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

FORM 10-K

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

For the fiscal year ended **December 31, 2022**

or

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

For the transition period from________________________to__________________________

Commission file number: 1-31398

NATURAL GAS SERVICES GROUP, INC.

(Exact Name of Registrant as Specified in its Charter)

Colorado	75-2811855
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
404 Veterans Airpark Lane, Suite 300, Midland, Texas	79705
(Address of principal executive offices)	(Zip Code)
Registrant’s telephone number, including area code:	(432) 262-2700

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $.01 par value	NGS	New York Stock Exchange

Securities registered pursuant to section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File to be submitted and posted pursuant to Rule 405 of Regulation S-T (§40232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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-K or any amendment to this Form 10-K.

Yes ☐ No ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

(Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☒ Emerging growth company ☐

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

Yes ☐ No ☒

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☐

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). ☐

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2022 was approximately $126,762,559 based on the closing price of the common stock on that date on the New York Stock Exchange.

At March 28, 2023, there were 12,447,614 shares of the Registrant's common stock outstanding.

Documents incorporated by reference

Certain information called for in Items 10, 11, 12, 13 and 14 of Part III are incorporated by reference to the registrant’s definitive proxy statement for the annual meeting of shareholders expected to be held on June 15, 2023.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- significant economic disruptions and adverse consequences resulting from current and possible long-term effects of the COVID-19 global pandemic and its variants;
- conditions in the oil and natural gas industry, including the supply and demand for natural gas and wide fluctuations in the prices of oil and natural gas;
- fluctuations in interest rates;
- regulation or prohibition of new well completion techniques;
- competition among the various providers of compression services and products;
- changes in safety, health and environmental regulations;
- changes in economic or political conditions in the markets in which we operate;
- failure of our customers to continue to rent equipment after expiration of the primary rental term;
- the inherent risks associated with our operations, such as equipment defects, malfunctions and natural disasters;
- our inability to comply with covenants in our debt agreements and the decreased financial flexibility associated with our debt;
- our future capital requirements and availability of financing;
- operational, fabrication and manufacturing costs and inflationary pressures;
- general economic conditions; and
- acts of terrorism;

We believe that it is important to communicate our expectations of future performance to our investors. However, events may occur in the future that we are unable to accurately predict or that we are unable to control. When considering our forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this Annual Report on Form 10-K.

Glossary of Industry Terms

"CiP" - A branded gas compressor product line designed, manufactured and packaged by the Company. The 'Cylinder in Plane' design results in a compact and vibration-free compressor unit that particularly lends itself to unconventional wellhead applications, air compression and compressed natural gas requirements.

"flare" – A tall stack equipped with burners used as a safety device at wellheads, refining facilities, gas processing plants, and chemical plants. Flares are used for the combustion and disposal of combustible gases. The gases are piped to a remote, usually elevated, location and burned in an open flame in the open air using a specially designed burner tip, auxiliary fuel, and steam or air. Combustible gases are flared most often due to emergency relief, overpressure, process upsets, startups, shutdowns and other operational safety reasons. Natural gas that is uneconomical for sale is also flared. Often natural gas is flared as a result of the unavailability of a method for transporting such gas to markets.

"gas lift" – A production enhancement technique whereby natural gas is injected into an oil well to increase/improve the oil production.

"oil shale" – Also referred to as tight oil, is petroleum that consists of light crude oil contained in petroleum-bearing formations of low-permeability, often shale or tight sandstone.

"reciprocating compressors" – A reciprocating compressor is a type of compressor which compresses vapor by using a piston in a cylinder and a back-and-forth motion.

"screw compressors" – A type of compressor used in low-pressure and vapor compression applications where two intermesh rotors create pockets of continuously decreasing volume, in which the gas is compressed and its pressure is increased.

PART I

ITEM 1. BUSINESS

Unless the context otherwise requires, references in this Annual Report on Form 10-K to “Natural Gas Services Group,” the “Company”, "NGS", “we,” “us,” “our” or “ours” refer to Natural Gas Services Group, Inc. Certain specialized terms used in describing our natural gas compressor business are defined in "Glossary of Industry Terms" on page i.

Smaller Reporting Company

We are a “smaller reporting company” as defined by the SEC. As such, we are eligible to comply with the scaled disclosure requirements in several Regulation S-K and Regulation S-X items. Our disclosures in this Annual Report reflect many of these scaled requirements.

The Company

We are a provider of natural gas compression equipment and services to the energy industry. We manufacture, fabricate, rent, sell and maintain natural gas compressors and flare systems for oil and natural gas production and plant facilities. We are headquartered in Midland, Texas, with fabrication facilities located in Tulsa, Oklahoma and Midland, Texas, and service facilities located in major oil and natural gas producing basins in the U.S.

We have shifted our focus over the last several years to medium to large horsepower applications that apply to natural gas associated with oil-weighted production. Our primary customers are exploration and production companies that utilize our compressor units for artificial lift applications, i.e., production enhancement enabled with high-pressure gas compression equipment, on unconventional oil wells on single and multi-well pads. In addition, our customer base includes oil and natural gas exploration and production ("E&P") companies that are focused on natural gas-weighted production (with typically smaller horsepower applications) as well as midstream companies. The Company's largest rental area is the Permian Basin (approximately 55.6% of rental revenues in 2022), with the majority of its remaining rental revenue being generated in other oil and natural gas producing regions and plays in Texas, New Mexico and Oklahoma, including the San Juan Basin, the Texas Panhandle/western Oklahoma, the Barnett Shale, and central Oklahoma. Other regions and plays in which we provide service include the Utica and Marcellus Shales, Michigan and the DJ Basin of Colorado.

Our revenue increased 17.1% to $84.8 million for the year ended December 31, 2022 from $72.4 million for the year ended December 31, 2021. This increase was largely the result of our rental revenues increasing 17.0% to $74.5 million in 2022 from $63.6 million in 2021 as well as sales revenue increasing 24.5% to $8.6 million in 2022 from $6.9 million in 2021. For the year ended December 31, 2022, the Company reported a net loss of $0.6 million as compared to a net loss of $9.2 million for the year ended December 31, 2021. In addition, the Company's adjusted earnings before interest, taxes, depreciation and amortization ("EBITDA") increased 55.8% to $29.2 million in 2022 from $18.7 million in 2021. See "Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations" for a reconciliation of adjusted EBITDA to its closest GAAP financial measure, net (loss) income.

At December 31, 2022, our current assets were $54.1 million, which included $3.4 million of cash and cash equivalents. Current liabilities were $30.4 million at year end 2022. Our stockholders' equity as of December 31, 2022 was $230.1 million.

Please see "Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations" for further information.

Our Operating Units

We identify our operating units based upon major revenue sources as Rental, Sales and Service and Maintenance.

Rental. Our rental compression units provide small, medium and large horsepower applications for unconventional oil and natural gas production. Our rental contracts typically provide for initial terms of six to 24 months, with our larger horsepower units having contract terms of up to 60 months. By outsourcing their compression needs, we believe our customers are able to increase their revenues by producing higher volumes of oil and natural gas due to greater equipment run time. Outsourcing allows our customers to reduce their compressor downtime, operating and maintenance costs, and capital investments, and more efficiently meet their changing compression needs. We maintain and service all of the compression equipment we rent to our customers.

The size, type and geographic diversity of our rental fleet enables us to provide our customers with a range of compression units that can serve a wide variety of applications, and to select the correct equipment for the job, rather than the customer trying to fit the job to its own equipment. We base our gas compressor rental rates on several factors, including the cost and size of the equipment, the type and complexity of service desired by the customer, the length of contract and the inclusion of any other services desired, such as installation, transportation and daily operation.

As of December 31, 2022, we had 1,869 natural gas compressors in our rental fleet totaling 425,340 horsepower. Of this total, we had 1,221 natural gas compressors totaling 318,350 horsepower rented to 81 customers. The utilization rate of our rental fleet as of December 31, 2022 was 65.3%, while our horsepower utilization for the same period was 74.8%. We added 45 units with approximately 33,000 horsepower to our fleet during 2022. Thirty-five of those units were 400 horsepower or larger, representing approximately 80% of the horsepower added.

Engineered Equipment Sales. This operating unit includes the following components:

- ***Compressor fabrication.*** Fabrication involves the design, fabrication and assembly of compressor components manufactured by us or other vendors into compressor units that are ready for rental or sale. In addition to fabricating compressors for our rental fleet, we engineer and fabricate custom-made natural gas compressors for sale to customers to meet their specifications based on well pressure, production characteristics and the particular applications for which compression is sought. Fabricated compressors comprised 42.0% and 27.5% of our sales revenue during 2022 and 2021, respectively.

- ***Parts sales and compressor rebuilds.*** To provide customer support for our compressor and flare sales businesses, we stock varying levels of replacement parts at our Midland, Texas facility and at field service locations. We also provide an exchange and rebuild program for small horsepower screw compressors and maintain an inventory of new and used compressors to facilitate this part of our business. Parts sales and compressor rebuilds comprised 55.2% and 67.2% of our sales revenue during 2022 and 2021, respectively.

- ***Flare fabrication.*** We design, fabricate, sell, install and service flare stacks and related ignition and control devices for the onshore and offshore incineration of gas compounds such as hydrogen sulfide, carbon dioxide, natural gas and liquefied petroleum gases. Applications for this equipment are often environmentally and regulatory driven.

- ***Compressor manufacturing.*** We design and manufacture our own proprietary line of reciprocating natural gas compressor frames, cylinders and parts known as our "CiP", or Cylinder-in-Plane, product line. We use the finished components to fabricate compressor units for our rental fleet or for sale to customers. We also sell finished components to other fabricators.

Service and Maintenance. We service and maintain compressors owned by our customers on an "as needed" and contract basis. Natural gas compressors require routine maintenance and periodic refurbishing to prolong their useful life. Routine maintenance includes physical and visual inspections and other parametric checks that indicate a change in the condition of the compressors. We perform engine and compressor overhauls on a condition-based interval or a time-based schedule or at the customer's request. Based on our past experience, these maintenance procedures maximize component life and unit availability and minimize downtime.

Business Strategy

Our long-term intentions to grow our revenue and profitability are based on the following business strategies:

- ***Expand rental fleet***. We intend to prudently increase the size of our medium and large horsepower rental fleet by fabricating compressor units in numbers that correspond to pre-contracted agreements with our customers and to market share gains we seek to achieve. We believe our future growth will be primarily driven through our placement of larger horsepower, centralized wellhead natural gas compressors for unconventional oil production, with select fabrication of medium horsepower compressors to meet customer demand beyond our inventory.

- ***Geographic expansion.*** We will continue to expand our operations in existing areas, as well as pursue focused expansion into new geographic regions as opportunities are identified. Our largest rental area is the Permian Basin (approximately 55.6% of rental revenues in 2022), where we have continued to gain market share and believe we have the most expansion opportunities going forward. The large majority of the Company's remaining rental revenue is being generated in other oil and natural gas producing regions and plays in Texas, New Mexico and Oklahoma, including the San Juan Basin, the Texas Panhandle/western Oklahoma, the Barnett Shale, and central Oklahoma. Other regions and plays in which we provide service include the Utica and Marcellus Shales, Michigan and the DJ Basin of Colorado.

- ***Selectively pursue acquisitions.*** We will continue to evaluate potential acquisitions, joint ventures and other opportunities that could enhance our current market position, but only those that provide compelling returns to the Company.

All of the above strategies are subject to revisions and adjustments as a result of several factors discussed in Item 1A, Risk Factors.

Competitive Strengths

We believe our competitive strengths include:

- ***Superior customer service.*** Our availability to provide a broad range of compressors has enabled us to effectively meet the evolving needs of our customers. We believe this ability, coupled with our personalized services and in-depth knowledge of our customers' operating needs and growth plans, have allowed us to enhance our relationships with existing customers as well as attract new customers. The size, type and geographic diversity of our rental fleet enable us to provide customers with a range of compression units that can serve a wide variety of applications. We are able to select the correct equipment for the job, rather than the customer trying to fit its application to our equipment.
- ***Diversified product line.*** Our compressors are available as low pressure rotary screw and higher pressure reciprocating packages. They are designed to meet a number of applications, including compression assisted gas lift on oil wells, wellhead compression on natural gas wells, natural gas gathering and transmission, and others. In addition, our compressors can be built to handle a variety of gas mixtures, including air, nitrogen, carbon dioxide, hydrogen sulfide and hydrocarbon gases. A diversified compression product line helps us compete by being able to satisfy widely varying pressure, volume and production conditions that customers encounter.
- ***Purpose-built rental compressors.*** Our rental compressor packages have been designed and built to address the primary requirements of our customers in the producing regions in which we operate. Our units are purpose-built but standardized, as the units are compact in design and are easy, quick and inexpensive to move, install and start-up. Our control systems are technically advanced, as these systems allow the operator to monitor as well as start and stop the majority of our units remotely and/or in accordance with well conditions.
- ***Experienced management and operating team.*** On average, our executive and operating team members have over 25 years of oilfield services and other energy industry experience. We believe our management and operating team has successfully demonstrated its ability to grow our business during times of expansion and to manage through downturns.
- ***Broad geographic presence.*** We presently provide our products and services to a customer base of oil and natural gas exploration and production companies operating in Texas, New Mexico, Oklahoma, Pennsylvania, West Virginia, Ohio, Michigan, Colorado and Wyoming. Our footprint allows us to service many of the largest oil and natural gas producing regions in the United States. We believe that operating in diverse geographic regions allows us better utilization of our compressors, minimal incremental expenses, operating synergies, volume-based purchasing, leveraged inventories and cross-trained personnel.
- ***Long-standing customer relationships.*** We have developed long-standing relationships providing compression equipment to many major and independent oil and natural gas companies. Our customers generally continue to rent our compressors after the expiration of the initial terms of our rental agreements, which we believe reflects their satisfaction with the reliability and performance of our services and products.

Overview and Outlook

The market for compression equipment and services is dependent on the condition of the oil and natural gas industry, including the capital expenditure budgets of domestic oil and gas companies. The level of activity and capital expenditures has generally been dependent upon the prevailing view of future gas and oil prices, which are influenced by numerous supply and demand factors, including availability and cost of capital, well productivity and development costs, global and domestic economic conditions, environmental regulations, policies of OPEC countries and Russia, and other factors. In addition, while overall capital budgets of E&P companies have increased relative to 2021, overall capital expenditure budgets of energy companies have become significantly more constrained over the last several years due to the deterioration of energy equity markets and strong demands from institutional investors that companies keep capital spending within operating cash flow and return capital through dividends and share repurchases. While our rental agreements are not typically capital in nature, overall capital investment typically drives our customers demand for incremental compression needs. Oil and natural gas prices and the level of development and production activity have historically been characterized by significant volatility.

