 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

    c) 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 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 Registrant's Board of Directors:

    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.

Date: September   , 2004

/s/ ROBERT S. HERLIN

Robert S. Herlin
Chief Executive Officer

QuickLinks

Exhibit 31.1 CERTIFICATION PURSUANT TO RULE 15D-14 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

Exhibit 31.2
CERTIFICATION PURSUANT TO RULE 15D-14 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED AS ADOPTED PURSUANT TO

SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Sterling H. McDonald, Chief Financial Officer of Natural Gas Systems, Inc., certify that:

1. I have reviewed this annual report on Form 10-KSB of Natural Gas Systems, Inc.;

2. Based on my knowledge, this quarterly 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 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)) 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) 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

   c) 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 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 Registrant's Board of Directors:

   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.

Date: September , 2004

/s/ STERLING H. MCDONALD

Sterling H. McDonald
Chief Financial Officer

QuickLinks

Exhibit 31.2 CERTIFICATION PURSUANT TO RULE 15D-14 OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED AS ADOPTED PURSUANT TO

Exhibit 32.1
CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. 1350)

The undersigned, Robert S. Herlin, President and Chief Executive Officer of Natural Gas Systems, Inc. (the "Company"), certifies in connection with the filing with the Securities and Exchange Commission of the Company's Annual Report on Form 10-KSB for the year ended June 30, 2004 (the "Report")") pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002, to his knowledge, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

IN WITNESS WHEREOF, the undersigned has executed this certification as of the 14th day of January, 2004.

/s/ ROBERT S. HERLIN

Robert S. Herlin
Chief Executive Officer

Exhibit 32.2
CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. 1350)

The undersigned, Sterling H. McDonald, Chief Financial Officer of Natural Gas Systems, Inc. (the "Company"), certifies in connection with the filing with the Securities and Exchange Commission of the Company's Annual Report on Form 10-KSB for the year ended June 30, 2004 (the "Report")") pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002, to his knowledge, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

IN WITNESS WHEREOF, the undersigned has executed this certification as of the 14th day of January 2004.

/s/ STERLING H. MCDONALD

Sterling H. McDonald
Chief Financial Officer