Finally, due to supply chain disruptions as a result of the COVID-19 pandemic and the Russian invasion of the Ukraine and the increased rate of inflation, we continue to experience cost increases and sporadic unavailability of many of our parts needed to fabricate and maintain our rental fleet. While we have a robust supplier network, pricing pressure from our customers and competitors presents challenges in increasing our rental rates to offset these increased costs. We believe our relationship with our major customer identified below continues to be strong, and it has continued to pay our invoices in a timely, consistent manner. Nevertheless, if any of these circumstances change, our business could be adversely affected. Please read Item 1A, Risk Factors, in this report.

Major Customer

Sales and rental income to Occidental Permian, LTD. ("Oxy") for the years ended December 31, 2022 and 2021 amounted to 42% and 40% of our revenue, respectively. No other single customer accounted for more than 10% of our revenues in 2022 or 2021.

Oxy amounted to 55% of our accounts receivable as of December 31, 2022 and 46% of our accounts receivable as of December 31, 2021. No other customers amounted to more than 10% of our accounts receivable as of December 31, 2022 or 2021. The loss of this key customer would have a material adverse effect on our business, financial condition, results of operations and cash flows, depending upon the demand for our compressors at the time of such loss and our ability to attract new customers.

Sales and Marketing

Our sales force pursues the rental and sales market for compressors and flare equipment and other services in their respective territories. Additionally, our personnel coordinate with each other to develop relationships with customers who operate in multiple regions. Our sales and marketing strategy is focused on communication with current customers and potential customers through frequent direct contact, technical assistance, print literature, direct mail and referrals. Our sales and marketing personnel coordinate with our operations personnel in order to promptly respond to and address customer needs. Our overall sales and marketing efforts concentrate on demonstrating our commitment to enhancing the customer’s cash flow through enhanced product design, fabrication, manufacturing, installation, operations, customer service and support.

Competition

We have a number of competitors in the natural gas compression segment, some of which have greater financial resources. We believe that we compete effectively on the basis of price, customer service, including the ability to place personnel in remote locations, flexibility in meeting customer needs, and quality and reliability of our compressors and related services.

Compressor industry participants can achieve significant advantages through increased size and geographic breadth. As the number of rental compressors in our rental fleet increases, the number of sales, support, and maintenance personnel required and the minimum level of inventory do not increase proportionately.

Backlog

As of December 31, 2022, we had no sales backlog compared to $1.5 million as of December 31, 2021. Sales backlog consists of firm customer orders for which a purchase or work order has been received, satisfactory credit or a financing arrangement exists, and delivery is scheduled. In addition, the major components of our compressors are acquired from suppliers through periodic purchase orders that currently require three to six months of lead time prior to delivery of the order.

Employees

As of December 31, 2022, we had 266 total employees, none of which are represented by a labor union. We believe we have good relations with our employees.

Liability and Other Insurance Coverage

Our equipment and services are provided to customers who are subject to hazards inherent in the oil and natural gas industry, such as explosions, fires, and oil spills. We maintain liability insurance that we believe is customary in the industry and which includes environmental cleanup, but excludes product warranty insurance because the majority of components on our compressor unit are covered by the manufacturers. We also maintain insurance with respect to our facilities. Based on our historical experience, we believe that our insurance coverage is adequate. However, there is a risk that our insurance may not be sufficient to cover any particular loss or that insurance may not cover all losses. In addition, insurance rates have in the past been subject to wide fluctuation, and changes in coverage could result in less coverage, increases in cost or higher deductibles and retentions.

Government Regulation

All of our operations and facilities are subject to numerous federal, state, foreign and local laws, rules and regulations related to various aspects of our business, including containment and disposal of hazardous materials, water quality and wastewater discharges, oilfield waste and other waste materials and protection of human health.

To date, we have not been required to expend significant resources in order to satisfy applicable environmental laws and regulations. We do not anticipate any material capital expenditures for environmental control facilities or extraordinary expenditures to comply with environmental rules and regulations in the foreseeable future. However, compliance costs under existing laws or under any new requirements could become material and we could incur liabilities for noncompliance. And as noted below, we may be indirectly affected by environmental laws that affect our customers.

Our business is generally affected by political developments and by federal, state, foreign and local laws and regulations, which relate to the oil and natural gas industry. The adoption of laws and regulations affecting the oil and natural gas industry for economic, environmental and other policy reasons could increase our costs and could have an adverse effect on our operations. The state and federal environmental laws and regulations that currently apply to our operations could become more stringent in the future.

We have utilized operating and disposal practices that were or are currently standard in the industry. However, materials such as solvents, thinner, waste paint, waste oil, wash down waters and sandblast material may have been disposed of or released in or under properties currently or formerly owned or operated by us or our predecessors. In addition, some of these properties have been operated by third parties over whom we have no control either as to such entities' treatment of materials or the manner in which such materials may have been disposed of or released.

The federal Comprehensive Environmental Response Compensation and Liability Act of 1980, commonly known as CERCLA, and comparable state statutes impose strict liability on:

- owners and operators of sites, and
- persons who disposed of or arranged for the disposal of "hazardous substances" found at sites.

The modification of existing laws or regulations or the adoption of new laws or regulations that result in the curtailment of exploratory or developmental drilling for oil and gas could materially and adversely affect our operations by discouraging our customers from drilling for hydrocarbons, disrupting revenue through permitting or similar delays. For example, on January 20, 2021, the Acting Secretary for the Department of the Interior signed an order effectively suspending new fossil fuel leasing and permitting on federal lands, including in the US Gulf of Mexico, for 60 days. Then on January 27, 2021, President Biden issued an executive order indefinitely suspending new oil and natural gas leases on public lands or in offshore waters pending completion of a comprehensive review and reconsideration of federal oil and gas permitting and leasing practices. Demand for our compression products and services could be diminished in connection with these initiatives. Further, to the extent that the review results in the development of additional restrictions on exploration and drilling, limitations on the availability of leases, or restrictions on the ability to obtain required permits, it could have a material adverse impact on our operations by reducing our customers’ compression needs and the demand for our services.

Further, as discussed below under the heading "Climate Change", President Biden has announced that he intends to take aggressive action to address climate-related issues and to set the United States on a path to be carbon-neutral by 2050.

Waste Management and Disposal

The federal Resource Conservation and Recovery Act ("RCRA") and analogous state laws and their implementing regulations govern the generation, transportation, treatment, storage and disposal of hazardous and non-hazardous solid wastes. During the course of our operations, we generate wastes (including, but not limited to, used oil, antifreeze, filters, paints and solvents) in quantities regulated under RCRA. The EPA and various state agencies have limited the approved methods of disposal for these types of wastes. CERCLA and analogous state laws and their implementing regulations impose strict, and under certain conditions, joint and several liability without regard to fault or the legality of the original conduct on classes of persons who are considered to be responsible for the release of a hazardous substance into the environment. These persons include current and past owners and operators of the facility or disposal site where the release occurred and any company that transported, disposed of, or arranged for the transport or disposal of the hazardous substances released at the site. Under CERCLA, such persons may be subject to joint and several liability for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources and for the costs of certain health studies. In addition, where contamination may be present, it is not uncommon for neighboring landowners and other third parties to file claims for personal injury, property damage and recovery of response costs allegedly caused by hazardous substances or other pollutants released into the environment.

We currently own or lease, and in the past have owned or leased, a number of properties that have been used in support of our operations for a number of years. Although we have utilized operating and disposal practices that were standard in the industry at the time, hydrocarbons, hazardous substances, or other regulated wastes may have been disposed of or released on or under the properties owned or leased by us or on or under other locations where such materials have been taken for disposal by companies sub-contracted by us. In addition, some of these properties may have been previously owned or operated by third parties whose treatment and disposal or release of hydrocarbons, hazardous substances or other regulated wastes was not under our control. These properties and the materials released or disposed thereon may be subject to CERCLA, RCRA and analogous state laws. Under such laws, we could be required to remove or remediate historical property contamination, or to perform certain operations to prevent future contamination. We are not currently under any order requiring that we undertake or pay for any cleanup activities. However, we cannot provide any assurance that we will not receive any such order in the future.

The Clean Water Act ("CWA") and the Oil Pollution Act of 1990 and implementing regulations govern:

- the prevention of discharges, including oil and produced water spills, and
- liability for drainage into waters.

The CWA and analogous state laws impose restrictions and strict controls with respect to the discharge of pollutants, including spills and leaks of oil and other substances, into waters of the United States. The discharge of pollutants into regulated waters and wetlands is prohibited, except in accordance with the terms of a permit issued by the EPA or an analogous state agency. The CWA also requires the development and implementation of spill prevention, control and countermeasures to help prevent the contamination of navigable waters in the event of a petroleum hydrocarbon spill or leak at hydrocarbon facilities. In addition, the CWA and analogous state laws require individual permits or coverage under general permits for discharges of storm water runoff from certain types of facilities. Federal and state regulatory agencies can impose administrative, civil and criminal penalties as well as other enforcement mechanisms for non-compliance with discharge permits or other requirements of the CWA and analogous state laws and regulations. Our compression operations do not generate process wastewaters that are discharged to waters of the U.S. However, the operations of our customers may generate such wastewaters subject to the CWA. While it is the responsibility of our customers to follow CWA regulations and obtain proper permits, violations of the CWA may indirectly impact our operations in a negative manner.

Safe Drinking Water Act. Some of our customers’ natural gas production is developed from unconventional sources that require hydraulic fracturing as part of the completion process. Legislation to amend the Safe Drinking Water Act (“SDWA”) to repeal the exemption for hydraulic fracturing from the definition of “underground injection” and require federal permitting and regulatory control of hydraulic fracturing, as well as legislative proposals to require disclosure of the chemical constituents of the fluids used in the fracturing process, have been proposed from time to time and the federal government continues to consider legislation to amend the SDWA. Some states have also proposed or adopted legislative or regulatory restrictions on hydraulic fracturing, including prohibitions on the practice. We cannot predict the future of such legislation and what additional, if any, provisions would be included. Additional levels of regulation or interpretation are adopted at the federal or state level could lead to increased operating costs and prohibitions or curtailment of current hydraulic practices could reduce demand for our compression services, which could materially adversely affect our results of operations and financial position.

Air Emissions

Our operations are also subject to federal, state, and local regulations. The Clean Air Act and implementing regulations and comparable state laws and regulations regulate emissions of air pollutants from various industrial sources and also impose various monitoring and reporting requirements, including requirements related to emissions from certain stationary engines, such as those on our compressor units. These laws and regulations impose limits on the levels of various substances that may be emitted into the atmosphere from our compressor units and require us to meet more stringent air emission standards and install new emission control equipment on all of our engines built after July 1, 2008.

For instance, in 2010, the U.S. Environmental Protection Agency ("EPA") published new regulations under the CAA to control emissions of hazardous air pollutants from existing stationary reciprocal internal combustion engines. In 2012, the EPA proposed amendments to the final rule in response to several petitions for reconsideration, which were finalized and became effective in 2013. The rule requires us to undertake certain expenditures and activities, including purchasing and installing emissions control equipment on certain compressor engines and/or purchasing certified engines from complaint manufacturers.

In recent years, the EPA has lowered the National Ambient Air Quality Standard ("NAAQs") for several air pollutants. For example, in 2013, the EPA lowered the annual standard for fine particulate matter from 15 to 12 micrograms per cubic meter. In 2015, the EPA published the final rule strengthening the standards for ground level ozone, and the states are expected to establish revised attainment/non-attainment regions. State implementation of the revised NAAQS could result in stricter permitting requirements, delay or prohibit our customers' ability to obtain such permits, and result in increased expenditures for pollution control equipment, which could negatively impact our customers' operations by increasing the cost of additions to equipment, and negatively impact our business.

In 2012, the EPA finalized rules that establish new air emission controls for oil and natural gas production and natural gas processing operations. Specifically, the EPA's rule package included New Source Performance Standards to address emissions of sulfur dioxide and volatile organic compounds ("VOCs") and a separate set of emission standards to address hazardous air pollutants frequently associated with oil and natural gas production and processing activities. The rules established specific new requirements regarding emissions from compressors and controls at natural gas processing plants, dehydrators, storage tanks and other production equipment as well as the first federal air standards for natural gas wells that are hydraulically fractured. The EPA has taken a number of steps to amend or expand on these regulations since 2012. For example, in June 2016, the EPA published New Source Performance Standards that require certain new, modified or reconstructed facilities in the oil and natural gas sector to reduce methane gas and VOC emissions. These standards expanded the 2012 standards by using certain equipment-specific emissions control practices, requiring additional controls for pneumatic controllers and pumps as well as compressors, and imposing leak detection and repair requirements for natural gas compressor and booster stations. In addition, in November 2021, the EPA proposed a rule to further reduce methane and VOC emissions from new and existing sources in the oil and gas sector. These standards, as well as any future laws and their implementing regulations, may impose stringent air permit requirements, or mandate the use of specific equipment or technologies to control emissions. We cannot predict the final regulatory requirements or the cost to comply with such requirements with any certainty.

We are also subject to air regulation at the state level. For example, sources of air emissions within Texas are controlled by the Texas Commission on Environmental Quality ("TCEQ"). Air emission sources that emit at greater than de minimis levels must obtain a permit prior to operation through the TCEQ. In addition, TCEQ has implemented revisions to certain air permit programs that significantly increase the air permitting requirements for new and certain existing oil and gas production and gathering sites for a number of counties in the Barnett Shale production area that established new emissions standards for engines, which impact the operation of specific categories of engines by requiring the use of alternative engines, compressor packages or the installation of aftermarket emissions control equipment. Expansion by the TCEQ of this type of program and the adoption of similar regulations in other states may increase our compliance costs.

Climate Change

In response to findings that emissions of carbon dioxide, methane and other Greenhouse Gases ("GHG") endanger public health and the environment, federal legislation has been drafted in Congress to reduce GHG emissions. At the federal level, the government could seek to pursue legislative, regulatory or executive initiatives that may impose significant restrictions on fossil-fuel exploration and production and use such as limitations or bans on hydraulic fracturing of oil and gas wells, bans or restrictions on new leases for production of minerals on federal properties, and imposing restrictive requirements on new pipeline infrastructure or fossil-fuel export facilities. Other energy legislation and initiatives could include a carbon tax, methane fee or cap and trade program. At the state level, many states, including the states in which we or our customers conduct operations, have adopted legal requirements that have imposed new or more stringent permitting, disclosure or well construction requirements on oil and gas activities. Further, although Congress has not passed such legislation, almost half of the states have begun to address GHG emissions, primarily through the planned development of emissions inventories or regional GHG cap and trade programs. Depending on the particular program, we could be required to control GHG emissions or to purchase and surrender allowances for GHG emissions resulting from our operations. The EPA has adopted regulations under existing provisions of the CAA that, among other things, establish construction and operating permit reviews for GHG emissions of certain large GHG emissions sources, including petroleum and natural gas facilities, such as natural gas transmission compression facilities that emit 25,000 metric tons or more of carbon dioxide equivalent per year. In addition, the Department of Transportation (the "DOT") has implemented GHG emissions limits on vehicles manufactured for operation in the United States.

At the international level, there is an agreement, the United Nations-sponsored "Paris Agreement," for nations to limit their GHG emissions through non-binding, individually-determined reduction goals every five years after 2020. President Biden pledged the renewed participation of the United States on his first day in office. In November 2021, the United States participated in the United Nations Climate Change Conference in Glasgow, Scotland, United Kingdom that resulted in a pact among approximately 200 countries, including the United States, called the Glasgow Climate Pact. Relatedly, the United States and European Union jointly announced the launch of the "Global Methane Pledge," which aims to cut global methane pollution at least 30% by 2030 relative to 2020 levels, including "all feasible reductions" in the energy sector. In conjunction with these pacts, the United States committed to an economy-wide target of reducing net greenhouse gas emissions by 50-52 percent below 2005 levels by 2030. Also in November 2021, President Biden signed a $1 trillion dollar infrastructure bill into law. The new infrastructure law includes several climate-focused investments, including upgrades to power grids to accommodate increased use of renewable energy and expansion of electric vehicle infrastructure. Although it is not possible at this time to predict what additional domestic legislation may be adopted in light of the Paris Agreement or the Glasgow Climate Pact, or how legislation or new regulations that may be adopted based on the Paris Agreement or the Glasgow Climate Pact to address GHG emissions would impact our business, any such future laws and regulations imposing reporting obligations on, or limiting emissions of GHGs from, our compressors could require us to incur costs to reduce emissions of GHGs associated with our operations and could decrease demand for oil and natural gas.

Additionally, various states and groups of states have adopted or are considering adopting legislation, regulations or other regulatory initiatives that are focused on such areas as GHG cap and trade programs, carbon taxes, reporting and tracking programs, and restriction of emissions. For example, in 2019, Colorado passed a bill which delegates authority to local governments to regulate oil and gas activities and requires the Colorado Oil and Gas Conservation Commission to minimize emissions of methane and other air contaminants. Likewise, the New Mexico Environment Department has adopted regulations to restrict the venting or flaring of methane.

Litigation risks are also increasing, as a number of cities and other local governments have sought to bring suit against the largest oil and natural gas exploration and production companies in state or federal court, alleging, among other things, that such companies created public nuisances by producing fuels that contributed to global warming effects, such as rising sea levels, and therefore are responsible for roadway and infrastructure damages, or alleging that the companies have been aware of the adverse effects of climate change for some time but defrauded their investors by failing to adequately disclose those impacts.

There are also increasing financial risks for fossil fuel producers and oil and gas field service providers (such as the Company) as shareholders currently invested in fossil-fuel energy and related service companies concerned about the potential effects of climate change may elect in the future to shift some or all of their investments into non-energy related sectors. Institutional lenders who provide financing to fossil-fuel energy and related companies also have become more attentive to sustainable lending practices and some of them may elect not to provide funding for fossil fuel energy companies. Additionally, the lending practices of institutional lenders have been the subject of intensive lobbying efforts in recent years, oftentimes public in nature, by environmental activists, proponents of the international Paris Agreement, and foreign citizenry concerned about climate change not to provide funding for fossil fuel producers. Limitation of investments in and financings for fossil fuel energy companies could result in the restriction, delay or cancellation of drilling programs or development or production activities of our customers, which in turn could have a material adverse effect on our compressor rental and sale business.

The adoption and implementation of new or more stringent international, federal or state legislation, regulations or other regulatory initiatives that impose more stringent standards for GHG emissions from the oil and natural gas sector or otherwise restrict the areas in which this sector may produce oil and natural gas or generate GHG emissions could result in increased costs of compliance or additional operating restrictions or reduced demand for our compressor products and services, and could have a material adverse effect on our business, financial condition and results of operations.

We believe that our existing environmental control procedures are adequate and that we are in substantial compliance with environmental laws and regulations, and the phasing in of emission controls and other known regulatory requirements should not have a material adverse affect on our financial condition or operational results. However, it is possible that future developments, such as new or increasingly strict requirements and environmental laws and enforcement policies there under, could lead to material costs of environmental compliance by us. While we may be able to pass on the additional cost of complying with such laws to our customers, there can be no assurance that attempts to do so will be successful. Some risk of environmental liability and other costs are inherent in the nature of our business, however, and there can be no assurance that environmental costs will not rise.

To the extent that new laws or other governmental actions restrict the energy industry or impose additional environmental protection requirements that result in increased costs to the oil and gas industry, we could be adversely affected. We cannot determine to what extent our future operations and earnings may be affected by new legislation, new regulations or changes in existing regulations.

Occupational Safety and Health

We are subject to the requirements of Occupational Safety and Health Administration ("OSHA") and comparable state statutes. These laws and the implementing regulations strictly govern the protection of the health and safety of employees. The OSHA hazard communication standard, the EPA community right-to-know regulations under Title III of CERCLA, and similar state statutes require that we maintain and/or disclose information about hazardous materials used or produced in our operations. We believe that we are in compliance with these applicable requirements and with other comparable laws.

Patents, Trademarks and Other Intellectual Property

We believe that the success of our business depends more on the technical competence, creativity and marketing abilities of our employees than on any individual patent, trademark, or copyright. Nevertheless, as part of our ongoing research, development and manufacturing activities, we may seek patents when appropriate on inventions concerning new products and product improvements. Although we continue to use technology that was previously covered by a patent and consider it useful in certain applications, we do not consider the expired patent to be material to our business as a whole.

Suppliers and Raw Materials

Fabrication of our rental compressors involves the purchase by us of engines, compressors, coolers and other components, and the assembly of these components on skids for delivery to customer locations. These major components of our compressors are acquired through periodic purchase orders placed with third-party suppliers on an "as needed" basis, which typically requires a three to six month lead time with delivery dates scheduled to coincide with our estimated production schedules. Although we do not have formal continuing supply contracts with any major supplier, we believe we have adequate alternative sources available. In the past, we have not experienced any sudden and dramatic increases in the prices of the major components for our compressors. However, the occurrence of such an event could have a material adverse effect on the results of our operations and financial condition, particularly if we are unable to increase our rental rates and sale prices proportionate to any such component price increases.

In addition, the COVID-19 outbreak and subsequent supply chain disruptions has increased the risk that our suppliers may be prevented from conducting their business at sufficient levels to provide us with necessary equipment and supplies in a timely and sufficient amount. While we have experienced no significant supply disruptions that materially disrupted operations, to the extent we have difficulties in obtaining needed products and supplies in a timely manner, our results of operations and financial position may be adversely affected.

Available Information

We use our website as a channel of distribution for Company information. We make available free of charge on the Investor Relations section of our website (www.ngsgi.com) our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K. We also make available through our website other reports filed with or furnished to the SEC under the Securities Exchange Act of 1934, as amended, including our proxy statements and reports filed by officers and directors under Section 16(a) of the Exchange Act, as well as our Code of Business Ethics and the charters to our various Committees of our Board of Directors. Paper copies of our filings are also available, without charge upon written request. Please mail requests to Natural Gas Services Group, Inc., 404 Veterans Airpark Lane, Suite 300, Midland, TX 79705. The information contained on our website is not part of this Report.

ITEM 1A. RISK FACTORS

You should carefully consider the following risks associated with owning our common stock. Although the risks described below are the risks that we believe are material, they are not the only risks relating to our industry, our business and our common stock. Additional risks and uncertainties, including those that we have not yet identified or that we currently believe are immaterial, may also adversely affect our business, financial condition or results of operations.

Risks Associated With Our Industry

Decreased oil and natural gas prices and oil and gas industry expenditure levels adversely affect our revenue.

Our revenue is derived primarily from expenditures in the oil and natural gas industry, which, in turn, are based on budgets to explore for, develop and produce oil and natural gas. When these expenditures decline, as they have at various times during the past several years, our revenue will suffer. The industry’s willingness to explore for, develop and produce oil and natural gas depends largely upon the prevailing view of future oil and natural gas prices. Prices for oil and natural gas historically have been, and are likely to continue to be, highly volatile. Many factors affect the supply and demand for oil and natural gas and, therefore, influence oil and natural gas prices, including:

- the level of oil and natural gas production;
- the level of oil and natural gas inventories;
- domestic and worldwide demand for oil and natural gas;
- the expected cost of developing new reserves;
- the cost of producing oil and natural gas;
- the level of drilling and completions activity;
- inclement weather;
- domestic and worldwide economic activity;
- regulatory and other federal and state requirements in the United States;
- the ability of the Organization of Petroleum Exporting Countries, national oil companies and other large producers to set and maintain production levels and prices for oil;
- political conditions in or affecting oil and natural gas producing countries;
- terrorist activities in the United States and elsewhere;
- the cost of developing alternative energy sources;
- environmental regulation; and
- tax policies.

Our rental contracts are generally short-term, and oil and natural gas companies tend to respond quickly to upward or downward changes in prices. Any prolonged reduction in drilling and production activities historically has reduced our compressor sales and materially eroded both rental pricing and utilization rates for our equipment and services and adversely affects our financial results. As a result of any such prolonged reductions, we may suffer losses, be unable to make necessary capital expenditures and be unable to meet our financial obligations.

The intense competition in our industry could result in reduced profitability and loss of market share for us.

We compete with the oil and natural gas industry’s largest equipment and service providers who have greater name recognition than we do. These companies also have substantially greater financial resources, larger operations and greater budgets for marketing, research and development than we do. They may be better able to compete because of their broader geographic dispersion and ability to take advantage of international opportunities, the greater number of compressors in their fleet or their product and service diversity. As a result, we could lose customers and market share to those competitors. These companies may also be better positioned than us to successfully endure downturns in the oil and natural gas industry.

Our operations may be adversely affected if our current competitors or new market entrants introduce new products or services with better prices, features, performance or other competitive characteristics than our products and services. Competitive pressures or other factors also may result in significant price competition that could harm our revenue and our business. Additionally, we may face competition in our efforts to acquire other businesses.

Adverse macroeconomic and business conditions may significantly and negatively affect our results of operations.

As a result of the COVID-19 outbreak and other economic conditions in the United States and abroad, our revenue and profitability has been adversely affected. The condition of domestic and global financial markets and the potential for disruption and illiquidity in the credit markets could have an adverse effect on our operating results and financial condition, and if sustained for an extended period, such adverse effects could also become significant. Uncertainty and turmoil in the credit markets may negatively impact the ability of our customers to finance purchases of our products and services and could result in a decrease in, or cancellation of, orders included in our backlog or adversely affect the collectability of our receivables. If the availability of credit to our customers is reduced, they may reduce their drilling and production expenditures, thereby decreasing demand for our products and services, which could have a negative impact on our financial condition. A prolonged period of depressed prices for oil and natural gas would likely result in delays or cancellation of projects by our customers, reducing the demand for our products and services.

Additionally, if we are not able to pass along increases to our costs due to inflation on parts, fluids, labor and other aspects of our business, it may adversely affect our results of operations and cash flows.

A reduction in demand for oil could adversely affect our business.

Our results of operations depend upon the level of activity in the energy market, including oil development, production, and transportation. Oil and natural gas prices and the level of drilling and exploration activity can be volatile. As a result, the demand for our natural gas compression services will be adversely affected. A reduction in demand has, and could continue to, force us to reduce our pricing substantially. Additionally, our customers' production from oil-weighted reserves constitutes the majority percentage of our business. These unconventional sources are generally less economically feasible to be developed in low oil price environments. A decline in demand for oil and natural gas generally has an adverse effect on our business, financial condition and results of operations.

Our industry is highly cyclical, and our results of operations may be volatile.

Our industry is highly cyclical, with periods of high demand and high pricing followed by periods of low demand and low pricing. Periods of low demand intensify the competition in the industry and often result in rental equipment being idle for long periods of time. We have been required to enter into lower rate rental contracts in response to market conditions and our rentals and sales revenue have decreased as a result of such conditions. Due to the short-term nature of most of our rental contracts, changes in market conditions can quickly affect our business. As a result of the cyclicality of our industry, we anticipate our results of operations will be volatile in the future.

Increased regulation or ban of current fracturing techniques could reduce demand for our compressors.

From time to time, for example, legislation has been proposed in Congress to amend the federal Safe Drinking Water Act ("SDWA") to require federal permitting of hydraulic fracturing and the disclosure of chemicals used in the hydraulic fracturing process. Further, the EPA completed a study finding that hydraulic fracturing could potentially harm drinking water resources under adverse circumstances such as injection directly into groundwater or into production wells lacking mechanical integrity. Further, legislation to amend the SDWA to repeal the exemption for hydraulic fracturing (except when diesel fuels are used) from the definition of "underground injection" and require federal permitting and regulatory control of hydraulic fracturing, as well as legislative proposals to require disclosure of the chemical constituents of the fluids used in the fracturing process, have been proposed in recent sessions of Congress. Several states and local jurisdictions also have adopted or are considering adopting regulations that could restrict or prohibit hydraulic fracturing in certain circumstances, impose more stringent operating standards and/or require the disclosure of the composition of hydraulic fracturing fluids. While we do not perform hydraulic fracturing, many of our customers do and their activity level drives demand for our products.

More recently, federal and state governments have begun investigating whether the disposal of produced water into underground injection wells has caused increased seismic activity in certain areas. The results of these studies could lead federal and state governments and agencies to develop and implement additional regulations.

A ban of hydraulic fracturing would likely halt some projects, including unconventional projects, at least temporarily. Expanded regulations are likely to introduce a period of uncertainty as companies determine ways to proceed. Any curtailment could result in a reduction of demand for our compressors, potentially affecting both sales and rentals of our units.

We are subject to extensive environmental laws and regulations that could require us to take costly compliance actions that could harm our financial condition.

Our fabrication and maintenance operations are significantly affected by stringent and complex federal, state and local laws and regulations governing the discharge of substances into the environment or otherwise relating to environmental protection. In these operations, we generate and manage hazardous wastes such as solvents, thinner, waste paint, waste oil, wash down wastes, and sandblast material. We attempt to use generally accepted operating and disposal practices and, with respect to acquisitions, will attempt to identify and assess whether there is any environmental risk before completing an acquisition. Based on the nature of the industry, however, hydrocarbons or other wastes may have been disposed of or released on or under properties owned or leased by us or on or under other locations where such wastes have been taken for disposal. The waste on these properties may be subject to federal or state environmental laws that could require us to remove the wastes or remediate sites where they have been released. We could be exposed to liability for cleanup costs, natural resource and other damages as a result of our conduct or the conduct of, or conditions caused by, prior owners, lessees or other third parties. Environmental laws and regulations have changed in the past, and they are likely to change in the future. If current existing regulatory requirements or enforcement policies change, we may be required to make significant unanticipated capital and operating expenditures.

Any failure by us to comply with applicable environmental laws and regulations may result in governmental authorities taking actions against our business that could harm our operations and financial condition, including the:

- issuance of administrative, civil and criminal penalties;
- denial or revocation of permits or other authorizations;
- reduction or cessation in operations; and
- performance of site investigatory, remedial or other corrective actions.

Increasing attention to environmental, social and governance matters and future related reporting requirements may impact our business, financial results and stock price.

In recent years, increasing attention has been given to corporate activities related to environmental, social and governance (“ESG”) matters in public discourse and the investment community. A number of advocacy groups, both domestically and internationally, have campaigned for governmental and private action to promote change at public companies related to ESG matters, including through the investment and voting practices of investment advisers, public pension funds, universities and other members of the investing community. These activities include increasing attention and demands for action related to climate change and energy transition matters, such as promoting the use of substitutes to fossil fuel products and encouraging the divestment of fossil fuel equities, as well as pressuring lenders and other financial services companies to limit or curtail activities with fossil fuel companies.

Members of the investment community have begun to screen companies for sustainability performance, including practices related to climate change. In addition, organizations that provide information to investors on corporate governance and related matters have developed ratings systems for evaluating companies on their approach to ESG matters. These ratings are used by some investors to inform their investment and voting decisions. Unfavorable ESG ratings may lead to increased negative investor sentiment toward us and our industry and to the diversion of investment to other industries, which could have a negative impact on our stock price and our access to and costs of capital.

Regulatory requirements related to ESG or sustainability reporting have been issued in the European Union that apply to financial market participants. In the United States, such regulations have been issued related to pension investments in California, and for the responsible investment of public funds in Illinois. Additional regulation is pending in other states. We expect regulatory requirements related to ESG matters to continue to expand globally. If we are not able to meet future sustainability reporting requirements of regulators or current and future expectations of investors, customers or other stakeholders, our business and ability to raise capital may be adversely affected.

Increasing attention to climate change, increasing societal expectations on companies to address climate change, and potential consumer use of substitutes to energy commodities may result in increased costs, reduced demand for our customers’ hydrocarbon products which will likely translate to reduced demand for compression services, reduced profits, increased investigations and litigation, increased governmental regulations and negative impacts on our stock price and access to capital markets.

International, national and state governments and agencies continue to evaluate and promulgate legislation and regulations that are focused on restricting greenhouse gas (GHG) emissions. Compliance with climate action regulations applicable to our customers' operations may have significant implications that could adversely affect our business and operating results in the fossil fuel sectors, and boosting demand for technologies contributing to the climate action agenda.

In the United States, the U.S. Environmental Protection Agency (EPA) has taken steps to regulate GHG emissions as air pollutants under the U.S. Clean Air Act of 1970, as amended. The EPA's Greenhouse Gas Reporting Rule requires monitoring and reporting of GHG emissions from, among others, certain mobile and stationary GHG emission sources in the oil and natural gas industry. In addition, the U.S. government has proposed rules in the past setting GHG emissions standards for, or otherwise aimed at reducing GHG emissions from, the oil and natural gas industry. Caps or fees on carbon emissions, including in the U.S., have been and may continue to be established and the cost of such caps or fees could disproportionately affect the fossil fuel sectors. We are unable to predict whether and when the proposed changes in laws or regulations ultimately will occur or what they ultimately will require, and accordingly, we are unable to assess the potential financial or operational impact they may have on our business. Other developments focused on restricting GHG emissions include the Regional Greenhouse Gas Initiative, the Western Climate Action initiative, and various state programs implementing the California Global Warming Solutions Act of 2006 (known as Assembly Bill 32).

Requirements and voluntary initiatives to reduce greenhouse gas emissions, as well as increased climate change awareness, may result in increased costs for the oil and gas industry to curb greenhouse gas emissions and could have an adverse impact on demand for oil and natural gas.

International, national, and state governments, agencies and bodies continue to evaluate and promulgate regulations and voluntary initiatives that are focused on restricting GHG emissions. These requirements and initiatives are likely to become more stringent over time and to result in increased costs for the oil and gas industry to curb GHG emissions. In addition, these developments, and public perception relating to climate change, may curtail production and demand for hydrocarbons such as oil and natural gas by shifting demand towards and investment in relatively lower carbon energy sources such as wind, solar and alternative energy solutions. If renewable energy becomes more competitive than fossil-fuel energy globally, it could have a material effect on our results of operations.

The potential for climate related changes may pose future risks to our operations and those of our customers.

These changes can include extreme variability in weather patterns such as increased frequency and severity of significant weather events (e.g. flooding, hurricanes and tropical storms), natural hazards (e.g., increased wildfire risk), rising mean temperature and sea levels, and long-term changes in precipitation patterns (e.g. drought, desertification, or poor water quality). Such changes have the potential to affect business continuity and operating results, particularly at facilities in coastal areas or areas prone to chronic water scarcity.

Risks Associated With Our Company

A significant majority of our compressor rentals are for terms of six months or less which, if terminated or not renewed, would adversely impact our revenue and our ability to recover our initial equipment costs.

The length of our compressor rental agreements with our customers varies based on customer needs, equipment configurations and geographic area. In most cases, under currently prevailing rental rates, the initial rental periods are not long enough to enable us to fully recoup the average cost of acquiring or fabricating the equipment. Of the 1,221 compressors rented at December 31, 2022, 841 were rented on a month-to-month basis. Given the volatility of the oil and gas market, we cannot be sure that a substantial number of our customers will continue to renew their rental agreements or that we will be able to re-rent the equipment to new customers or that any renewals or re-rentals will be at comparable rental rates. The inability to timely renew or re-rent a substantial portion of our compressor rental fleet has and will have a material adverse effect upon our business, financial condition, results of operations and cash flows.

We could be subject to substantial liability claims that could harm our financial condition.

Our products are used in production applications where an accident or a failure of a product can cause personal injury, loss of life, damage to property, equipment or the environment, or suspension of operations. While we maintain insurance coverage, we face the following risks under our insurance coverage:

- we may not be able to continue to obtain insurance on commercially reasonable terms;

- we may be faced with types of liabilities that will not be covered by our insurance, such as damages from significant product liabilities and from environmental contamination;
- the dollar amount of any liabilities may exceed our policy limits; and
- we do not maintain coverage against the risk of interruption of our business.

Any claims made under our policies will likely cause our premiums to increase. Any future damages caused by our products or services that are not covered by insurance, are in excess of policy limits or are subject to substantial deductibles, would reduce our earnings and our cash available for operations.

A significant amount of our revenues and accounts receivable are related to one customer and a loss of this customer or other current customers could adversely affect our results of operations.

Our business is dependent not only on securing new customers but also on maintaining current customers. We had one customer that accounted for an aggregate of approximately 42% of our revenue for the year ended December 31, 2022, and the same customer accounted for an aggregate of approximately 40% of our revenue for the year ended December 31, 2021. At December 31, 2022, this same customer accounted for an aggregate of 55% of our accounts receivable. Unless we are able to retain our existing customers, or secure new customers if we lose one or more of our significant customers, our revenue and results of operations would be adversely affected. In addition, the default on payments by our significant customer or other important customers would negatively impact our cash flow and current assets.

Loss of key members of our management could adversely affect our business.

In keeping with our streamlined approach to our business, our executive management team consists of three officers: our (i) Chief Executive Officer, (ii) Chief Financial Officer and (iii) Vice President of Technical Services. Stephen C. Taylor, our Interim President and Chief Executive Officer who has been our President, Chief Executive Officer and Board member since 2004, has announced his intention to retire as an officer from the Company effective June 30, 2023. We currently have an Interim Chief Financial Officer after the resignation of our prior Chief Financial Officer on February 28, 2023. If either of these positions are not adequately or timely replaced, our business operations could be materially adversely affected. We do not carry any key-man insurance on any of our officers or directors.

The erosion of the financial condition of our customers could adversely affect our business.

Many of our customers finance their exploration and development activities through cash flow from operations, the incurrence of debt or the issuance of equity. During times when the oil or natural gas markets are weak, our customers are more likely to experience a downturn in their financial condition. Many of our customers’ equity values and liquidity substantially declined during the most recent fall in oil and natural gas prices, and in some cases access to capital markets may be an unreliable source of financing for some customers. The combination of a reduction in cash flow resulting from declines in commodity prices, an increase in the interest rates charged for debt incurrence, a reduction in borrowing bases under reserve-based credit facilities and the lack of availability of debt or equity financing may result in a reduction in our customers’ spending for our products and services in 2023. For example, our customers could seek to preserve capital by canceling month-to-month contracts, canceling or delaying scheduled maintenance of their existing natural gas compression equipment or determining not to enter into any new natural gas compression service contracts or purchase new compression equipment.

We might be unable to employ qualified technical personnel, which could hamper our present operations or increase our costs.

Many of the compressors that we sell or rent are mechanically complex and often must perform in harsh conditions. We believe that our success depends upon our ability to employ and retain a sufficient number of technical personnel who have the ability to design, utilize, enhance and maintain these compressors. Our ability to maintain and expand our operations depends in part on our ability to utilize and increase our skilled labor force. The demand for skilled workers is high, and supply is limited. A significant increase in the wages paid by competing employers could result in a reduction of our skilled labor force or cause an increase in the wage rates that we must pay or both. If either of these events were to occur, our cost structure could increase and our operations and growth potential could be impaired.

We may require a substantial amount of capital to expand our compressor rental fleet and grow our business.

During 2023, the amount we will spend on capital expenditures related to rental compression equipment will be determined primarily by the activity of our customers, our financial resources and access to capital. The amount and timing of any capital expenditures may vary depending on a variety of factors, including the level of activity in the oil and natural gas exploration and production industry and the presence of alternative uses for our capital, including any acquisitions that we may pursue.

During the past year, we funded our capital expenditures through cash flows from operations and borrowings from our revolving credit facility. Although we believe that cash on hand, cash flows from our operations and bank borrowing from revolving credit facility will provide us with sufficient cash to fund our planned capital expenditures for 2023, we cannot assure you that these sources will be sufficient. We may require additional capital to fund any significant unanticipated capital expenditures, such as a material acquisition. To the extent we would require any necessary capital, it may not be available to us when we need it or on acceptable terms. Our ability to raise additional capital will depend on the results of our operations and the status of various capital and industry markets at the time we seek such capital. Failure to generate sufficient cash flow, together with the absence of alternative sources of capital, could have a material adverse effect on our business, financial condition, results of operations or cash flow.

Our debt levels may negatively impact our current and future financial stability.

In February 2023, we significantly increased the borrowing commitment of our revolving credit facility from $50 million to $175 million (subject to borrowing base limitation and customary covenants) and at December 31, 2022 we had $25 million outstanding on the revolving credit facility and anticipate additional significant borrowing on the facility through 2023. Should we utilize our full debt capacity growth beyond that point could be impacted. As a result of our indebtedness at any given point in time, we might not have the ability to incur any substantial additional indebtedness. The level of our indebtedness could have several important effects on our future operations, including:

- our ability to obtain additional financing for working capital, acquisitions, capital expenditures and other purposes may be limited;
- a significant portion of our cash flow from operations may be dedicated to the payment of principal and interest (which is variable on our revolving credit facility) on our debt, thereby reducing funds available for other purposes; and
- our leverage if increased to an unacceptable level, could make us more vulnerable to economic downturns.

If we borrow under our credit line and are unable to service our debt, we will likely be forced to take remedial steps that are contrary to our business plan.

If we were to materially borrow under our line of credit or other borrowing arrangements, it is possible that our business will not generate sufficient cash flow from operations to meet any debt service requirements and the payment of principal when due depending on the amount of borrowings at any given time. If this were to occur, we may be forced to:

- sell assets at disadvantageous prices;
- obtain additional financing; or
- refinance all or a portion of our indebtedness on terms that may be less favorable to us.

Our current credit agreement contains covenants that limit our operating and financial flexibility and, if breached, could expose us to severe remedial provisions.

Under the terms of our current credit agreement, we must:

- comply with various leverage, commitment coverage and other customary ratios;
- not exceed specified levels of debt
- comply with limits on asset sales;
- comply with limits on cash dividends;
- and other customary limitations.

Our ability to meet the financial ratios and tests under our credit agreement can be affected by events beyond our control, and we may not be able to satisfy those ratios and tests. A breach of any one of these covenants or requirements could permit the lending organization to accelerate outstanding amounts so that it is immediately due and payable. If a breach occurs, no further borrowings would be available under our credit arrangement. If we are unable to repay any outstanding amounts, the lending organization could proceed against and foreclose on the assets we pledged as collateral to secure payment of our indebtedness.

If we fail to acquire or successfully integrate additional businesses, our growth may be limited and our results of operations may suffer.

As part of our business strategy, we evaluate potential acquisitions of other businesses or assets. However, there can be no assurance that we will be successful in consummating any such acquisitions. Successful acquisition of businesses or assets will depend on various factors, including, but not limited to, our ability to obtain financing and the competitive environment for acquisitions. In addition, we may not be able to successfully integrate any businesses or assets that we acquire in the future. The integration of acquired businesses is likely to be complex and time consuming and place a significant strain on management and may disrupt our business. We also may be adversely impacted by any unknown liabilities of acquired businesses, including environmental liabilities. We may encounter substantial difficulties, costs and delays involved in integrating common accounting, information and communication systems, operating procedures, internal controls and human resources practices, including incompatibility of business cultures and the loss of key employees and customers. These difficulties may reduce our ability to gain customers or retain existing customers, and may increase operating expenses, resulting in reduced revenues and income and a failure to realize the anticipated benefits of acquisitions.

Failure to effectively manage our business and growth could adversely affect our operating results and our internal controls.

Our strategy envisions the expansion and growth of our business, subject to the demand for oil and gas and the impact of the other risks set forth in this risk factor section and elsewhere in this Report. Growth may place a strain on our management systems and resources. We must continue to refine and expand our business capabilities, our systems and processes, and our access to financing sources. If we expand, we must continue to hire, train, supervise and manage new employees. We cannot assure that we will be able to:

- meet our capital needs;
- upgrade and expand our office and manufacturing infrastructure so that it is appropriate for our level of activity;
- expand our systems effectively or efficiently or in a timely manner, including financial and management controls, reporting systems and procedures; and
- attract, hire, train and retain additional highly skilled and motivated officers and employees and allocate our human resources optimally.

If we are unable to manage our growth, our financial conditions and results of operations may be adversely affected.

Liability to customers under warranties and indemnification provisions may materially and adversely affect our results of operations.

We provide warranties as to the proper operation and conformance to specifications of the equipment we manufacture. Our equipment is complex and often deployed in harsh environments. Failure of this equipment to operate properly or to meet specifications may increase our costs by requiring additional engineering resources and services, replacement of parts and equipment or monetary reimbursement to a customer. We have in the past received warranty claims and we expect to continue to receive them in the future. To the extent that we incur substantial warranty claims in any period, our reputation, our ability to obtain future business and our results of operations could be materially and adversely affected.

Our rental and sales contracts provide for varying forms of indemnification from our customers and in most cases may require us to indemnify our customers. Under some of our rental and sales contracts, liability with respect to personnel and property is customarily assigned on a “knock-for-knock” basis, which means that we and our customers assume liability for our respective personnel and property. However, in certain rental and sales contracts we assume liability for damage to our customer’s property and other third-party on the site resulting from our negligence. Since our products are used in production applications in the energy industry, expenses and liabilities in connection with accidents involving our products and services could be extensive and may exceed our insurance coverages.

Our income taxes may change.

We are subject to income tax on a jurisdictional or legal entity basis and significant judgment is required in certain instances to allocate our taxable income to a jurisdiction and to determine the related income tax expense and benefits. Losses in one jurisdiction generally may not be used to offset profits in other jurisdictions. As a result, changes in the mix of our earnings (or losses) between jurisdictions, among other factors, could alter our overall effective income tax rate, possibly resulting in significant tax rate increases.

We are regularly audited by various tax authorities. Income tax audit assessments or changes in tax laws, regulations, or other interpretations may result in increased tax provisions which could materially affect our operating results in the period or periods in which such determinations are made or changes occur.

Failure to maintain effective internal controls could have a material adverse effect on our operations.

Section 404 of the Sarbanes-Oxley Act requires annual management assessments of the effectiveness of our internal control over financial reporting. If we fail to maintain effective internal controls, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Moreover, effective internal controls are necessary for us to produce reliable financial reports and to help prevent financial fraud. If, as a result of deficiencies in our internal controls, we cannot provide reliable financial reports or prevent fraud, our business decision process may be adversely affected, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the price of our stock could decrease as a result.

We are exposed to risks related to computer systems failures or cyber security threats

In the conduct of our business we are dependent upon our computing systems and those of third parties to collect, store, transmit and process data used in our operational activities and to record, process and track financial transactions. If interruptions were to occur we would be unable to access these systems for a period of time and there is a risk of data loss. Data backup and storage measures are in place that would allow recovery in a time frame that we believe would not materially impact our ability to conduct business.

We are also subject to cyber security attacks and have taken steps to minimize the probability of an attack penetrating our systems. These include network security, virus protection, filtering software and intrusion protection measures.

Risks Associated With Our Common Stock

The price of our common stock may fluctuate.

The trading price of our common stock and the price at which we may sell securities in the future are subject to substantial fluctuations in response to various factors, including our ability to successfully accomplish our business strategy, the trading volume of our stock, changes in governmental regulations, actual or anticipated variations in our quarterly or annual financial results, our involvement in litigation, general market conditions, the prices of oil and natural gas, announcements by us and our competitors, our liquidity, our ability to raise additional funds, and other events such as those discussed in the factors above.

Future sales of our common stock could adversely affect our stock price.

Substantial sales of our common stock in the public market, or the perception by the market that those sales could occur, may lower our stock price or make it difficult for us to raise additional equity capital in the future. According to filings made with the Securities and Exchange Commission in February 2022, an aggregate of approximately 38.1% of the outstanding shares of our common stock are owned by five institutional investors, each of which owns more than 5% of our outstanding shares as of the date of their respective filings in February 2022. Potential sales of large amounts of these shares in a short period of time by one or more of these significant investors could have a negative impact on our stock price. In addition, potential sales of our common stock by our directors and officers, who beneficially own approximately 6.9% of the outstanding shares of our common stock as of March 28, 2023, and because of the negative perception of sales by insiders, could also have a negative impact on our stock price.

We have a comparatively low number of shares of common stock outstanding and, therefore, our common stock may suffer from limited liquidity and its prices will likely be volatile and its value may be adversely affected.

Because of our relatively low number of outstanding shares of common stock, the trading price of our common stock will likely be subject to significant price fluctuations and limited liquidity. This may adversely affect the value of your investment. In addition, our common stock price is subject to fluctuations in response to variations in quarterly operating results, changes in management, future announcements concerning us, general trends in the industry and other events or factors such as those described above.

If we issue debt or equity securities, you may lose certain rights and be diluted.

If we raise funds in the future through the issuance of debt or equity securities, the securities issued may have rights and preferences and privileges senior to those of holders of our common stock, and the terms of the securities may impose restrictions on our operations or dilute your ownership in our Company.

We currently have on file with the SEC an effective "universal" shelf registration statement on Form S-3, which enables us to sell, from time to time, our common stock and other securities covered by the registration statement in one or more public offerings. The shelf registration statement allows us to enter the public markets and consummate sales of the registered securities in rapid fashion and with little or no notice. Issuances of securities under our shelf registration statement may dilute our existing shareholders.

If securities analysts downgrade our stock or cease coverage of us, the price of our stock could decline.

The trading market for our common stock relies in part on the research and reports that industry or financial analysts publish about us or our business. We do not control these analysts. Furthermore, there are many large, well-established, publicly traded companies active in our industry and market, which may mean that it is less likely that we will receive widespread analyst coverage. If one or more of the analysts who do cover us downgrade our stock, our stock price would likely decline rapidly. If one or more of these analysts cease coverage of our company, we could lose visibility in the market, which in turn could cause our stock price to decline.

Provisions contained in our governing documents could hinder a change in control of us.

Our articles of incorporation and bylaws contain provisions that may discourage acquisition bids and may limit the price investors are willing to pay for our common stock. Our articles of incorporation and bylaws provide that:

- directors are elected for three-year terms, with approximately one-third of the board of directors standing for election each year;
- cumulative voting is not allowed, which limits the ability of minority shareholders to elect any directors;
- advance notice for nominations of directors by shareholders and for shareholders to include matters to be considered at our annual meeting;
- the unanimous vote of the board of directors or the affirmative vote of the holders of not less than 80% of the votes entitled to be cast by the holders of all shares entitled to vote in the election of directors is required to change the size of the board of directors; and
- directors may be removed only for cause or by the holders of not less than 80% of the votes entitled to be cast on the matter.

Our Board of Directors has the authority to issue up to five million shares of preferred stock. The Board of Directors can fix the terms of the preferred stock without any action on the part of our shareholders. The issuance of shares of preferred stock may delay or prevent a change in control transaction. In addition, preferred stock could be used in connection with the Board of Directors’ adoption of a shareholders’ rights plan (also known as a poison pill), which would make it much more difficult to effect a change in control of our Company through acquiring or controlling blocks of stock. Also, our directors and officers as a group will continue to beneficially own stock and although this is not a majority of our stock, it confers substantial voting power in the election of directors and management of our Company. This would make it difficult for other minority shareholders to effect a change in control or otherwise extend any significant control over our management. This may adversely affect the market price and interfere with the voting and other rights of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The table below describes the material facilities owned or leased by Natural Gas Services Group as of December 31, 2022:

Location	Status	Square Feet	Uses
Tulsa, Oklahoma	Owned and Leased	91,780	Compressor fabrication, rental and services
Midland, Texas	Owned	70,000	Compressor fabrication, rental and services
Lewiston, Michigan	Owned	15,360	Compressor fabrication, rental and services
Midland, Texas	Owned	45,000	Corporate office
Bloomfield, New Mexico	Owned	7,000	Office and parts and services
Godley, Texas	Leased	5,000	Parts and services
Bridgeport, Texas	Leased	4,500	Office and parts and services
Midland, Texas	Owned	4,100	Parts and services
Vernal, Utah	Leased	3,200	Parts and services
Carrollton, Ohio	Leased	2,600	Parts and services
Wheeler, Texas	Leased	2,160	Parts and services

We believe that our properties are generally well maintained and in good condition and adequate for our purposes.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are a party to various legal proceedings in the ordinary course of our business. While management is unable to predict the ultimate outcome of these actions, it believes that any ultimate liability arising from these actions will not have a material effect on our financial position, results of operations or cash flow. We are not currently a party to any bankruptcy, receivership, reorganization, adjustment or similar proceeding, and we are not aware of any material threatened litigation.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock currently trades on the New York Stock Exchange under the symbol "NGS". As of December 31, 2022 as reflected by our transfer agent records, we had 13 record holders of our common stock. This number does not include any beneficial owners for whom shares of common stock may be held in "nominee" or "street" name. On March 28, 2023, the last reported sale price of our common stock as reported by the New York Stock Exchange was $10.12 per share.

Dividends

To date, we have not declared or paid any dividends on our common stock. We currently do not anticipate paying a cash dividend on our common stock. Although we intend to retain our earnings, if any, to finance the growth of our business, our Board of Directors will have the discretion to declare and pay dividends in the future. Payment of dividends in the future will depend upon our earnings, capital requirements, and other factors, which our Board of Directors may deem relevant. Our credit agreement also contains restrictions on our paying dividends under certain circumstances.

Equity Compensation Plans

The following table summarizes certain information regarding our equity compensation plans as of December 31, 2022:

Plan Category	(a) Number of securities to vest or be issued upon exercise of outstanding options	(b) Weighted-average issuance or exercise price of outstanding options	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders:			
Stock Option Plan	201,584 [1]	$ 19.32	344,253
2019 Equity Incentive Plan	250,847	$ 9.14	570,473
Total	452,431		914,726

[1] Total number of shares to be issued upon exercise of options granted to employees, officers, and directors under our 1998 Stock Option Plan.

Sale of Unregistered Securities

We made no sales of unregistered securities during the year ended December 31, 2022.

ITEM 6. RESERVED

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to assist you in understanding our financial position and results of operations for each of the years ended December 31, 2022 and 2021. You should read the following discussion and analysis in conjunction with our audited financial statements and the related notes.

The following discussion contains forward-looking statements. For a description of limitations inherent in forward-looking statements, see "Special Note Regarding Forward-Looking Statements" on page ii.

Overview

We fabricate, manufacture, rent and sell natural gas compressors and related equipment. Our primary focus is on the rental of natural gas compressors. Our rental contracts generally provide for initial terms of six to 60 months, with our larger horsepower units having longer initial terms. After the initial term of our rental contracts, most of our customers have continued to rent our compressors on a month-to-month basis. Rental amounts are billed monthly in advance and include maintenance of the rented compressors. As of December 31, 2022, we had 1,221 natural gas compressors totaling 318,350 horsepower rented to 81 customers, compared to 1,254 natural gas compressors totaling 297,808 horsepower rented to 83 customers at December 31, 2021. Of the 1,221 compressors rented at December 31, 2022, 841 were rented on a month-to-month basis.

We also fabricate natural gas compressors for sale to our customers, designing compressors to meet unique specifications dictated by well pressures, production characteristics and particular applications for which compression is sought. Fabrication of compressors involves our purchase of engines, compressors, coolers and other components, and our assembling of these components on skids for delivery to customer locations. These major components of our compressors are acquired through periodic purchase orders placed with third-party suppliers on an "as needed" basis, which presently requires a minimum three to six month lead time with delivery dates scheduled to coincide with our estimated production schedules. Although we do not have formal continuing supply contracts with any major supplier, we believe we have adequate alternative sources available. Finally due to supply chain disruptions as a result of the COVID-19 pandemic and the Russian invasion of the Ukraine and the increased rate of inflation, we continue to experience cost increases and sporadic unavailability of many of our parts needed to fabricate and maintain our rental fleet. While we have a robust supplier network, pricing pressure from our customers and competitors presents challenges in increasing our rental rates to offset these increased costs which could have a material adverse effect on the results of our operations and financial condition, particularly if we were unable to increase our rental rates and sales prices proportionate to any such component price increases.

We also manufacture a line of compressor frames, cylinders and parts, known as our CiP (Cylinder-in-Plane) product line. We use finished CiP component products in the fabrication of compressor units for sale or rental by us or sell the finished component products to other compressor fabricators. We also design, fabricate, sell, install and service flare stacks and related ignition and control devices for onshore and offshore incineration of gas compounds such as hydrogen sulfide, carbon dioxide, natural gas and liquefied petroleum gases. To provide customer support for our compressor and flare sales businesses, we stock varying levels of replacement parts at our Midland, Texas facility and at field service locations. We also provide an exchange and rebuild program for screw compressors and maintain an inventory of new and used compressors to facilitate this business.

We provide service and maintenance to our non-rental customers under written maintenance contracts or on an as-required basis in the absence of a service contract. Maintenance agreements typically have terms of six months to one year and require payment of a monthly fee.

The following table sets forth our revenues from each of our three operating categories for the periods presented:

	Year Ended December 31,	
	2022	2021
	(in thousands)	
Rental	$ 74,465	$ 63,624
Sales	8,568	6,882
Service and maintenance	1,792	1,914
Total	$ 84,825	$ 72,420

Our strategy for growth is focused on our compressor rental business. Margins, exclusive of depreciation and amortization, for our rental business historically run in the mid-40% to low-60% range, while margins for the compressor sales business tend to be in the mid-20% range. If our rental business grows and contributes a larger percentage of our total revenues, we expect our overall company-wide margins, exclusive of depreciation and amortization, to improve over time.

The oil and natural gas equipment rental and services industry is cyclical in nature. The most critical factor in assessing the outlook for the industry is the worldwide supply and demand for oil and natural gas and the corresponding changes in commodity prices. As demand and prices increase, oil and natural gas producers typically increase their capital expenditures for drilling, development and production activities, although recent equity capital constraints and demands from institutional investors to keep spending within operating cash flow have meaningfully restrained capital expenditure budgets of domestic exploration and production companies. Generally, increased capital expenditures ultimately result in greater revenues and profits for service and equipment companies.

In general, we expect our overall business activity and revenues to track the level of activity in the oil and natural gas industry, with changes in crude oil and condensate production and consumption levels and prices affecting our business more than changes in domestic natural gas production and consumption levels and prices. In recent years we have increased our rental and sales in unconventional oil shale plays, which are more dependent on crude oil prices. With this shift towards oil production the demand for overall compression services and products is driven by two general factors; an increased focus by producers on artificial lift applications, e.g., production enhancement with compression assisted gas lift; and declining reservoir pressure in maturing natural gas producing fields, especially non-conventional production. These types of applications have historically been serviced by wellhead size compressors, and continue to be, but there has also been an economic move by our customers towards centralized drilling and production facilities, which have increased the market need for larger horsepower compressor packages. We recognized this need in recent years and have shifted our cash and fabrication resources towards designing, fabricating and renting gas compressor packages that range from 400 horsepower up to 2,500 horsepower. While this is a response to market conditions and trends, it also provides us with the opportunity to compete as a full-line compression provider.

We typically experience a decline in demand during periods of low crude oil and natural gas prices. During 2019, we witnessed a moderation of crude oil prices as well as drilling and completion activity levels. During the first quarter of 2020, we saw a substantial decline in the prices for oil and natural gas. While prices largely recovered in 2021 and the stabilized in 2022, activity levels of exploration and production companies have been and will continue to be dependent not only on commodity prices, but also on their ability to generate sufficient operational cash flow to fund their activities. Generally, though, we feel that production activities (in which we are involved) will fare better than drilling activity.

For fiscal year 2023, our forecasted capital expenditures will be directly dependent upon our customers' compression requirements and are anticipated to exceed our internally generated cash flows by a significant amount. As such, we are likely to incur debt at levels that far exceed our historical activity. Any required capital will be for additions to our compressor rental fleet and/or addition or replacement of service vehicles. We believe that cash on hand, cash flows from operations and borrowings under our revolving credit facility will be sufficient to satisfy our capital and liquidity requirements through 2023. If we require additional capital to fund any significant unanticipated expenditures, including any material acquisitions of other businesses, joint ventures or other opportunities, this additional capital could exceed our current resources, might not be available to us when we need it, or might not be on acceptable terms.

Critical Accounting Policies and Practices

We have identified the policies below as critical to our business operations and the understanding of our results of operations. In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements in conformity with accounting principles generally accepted in the United States. Actual results could differ significantly from those estimates under different assumptions and conditions. We believe that the following discussion addresses our most critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and require our most difficult, subjective, and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We describe our significant accounting policies more fully in Note 2 ("Summary of Significant Accounting Policies") to our consolidated financial statements.

Our critical accounting policies are as follows:

- revenue recognition;
- estimating the allowance for doubtful accounts receivable;
- accounting for income taxes;
- accounting for long-lived assets; and
- accounting for inventory.

Revenue Recognition Policy

The Company adopted ASC 606, Revenue from Contracts with Customers ("ASC 606") on January 1, 2018. Revenue is measured based on a consideration specified in a customer’s contract, excluding any sale incentives and taxes collected on behalf of third parties (i.e. sales and property taxes). We recognize revenue once a performance obligation has been satisfied and control over a product or service has transferred to the customer. Shipping and handling costs incurred are accounted for as fulfillment costs and are included in cost of revenues in our Consolidated Statements of Operations.

Nature of Goods and Services

Rental Revenue. The Company generates revenue from renting compressors and flare systems to our customers. These contracts may also include a fee for servicing the compressor or flare during the rental contract. Our rental contracts typically range from six to 60 months, with our larger horsepower compressors having longer minimum contract terms. Our rental revenue is recognized over time, with equal monthly payments over the term of the contract. After the terms of the contract have expired, a customer may renew their contract or continue renting on a monthly basis thereafter.

Sales Revenue. The Company generates revenue by the sale of custom/fabricated compressors, flare systems and parts, as well as, exchange/rebuilding customer owned compressors and sale of used rental equipment. The Company designs and fabricates compressors and flares based on the customer’s specifications outlined in their contract. Though the equipment being built is customized by the customer, control under these contracts does not pass to the customer until the compressor or flare package is completed and shipped, or, in accordance with a bill and hold arrangements, the customer accepts title and assumes the risk and rewards of ownership. We request some of our customers to make progressive payments as the product is being built; these payments are recorded as a contract liability on the Deferred Income line on the consolidated balance sheet until control has been transferred. These contracts also may include an assurance warranty clause to guarantee the product is free from defects in material and workmanship for a set duration of time; this is a standard industry practice and is not considered a performance obligation.

Allowance for Doubtful Accounts Receivable

We perform ongoing credit evaluations of our customers and adjust credit limits based on management's assessment of the customer's financial condition and payment history, as well as industry conditions and general economic conditions. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Management believes that its allowance for doubtful accounts is adequate; however, actual write-offs may exceed the recorded allowance.

Accounting for Income Taxes

As part of the process of preparing our financial statements, we are required to estimate our federal income taxes as well as income taxes in each of the states in which we operate. This process involves us estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not probable, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense in the tax provision in the statement of income.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We currently have no valuation allowance and fully expect to utilize all of our deferred tax assets.

ASC 740 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In order to record any financial statement benefit, we are required to determine, based on technical merits of the position, whether it is more likely than not (a likelihood of more than 50 percent) that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes. If that step is satisfied, then we must measure the tax position to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of the benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Our policy regarding income tax interest and penalties is to expense those items as other expense.

Long-Lived Assets

Rental Equipment, Property and Equipment (Including Retirement of Rental Equipment)

Rental equipment and property and equipment are recorded at cost less accumulated depreciation, except for work-in-progress on new rental equipment which is recorded at cost until it’s complete and added to the fleet. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Our rental equipment has an estimated useful life between 15 and 25 years, while our property and equipment has an estimate useful lives which range from 3 to 39 years. The majority of our property and equipment, including rental equipment, is a direct cost to generating revenue.

We assess the impairment of rental equipment and property and equipment whenever events or changes in circumstances indicate that the net recorded amount may not be recoverable. The following factors could trigger an impairment review: significant underperformance relative to historical or projected future cash flows; significant adverse changes in the extent or manner in which asset (or asset group) is being used or its condition, including a meaningful drop in fleet utilization over the prior four quarters; significant negative industry or company-specific trends or actions, including meaningful capital expenditure budget reductions by our major customers or other sizable exploration and production or midstream companies, as well as significant declines in oil and natural gas prices; legislative changes prohibiting us from leasing our units or flares; or poor general economic conditions. An impairment loss is recognized if the future undiscounted cash flows associated with the asset (or asset group) and the estimated fair value of the asset are less than the asset's carrying value.

Inventories

We value our total inventory (current and long-term) at the lower of the actual cost and net realizable value of the inventory. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on current and anticipated customer demand and production requirements. The Company accesses anticipated customer demand based on current and upcoming capital expenditure budgets of its major customers as well as other significant companies in the industry, along with oil and natural gas price forecasts and other factors affecting the industry. For the year ended December 31, 2022 and 2021, inventory allowance and write-off totaled $0.1 million.

Our Performance Trends and Outlook

On January 30, 2020, the World Health Organization (“WHO”) announced a global health emergency because of a new strain of coronavirus known as COVID-19 due to the risks it imposes on the international community as the virus spreads globally. In March 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally. During this time, the market began to experience a decline in oil prices in response to oil demand concerns due to the global economic impacts of COVID-19. These developments led to significant weaknesses in oil prices and ensuing reductions of exploration and production company capital and operating budgets. Oil markets largely recovered in 2021, and prices continued to rise throughout 2022.

With the capital restraint by E&P companies, we expect rental demand for our large and medium horsepower units to remain strong for the remainder of 2023. In terms of sales, we expect minimal compressor sales for the year due to shifts in capital expenditure budget concentrations throughout the industry, including those of our major customers, as many upstream producers prefer to rent compression as opposed to purchasing units as part of their capital budget allocations. Finally, we have recently experienced and expect to continue to experience supply chain disruptions. While we believe we have a strong vendor network that provides flexibility in sourcing needed materials, we have incurred longer than normal wait times for certain components as well as increases in costs. Lastly, our relationship with our major customer continues to be strong, and it has continued to pay our invoices in a timely, consistent manner. Nevertheless, if any of these circumstances change, our business could be adversely affected.

Results of Operations

Year Ended December 31, 2022 Compared to the Year Ended December 31, 2021

The table below shows our revenues and percentage of total revenues for each of our product lines for the years ended December 31, 2022 and 2021.

	Revenue			
	Year Ended December 31,			
	2022		2021	
	(dollars in thousands)			
Rental	$ 74,465	87.8 %	$ 63,624	87.9 %
Sales	8,568	10.1 %	6,882	9.5 %
Service & Maintenance	1,792	2.1 %	1,914	2.6 %
Total	$ 84,825		$ 72,420	

Total revenue increased to $84.8 million from $72.4 million, or 17.1%, for the year ended December 31, 2022 compared to 2021. This increase was mainly a result of increased rental revenue (17.0% increase) primarily due to a greater number of large horsepower units being rented as well as higher sales revenue (24.5% increase) primarily due to increased compressor and parts sales.

Rental revenue increased to $74.5 million (17.0%) from $63.6 million for the year ended December 31, 2022 compared to 2021. As of December 31, 2022, we had 1,869 natural gas compressors in our rental fleet, down from 2,023 units at year end 2021. In addition, the Company's total unit horsepower increased by 1.7% to 425,340 at December 31, 2022 compared to 418,041 horsepower year end 2021. However, as of December 31, 2022, we had 1,221 natural gas compressors totaling 318,350 horsepower rented to 81 customers, compared to 1,254 natural gas compressors totaling 297,808 horsepower rented to 83 customers as of December 31, 2021. This increase in rented horsepower reflects the addition of 35 high horsepower compressors with 26,320 horsepower to the Company's fleet during 2022. The rental fleet had a unit utilization as of December 31, 2022 and 2021 of 65.3% and 62.0%, respectively, while our horsepower utilization for the same periods was 74.8% and 71.2%, respectively. The increase in both utilization metrics was mainly the result of the addition and increased demand for our higher horsepower units. During the year ended December 31, 2022 we placed into service 174 newly set units during the year, 35 of which were 400 horsepower or larger.

Sales revenue increased to $8.6 million from $6.9 million for the year ended December 31, 2022, compared to 2021. This increase in largely attributable to an increase in compressor and parts sales during 2022. Sales are subject to fluctuations in timing of industry activity related to capital projects and, as such, can vary substantially between periods.

Company management routinely reviews its inventory for obsolescence. Due to the slow moving nature or obsolescence of a portion of the Company's long-term inventory and inventory related to the retirement of certain rental equipment, management recorded an increase of $83,000 in the inventory allowance reserve for costs that may not be recoverable in the future. We ended 2022 with an inventory allowance balance of $120,000.

Company management also routinely reviews its rental fleet to determine which units are no longer of the type, configuration, make or model that our customers are demanding or that are not cost efficient to refurbish, maintain and/or operate. As a result of this review, we determined 124 units should be retired from our rental fleet. Accordingly, we recorded a $0.2 million loss on retirement of rental equipment during the year ended December 31, 2022.

Operating income increased to $0.4 million for the year ended December 31, 2022 compared to an operating loss of $12.4 million for the year ended December 31, 2021. The increase in operating income was mainly due to 1) a $12.4 million increase in revenues and 2) a $2.9 million decrease in loss related to the retirement of 124 units, partially offset by a $2.9 million increase in selling, general and administrative expenses and a $1.1 million increase in costs of rentals primarily related to inflationary pressures on parts and labor expenses.

Selling, general, and administrative expenses increased by $2.9 million to $13.6 million for the year ended December 31, 2022, as compared to $10.8 million for 2021. This 26.8% increase was primarily the result of $2.5 million of severance expenses related to the planned retirement of Stephen C. Taylor and other severance costs related to the resignation of John Chisholm, our interim Chief Executive Officer and director during a portion of 2022. The remaining increase was related to increases in information technology expenses driven by our ongoing data automation program.

Depreciation and amortization expense decreased to $24.1 million from $25.4 million, or 5.0%, for the year ended December 31, 2022, compared to 2021. The decrease is the result of the retirement of 263 units from our rental fleet in the fourth quarter of 2021 which reduced our depreciable asset base by $3.1 million. This decrease was partially offset by higher capital expenditures for larger horsepower units being added to the fleet. We added 45 units (approximately 33,000 horsepower) to our fleet during the twelve-month period ended December 31, 2022. Thirty-five of those units were 400 horsepower or larger, representing approximately 80% of the horsepower added.

Income tax (expense)/benefit increased to $(0.5) million from $2.6 million for the year ended December 31, 2022 compared to 2021. Our effective tax rate for both years differs from the U.S. federal statutory rate of 21%. On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted in response to the economic impact caused the COVID-19 pandemic. The CARES Act allows federal net operating losses ("NOL") incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid federal income taxes. The Company generated significant NOLs during 2018 and 2019. The Company filed its NOL carryback claims for 2018 and 2019 during 2020. Accordingly, the Company initially recorded a federal income tax receivable of $15.0 million and an increase to its deferred income tax liability of $10.1 million on its condensed consolidated balance sheet. During the third quarter of 2020, the Company received refunds totaling $3.9 million related to its 2018 NOLs, which, along with year-end provision adjustments, reduced its federal income tax receivable to $11.5 million on its consolidated balance sheet as of December 31, 2022. In addition, the Company recorded a current income tax benefit of $2.6 million on its consolidated statement of operations for the year ended December 31, 2021. Our income tax expense in 2022 was largely due to certain executive severance compensation expenses incurred during 2022 that are non-deductible for income tax purposes. As such, we recognized income tax expense of $0.5 million while incurring net loss before income taxes less than $0.1 million for the year ended December 31, 2022.

Adjusted Gross Margin Year Ended December 31, 2022 Compared to the Year Ended December 31, 2021

The table below shows our adjusted gross margin and related percentages for each of our product lines for the years ended December 31, 2022 and December 31, 2021. Adjusted gross margin is the difference between revenue and cost of revenues, exclusive of depreciation and amortization expense.

	Adjusted Gross Margin [1]			
	Year Ended December 31,			
	2022		**2021**	
	(dollars in thousands)			
Rental	$ 36,715	49.3 %	$ 26,986	42.4 %
Sales	918	10.7 %	(947)	(13.8)%
Service & Maintenance	835	46.6 %	1,016	53.1 %
Total	$ 38,468	45.3 %	$ 27,055	37.4 %

[1] For a reconciliation of adjusted gross margin to its most directly comparable financial measure calculated and presented in accordance with GAAP, please read "Non-GAAP Financial Measures" below.

Our overall adjusted gross margin percentage increased to 45.3% for the year ended December 31, 2022 compared to 37.4% for the year ended December 31, 2021. Our increase in gross margins is mainly due to an increase in rental revenues. Rental revenues increased 17.0% over 2021, while our costs of rentals increased 3.0% driven by inflationary pressures primarily in labor and parts costs. Rental revenues comprised 88% of our total revenues for the year ended December 31, 2022 compared to 88% of total revenues for the year ended December 31, 2021. Our sales margin improved to 10.7% in 2022 from

(13.8)% in 2021. Sales revenues increased 24.5% attributable to increased compressor sales, which realizes a higher gross margin than parts sales. While many sales costs are variable, certain costs such as labor are less variable as a certain staff level is retained to meet demand when market forces shift. Third party service and maintenance margins decreased to 46.6% from 53.1% for the year ended December 31, 2022 compared to 2021. Service and maintenance only represents 2.1% of our revenue in 2022, providing minimal impact on our overall adjusted gross margin.

Non-GAAP Financial Measures

Our definition and use of Adjusted EBITDA

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

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

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

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

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

Reconciliation

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

	Year Ended December 31,	
	2022	2021
	(in thousands)	
Net loss	$ (569)	$ (9,183)
Interest expense	364	65
Income tax expense (benefit)	528	(2,603)
Depreciation and amortization	24,116	25,397
Inventory allowance	83	208
Retirement of rental equipment	196	3,096
Severance expenses	2,537	—
Stock compensation expense	1,910	1,738
Adjusted EBITDA	$ 29,165	$ 18,718

Our definition and use of Adjusted Gross Margin

We define “Adjusted Gross Margin” as total revenue less costs of revenues (excluding depreciation and amortization expense). Adjusted gross margin is included as a supplemental disclosure because it is a primary measure used by our management as it represents the results of revenue and costs (excluding depreciation and amortization expense), which are key components of our operations. Adjusted gross margin differs from gross margin, in that gross margin includes depreciation expense. We believe adjusted gross margin is important because it focuses on the current operating performance of our operations and excludes the impact of the prior historical costs of the assets acquired or constructed that are utilized in those operations. Depreciation expense does not accurately reflect the costs required to maintain and replenish the operational usage of our assets and therefore may not portray the costs from current operating activity. Rather, depreciation expense reflects the systematic allocation of historical property and equipment values over the estimated useful lives.

Adjusted gross margin has certain material limitations associated with its use as compared to gross margin. These limitations are primarily due to the exclusion of depreciation expense, which is material to our results of operations. Because we use capital assets, depreciation expense is a necessary element of our costs and our ability to generate revenue. In order to compensate for these limitations, management uses this non-GAAP measure as a supplemental measure to other GAAP results to provide a more complete understanding of our performance.

As an indicator of our operating performance, adjusted gross margin should not be considered an alternative to, or more meaningful than, gross margin as determined in accordance with GAAP. Our adjusted gross margin may not be comparable to a similarly titled measure of another company because other entities may not calculate adjusted gross margin in the same manner.

Reconciliation

The following table calculates gross margin, the most directly comparable GAAP financial measure, and reconciles it to adjusted gross margin:

	Year Ended December 31,	
	2022	2021
	(in thousands)	
Total revenue	$ 84,825	$ 72,420
Costs of revenue, exclusive of depreciation and amortization	(46,357)	(45,365)
Depreciation allocable to costs of revenue	(23,551)	(24,753)
Gross margin	14,917	2,302
Depreciation allocable to costs of revenue	23,551	24,753
Adjusted gross margin	$ 38,468	$ 27,055

Liquidity and Capital Resources

Our working capital positions as of December 31, 2022 and 2021 were as follows:

	As of December 31,	
	2022	2021
	(in thousands)	
Current Assets:		
Cash and cash equivalents	$ 3,372	$ 22,942
Trade accounts receivable, net	14,668	10,389
Inventory, net	23,414	19,329
Federal income tax receivable	11,538	11,538
Prepaid income taxes	10	51
Prepaid expenses and other	1,145	854
Total current assets	54,147	65,103
Current Liabilities:		
Accounts payable	6,481	4,795
Accrued liabilities	23,726	14,103
Current operating leases	155	68
Deferred income	37	1,312
Total current liabilities	30,399	20,278
Net working capital	$ 23,748	$ 44,825

For the year ended December 31, 2022, we invested approximately $65.1 million in rental equipment, property and other equipment. During the year, we added $61.7 million in new equipment to our rental fleet and $3.4 million in other property and equipment. Our investment in rental equipment includes any changes to work-in-progress related to our rental fleet jobs at the beginning of the year compared to the end of the year. Our rental work-in-progress increased by $31.8 million during 2022. We financed our investment in rental equipment, property and other equipment with cash flows from operations during 2022 and borrowings under our revolving credit facility. We anticipate that our cash flows from operations as well as our borrowing capacity under our New Credit Agreement (defined below) will provide ample liquidity for our planned capital expenditures during 2023 and beyond.

Cash flows

At December 31, 2022, we had cash and cash equivalents of $3.4 million compared to $22.9 million at year end 2021. Our cash flow from operations of $27.8 million was offset by capital expenditures of $65.1 million during 2022. We had net proceeds of $25.0 million from borrowings under our revolving credit facility. In addition, we expended $6.7 million in connection with our share repurchase program. We also had working capital of $23.7 million at December 31, 2022 compared to $44.8 million at December 31, 2021. We had net cash flow from operating activities of $27.8 million during 2022 compared $28.5 million during 2021. Our cash flow from operating activities of $27.8 million was primarily the result of our rental and sales gross margins.

Senior Bank Borrowings

Previous Credit Agreement

We had a senior secured revolving credit agreement (the "Previous Credit Agreement") with JP Morgan Chase Bank, N.A (the "Lender") that matured on March 31, 2021. The Previous Credit Agreement had an aggregate commitment of $30 million, subject to collateral availability.

New Credit Agreement

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

Amended and Restated Credit Agreement

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

Borrowing Base. At any time before the maturity of the Amended and Restated Credit Agreement, we may draw, repay and re-borrow amounts available under the borrowing base up to the maximum aggregate availability discussed above. Generally, the borrowing base equals the sum of (a) 85% of eligible accounts receivable owed to the Company, plus (b) 50% of the eligible inventory, valued at the lower of cost or market value at such time, subject to a cap of this component not to exceed $2.5 million, plus (c) the lesser of (i) 95% of the net book value of the compressors that the Lender has determined are eligible for the extension of credit, valued at the lower of cost or market value with depreciation not to exceed 25 years, at such time and (ii) 80% of the net liquidation value percentage of the net book value of the eligible compressors that the Lender has determined are eligible for the extension of credit, valued at the lower of cost or market value with depreciation not to exceed 25 years, at such time, plus (d) 80% of the net book value, valued at the lower of cost (excluding any costs for capitalized interest or other noncash capitalized costs) or market of the eligible new compressor fleet, minus (e) any required availability reserves determined by the Lender in its sole discretion. The Lender may adjust the borrowing base components if material deviations in the collateral are discovered in future audits of the collateral.

Interest and Fees. Under the terms of the Amended and Restated Credit Agreement, we have the option of selecting the applicable variable rate for each revolving loan, or portion thereof, of either (a) the Base Rate (as defined below) plus the Applicable Margin, or (b) in the case of a Term SOFR ("Secured Overnight Financing Rate") Loan, the Adjusted Term SOFR rate plus the Applicable Margin. "Base Rate" means, for any day, a rate of interest per annum equal to the highest of (a) the prime rate for such day; (b) the sum of the federal funds rate for such day plus 0.50%; and (c) the Adjusted Term SOFR for such day plus 1.00%. The Applicable Margin is determined based upon the leverage ratio as set forth in the most recent compliance certificate received by the Lender for each fiscal quarter from time to time pursuant to the Amended and Restated Credit Agreement. Depending on the leverage ratio, the Applicable Margin can be 2.00% to 2.75% for Base Rate Loans (as defined in the Amended and Restated Credit Agreement) and 3% to 3.75% for Term SOFR Loans and for requested letters of credit. In addition, we are required to pay a monthly commitment fee on the daily average unused amount of the commitment while the Amended and Restated Credit Agreement is in effect at an annual rate equal to 0.50% of the unused commitment amount. Accrued interest is payable monthly on outstanding principal amounts and unused commitment fee, provided that accrued interest on Term SOFR Loans is payable at the end of each interest period, but in no event less frequently than quarterly.

Covenants. The Amended and Restated Credit Agreement contains customary representations and warranties, as well as covenants which, among other things, condition or limit our ability to incur additional indebtedness and liens; enter into transactions with affiliates; make acquisitions in excess of certain amounts; pay dividends; redeem or repurchase capital stock or senior notes; make investments or loans; make negative pledges; consolidate, merge or effect asset sales; or change the nature of our business. In addition, we are subject to certain financial covenants in the Amended and Restated Credit Agreement that require us to maintain (i) a leverage ratio, as defined, lesser than or equal to 3.50 to 1.00 as of the last day of each fiscal quarter ending on or prior to December 31, 2024 and 3.25 to 1.00 for the fiscal quarter ending March 31, 2025 and for each fiscal quarter thereafter and (ii) a fixed charge coverage ratio greater than or equal to1.25 to 1.00 as of the last day of each fiscal quarter.

Events of Default and Acceleration. The Amended and Restated Credit Agreement contains customary events of default for credit facilities of this size and type, and includes, without limitation, payment defaults; defaults in performance of covenants or other agreements contained in the Amended and Restated Credit Agreement and the other transaction documents; inaccuracies in representations and warranties; certain defaults, termination events or similar events; certain defaults with respect to any other Company indebtedness in excess of $1 million; certain bankruptcy or insolvency events; the rendering of certain judgments in excess of $1 million; certain ERISA events; certain change in control events and the defectiveness of any liens under the secured revolving credit agreement. Obligations outstanding under the Amended and Restated Credit Agreement may be accelerated upon the occurrence of an event of default.

As of December 31, 2022, we were in compliance with all financial covenants in our 2022 Credit Agreement.

Components of Our Principal Capital Expenditures

Capital expenditures for the years ended December 31:

Expenditure Category	2022	2021
	(in thousands)	
Rental equipment and property and equipment	$ 65,122	$ 25,710

The level of our expenditures will vary in future periods depending on energy market conditions and other related economic factors. Based upon existing economic and market conditions, we believe that our cash on hand, operating cash flow and available line of credit are adequate to fully fund our net capital expenditures requirements for 2023. We also believe we have flexibility with respect to our financing alternatives and adjustments to our capital expenditure plans if circumstances warrant. We do not have any material continuing commitments related to our current operations that cannot be met with our cash on hand and our line of credit. However, our financing capacity could be negatively impacted by other economic factors. Please see Item 1A, Risk Factors, of this report.

Off-Balance Sheet Arrangements

From time-to-time, we enter into off-balance sheet arrangements and transactions that can give rise to off-balance sheet obligations. As of December 31, 2022, we did not have any material off-balance sheet arrangements.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (ASC Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments to ASC Topic 326 require immediate recognition of estimated credit losses expected to occur over the remaining life of many financial assets, including trade receivables. For companies that qualify as smaller reporting companies, the amendments in this update are effective for interim and annual periods beginning after January 1, 2023. We are currently evaluating the impact of ASU 2016-13 on our consolidated financial statements and note disclosures.

Environmental Regulations

Various federal, state and local laws and regulations covering the discharge of materials into the environment, or otherwise relating to protection of human safety and health and the environment, affect our operations and costs. Compliance with these laws and regulations could cause us to incur remediation or other corrective action costs or result in the assessment of administrative, civil and criminal penalties and the issuance of injunctions delaying or prohibiting operations. In addition, we have acquired certain properties and plant facilities from third parties whose actions with respect to the management and disposal or release of hydrocarbons or other wastes were not under our control. Under environmental laws and regulations, we could be required to remove or remediate wastes disposed of or released by prior owners. In addition, we could be responsible under environmental laws and regulations for properties and plant facilities we lease, but do not own. Compliance with such laws and regulations increases our overall cost of business, but has not had a material adverse effect on our operations or financial condition. It is not anticipated, based on current laws and regulations, that we will be required in the near future to expend amounts that are material in relation to our total expenditure budget in order to comply with environmental laws and regulations but such laws and regulations are frequently changed and we are unable to predict the ultimate cost of compliance. We also could incur costs related to the cleanup of sites to which we send equipment and for damages to natural resources or other claims related to releases of regulated substances at such sites.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable to Smaller Reporting Companies.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and supplementary financial data are included in this Annual Report on Form 10-K beginning on page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms and (2) accumulated and communicated to our management, including our principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our management, with the participation of our Interim Chief Executive Officer and Interim Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2022. Based upon the evaluation, our Interim Chief Executive Officer and Interim Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were not effective at a reasonable assurance level, due to the material weakness identified during fiscal year 2022,

Management’s Report on Internal Control Over Financial Reporting

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

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

Our management conducted an evaluation of the effectiveness of the Company’s internal control over financial reporting as of December 31, 2022, based on the Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on the results of this evaluation, the Company’s management concluded that internal control over financial reporting was not effective as of December 31, 2022, due to the material weakness listed below.

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

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

After giving full consideration to this material weakness, and the additional analyses and other procedures that we performed to ensure that our consolidated financial statements included in this Annual Report on Form 10-K were prepared in accordance with U.S. generally accepted accounting principles ("US GAAP"), our management has concluded that our consolidated financial statements present fairly, in all material respects our financial position, results of operations and cash flows for the periods disclosed in conformity with US GAAP.

Remediation Plan for Material Weakness

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

Our planned internal control remediation efforts include:

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

While these actions and planned actions are subject to ongoing management evaluation and will require validation and testing of the design and operating effectiveness of internal controls over a sustained period of financial reporting cycles, we are committed to the continuous improvement of our internal control over financial reporting and will continue to diligently review our internal control over financial reporting.

Attestation Report of the Registered Public Accounting Firm

This Annual Report on Form 10-K does not include an attestation report of our registered public accounting firm on our ICFR because we are a Smaller Reporting Company and are not subject to auditor attestation requirements under applicable SEC rules.

Changes in Internal Control Over Financial Reporting

During the quarter ended December 31, 2022, there were no changes in our ICFR that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

ITEM 9C. DISCLOSURES REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated herein by reference to the sections “Election of Directors,” “Executive Officers,” “Corporate Governance” and “The Board of Directors and its Committees” in our definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2022 or as such period may be extended by action of the Securities and Exchange Commission.

We have adopted a Code of Business Conduct and Ethics that applies to our directors, officers and employees. The Code of Business Conduct and Ethics is posted in the "Investor Relations" section of our website at www.ngsgi.com. The Code of Business Conduct and Ethics maybe obtained free of charge by writing before to Natural Gas Services Group, Inc., Attn: Investor Relations, 404 Veterans Airpark Lane, Ste 300 Midland, TX 79705.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to the section “Executive Compensation” in our definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2022 or as such period may be extended by action of the Securities and Exchange Commission.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated herein by reference to the section “Principal Shareholders and Security Ownership of Management” in our definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2022 or as such period may be extended by action of the Securities and Exchange Commission.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated herein by reference to the sections “Related Person Transactions” and “Corporate Governance” in our definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2022 or as such period may be extended by action of the Securities and Exchange Commission.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated herein by reference to the section “Principal Accountant Fees and Services” in our definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2022 or as such period may be extended by action of the Securities and Exchange Commission.

PART IV

ITEM 15. EXHIBITS AND CONSOLIDATED FINANCIAL STATEMENTS

The following documents are filed as part of this Annual Report on Form 10-K:

(a)(1) and (a)(2) Consolidated Financial Statements

For a list of Consolidated Financial Statements, see “Index to Consolidated Financial Statements” incorporated herein by reference.

(a)(3) Exhibits

A list of exhibits to this Annual Report on Form 10-K is set forth below:

Exhibit No.	Description
3.1	Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3.1 of the 10-QSB filed and dated November 10, 2004).
3.2	Bylaws, as amended (Incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 10, 2021.)
4.1	Description of Securities (Incorporated by reference to the Registrant's Registration Statement on From 8-A, filed with the SEC on October 27, 2008.)
4.2	Form of Senior Indenture (Incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on From S-3 (No. 333-261091) and filed on November 16, 2021)
4.3	Form of Subordinated Indenture (Incorporated by reference to Exhibit 4.4 of the Registrant's Registration Statement on Form S-3 (No. 333-261091) and filed on November 16, 2021
10.1†	2019 Equity Incentive Plan, as amended (Incorporated by reference to Exhibit 4.3 of the Registrant’s Registration Statement on Form S-8 filed with the Securities and Exchange Commission on July 12, 2022.)
10.2†	Stock Option Plan, as amended and restated (Incorporated by reference to Exhibit 10.1 of the Registrant’s Current Report on Form 8-K filed with the Securities and Exchange Commission on June 21, 2016.)
10.3†	Retirement Agreement dated May 17, 2022 between Natural Gas Services Group, Inc. and Stephen C. Taylor (Incorporated by reference to Exhibit 10.1 of the Registrant’s Current Report on Form 8-K filed with the Securities and Exchange Commission on May 19, 2022.)
10.4†	Severance Agreement and Release Between Natural Gas Services Group, Inc. and John W. Chisholm dated December 21, 2022 (Incorporated by reference to Exhibit 10.1 of the Registrant’s Current Report on Form 8-K filed with the Securities and Exchange Commission on December 28, 2022.)
10.5†	Letter Agreement between Natural Gas Services Group, Inc. and James D. Faircloth dated February 8, 2023 (Incorporated by reference to Exhibit 10.1 of the Registrant’s Current Report on Form 8-k filed with the Securities and Exchange Commission on February 13, 2023.)
10.6†	The Executive Nonqualified Excess Plan Adoption Agreement, referred to as the Nonqualified Deferred Compensation Plan (Incorporated by reference to Exhibit 10.11 of the Registrant's Quarterly report on Form 10-Q filed with the Securities and Exchange Commission on May 6, 2016.)
10.7	Amended and Restated Credit Agreement dated February 28, 2023, among Natural Gas Services Group, Inc., the other Loan Parties thereto, Texas Capital Bank, in its capacity as Administrative Agent and the Lenders party thereto (Incorporated by reference to Exhibit 10.1 of the Registrant’s Current Report on Form 8-K filed with the Securities and Exchange Commission on March 6, 2023.)
10.8	Amended and Restated Pledge and Security Agreement dated February 28, 2023, among Natural Gas Services Group, Inc., the Grantors thereto, Texas Capital Bank, in its capacity as Administrative Agent, for the Lenders and other Secured Parties (Incorporated by reference to Exhibit 10.2 of the Registrant’s Current Report on Form 8-K filed with the Securities and Exchange Commission on March 6, 2023.)

10.9†	Letter Agreement dated June 9, 2022 between Natural Gas Services Group, Inc. and John W. Chisholm (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 13, 2022.)
*21.1	Subsidiaries of the registrant
*23.1	Consent of Ham, Langston & Brezina L.L.P.
*23.2	Consent of Moss Adams LLP
*31.1	Certification of Interim Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*31.2	Certification of Interim Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*32.1	Certification of Interim Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*32.2	Certification of Interim Principal Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

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

NATURAL GAS SERVICES GROUP, INC.

March 31, 2023

By: /s/ Stephen C. Taylor

Stephen C. Taylor
Chairman of the Board, Interim President and Chief Executive Officer
(Principal Executive Officer)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Stephen C. Taylor and James D. Faircloth, jointly and severally, as his/her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him/her and in his/her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises hereby ratifying and confirming all that said attorneys-in-fact and agents, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of 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:

Signature	Title	Date
/s/ Stephen C. Taylor Stephen C. Taylor	Chairman of the Board of Directors, Interim Chief Executive Officer and President (Principal Executive Officer)	March 31, 2023
/s/ James D. Faircloth James D. Faircloth	Interim Chief Financial Officer (Principal Accounting Officer)	March 31, 2023
/s/ Leslie A. Beyer Leslie A. Beyer	Director	March 31, 2023
/s/ Nigel J. Jenvey Nigel J. Jenvey	Director	March 31, 2023
/s/ David L. Bradshaw David L. Bradshaw	Director	March 31, 2023

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of
Natural Gas Services Group, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of Natural Gas Services Group, Inc. and subsidiary (the "Company") as of December 31, 2022, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2022, and the consolidated results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audit we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audit included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

Critical Audit Matter

Critical audit matters are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. We determined that there are no critical audit matters.

/s/ Ham, Langston & Brezina LLP

Houston, Texas
March 31, 2023

We have served as the Company's auditor since 2022.

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of
Natural Gas Services Group, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of Natural Gas Services Group, Inc. and subsidiary (the “Company”) as of December 31, 2021, and the related consolidated statements of operations, stockholders’ equity, and cash flows for the year then ended, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2021, and the consolidated results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audit we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audit included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

/s/ Moss Adams LLP

Dallas, Texas
March 18, 2022

We have served as the Company's auditor from 2020 to 2022.

NATURAL GAS SERVICES GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)

	December 31, 2022	December 31, 2021
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 3,372	$ 22,942
Trade accounts receivable, net of allowance for doubtful accounts of $338 and $1,129, respectively	14,668	10,389
Inventory	23,414	19,329
Federal income tax receivable	11,538	11,538
Prepaid income taxes	10	51
Prepaid expenses and other	1,145	854
Total current assets	54,147	65,103
Long-Term Inventory, net of allowance for obsolescence of $120 and $64, respectively	1,557	1,582
Rental equipment, net of accumulated depreciation of $177,729 and $172,563, respectively	246,450	206,985
Property and equipment, net of accumulated depreciation of $16,981 and $15,784, respectively	22,176	20,828
Right of use assets - operating leases, net of accumulated amortization $721 and $555, respectively	349	285
Intangibles, net of accumulated amortization of $2,259 and $2,134, respectively	900	1,025
Other assets	2,667	2,698
Total assets	$ 328,246	$ 298,506
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 6,481	$ 4,795
Accrued liabilities	23,726	14,103
Current operating leases	155	68
Deferred income	37	1,312
Total current liabilities	30,399	20,278
Credit facility	25,000	—
Deferred income tax liability	39,798	39,288
Long-term operating leases	194	217
Other long-term liabilities	2,779	2,813
Total liabilities	98,170	62,596
Commitments and contingencies (Note 15)		
Stockholders’ Equity:		
Preferred stock, 5,000 shares authorized, no shares issued or outstanding	—	—
Common stock, 30,000 shares authorized, par value $0.01; 13,519 and 13,394 shares issued, respectively	135	134
Additional paid-in capital	115,411	114,017
Retained earnings	129,534	130,103
Treasury shares, at cost, 1,310 shares and 775, respectively	(15,004)	(8,344)
Total stockholders' equity	230,076	235,910
Total liabilities and stockholders' equity	$ 328,246	$ 298,506

See accompanying notes to these consolidated financial statements.

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

	Year Ended December 31,	
	2022	**2021**
Revenue:		
Rental income	$ 74,465	$ 63,624
Sales	8,568	6,882
Service and maintenance income	1,792	1,914
Total revenue	84,825	72,420
Operating costs and expenses:		
Cost of rentals, exclusive of depreciation stated separately below	37,750	36,638
Cost of sales, exclusive of depreciation stated separately below	7,650	7,829
Cost of service and maintenance, exclusive of depreciation stated separately below	957	898
Selling, general and administrative expenses	13,642	10,762
Depreciation and amortization	24,116	25,397
Inventory allowance	83	208
Retirement of rental equipment	196	3,096
Total operating costs and expenses	84,394	84,828
Operating income (loss)	431	(12,408)
Other income (expense):		
Interest expense	(364)	(65)
Other income (expense)	(108)	687
Total other income, net	(472)	622
Income (loss) before income taxes:	(41)	(11,786)
(Provision for) benefit from income taxes:		
Current	(17)	1
Deferred	(511)	2,602
Total income tax benefit (expense)	(528)	2,603
Net loss	$ (569)	$ (9,183)
Loss per share:		
Basic	$ (0.05)	$ (0.70)
Diluted	$ (0.05)	$ (0.70)
Weighted average shares outstanding:		
Basic	12,305	13,100
Diluted	12,305	13,100

See accompanying notes to these consolidated financial statements.

NATURAL GAS SERVICES GROUP, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Total Stockholders' Equity
	Shares	Amount	Shares	Amount			Shares	Amount	
BALANCES, December 31, 2020	—	$ —	13,296	$ 133	$ 112,615	$ 139,286	38	$ (490)	$ 251,544
Compensation expense on common stock options	—	—	—	—	1	—	—	—	1
Issuance of restricted stock	—	—	98	—	—	—	—	—	—
Compensation expense on restricted common stock	—	—	—	1	1,737	—	—	—	1,738
Taxes paid related to net shares settlement of equity awards	—	—	—	—	(336)	—	—	—	(336)
Purchase of treasury shares	—	—	—	—	—	—	737	(7854)	(7,854)
Net loss	—	—	—	—	—	(9,183)	—	—	(9,183)
BALANCES, December 31, 2021	—	—	13,394	134	114,017	130,103	775	(8,344)	235,910
Compensation expense on common stock options	—	—	—	—	255	—	—	—	255
Issuance of restricted stock	—	—	125	—	—	—	—	—	—
Compensation expense on restricted common stock	—	—	—	1	1,654	—	—	—	1,655
Taxes paid related to net shares settlement of equity awards	—	—	—	—	(515)	—	—	—	(515)
Purchase of treasury shares	—	—	—	—	—	—	535	(6,660)	(6,660)
Net loss	—	—	—	—	—	(569)	—	—	(569)
BALANCES, December 31, 2022	—	$ —	13,519	$ 135	$ 115,411	$ 129,534	1,310	$ (15,004)	$ 230,076

See accompanying notes to these consolidated financial statements.

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

	Year Ended December 31,	
	2022	**2021**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (569)	$ (9,183)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	24,116	25,397
Amortization of debt issuance costs	48	31
Deferred taxes	510	(2,602)
Gain on disposal of assets	(250)	(182)
Retirement of rental equipment	196	3,096
Bad debt allowance	—	65
Inventory allowance	83	208
Stock-based compensation	1,910	1,738
(Gain) loss on company owned life insurance	389	(298)
Changes in operating assets and liabilities:		
Trade accounts receivables	(4,279)	1,430
Inventory	(4,143)	(1,277)
Prepaid income taxes and prepaid expenses	(250)	(460)
Accounts payable and accrued liabilities	11,309	9,756
Deferred income	(1,275)	208
Other	(31)	600
NET CASH PROVIDED BY OPERATING ACTIVITIES	27,764	28,527
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of rental equipment, property and other equipment	(65,122)	(25,710)
Purchase of company owned life insurance	(329)	(150)
Proceeds from sale of property and equipment	372	195
NET CASH USED IN INVESTING ACTIVITIES	(65,079)	(25,665)
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Proceeds from line of credit	25,000	—
Proceeds of other long-term liabilities	(3)	(1)
Repayments of line of credit, net	—	(417)
Payments of debt issuance costs	(77)	(237)
Purchase of treasury shares	(6,660)	(7,854)
Taxes paid related to net share settlement of equity awards	(515)	(336)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	17,745	(8,845)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(19,570)	(5,983)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	22,942	28,925
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 3,372	$ 22,942
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid	$ 276	$ 30
NON-CASH TRANSACTIONS		
Right of use asset acquired through an operating lease	229	—

See accompanying notes to these consolidated financial statements.

NATURAL GAS SERVICES GROUP INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business

Natural Gas Services Group, Inc. (the "Company", “NGS”, "Natural Gas Services Group", "we" or "our") (a Colorado corporation), is a leading provider of natural gas compression equipment and services to the energy industry. The Company manufactures, fabricates, rents, sells and maintains natural gas compressors and flare systems for oil and natural gas production and plant facilities. NGS is headquartered in Midland, Texas, with fabrication facilities located in Tulsa, Oklahoma and Midland, Texas, and service facilities located in major oil and natural gas producing basins in the U.S. The Company was formed on December 17, 1998.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company, its subsidiary, NGSG Properties, LLC and the rabbi trust associated with the Company’s deferred compensation plan, see Note 10. All significant intercompany accounts and transactions for the periods presented have been eliminated in consolidation.

Use of Estimates

The preparation of our consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires our management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates include fixed asset lives, bad debt allowance and the allowance for inventory obsolescence. Additionally, NGS conducts a yearly review of impairment of long-lived assets. Throughout the review, determining factors are based on estimates that can significantly impact the carrying value of these assets. It is at least reasonably possible these estimates could be revised in the near term and the revisions could be material.

Cash Equivalents and Financial Instruments

For purposes of reporting cash flows, we consider all short-term investments with an original maturity of three months or less to be cash equivalents. We invest our cash primarily in deposits and money market funds with commercial banks. At times, cash balances at banks and financial institutions may exceed federally insured amounts.

Accounts Receivable

Our trade receivables consist of customer obligations for the sale of compressors and flare systems due under normal trade terms, and operating leases for the use of our natural gas compressors. The receivables are not collateralized except as provided for under lease agreements. However, we typically require deposits of as much as 50% or use of progress payments for large custom sales contracts. We perform ongoing credit evaluations of our customers and adjust credit limits based on management's assessment of the customer's financial condition and payment history, as well as industry conditions and general economic conditions. We continuously monitor collections and payments from our customers, and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. One customer accounted for 55% and 46% of our accounts receivable as of December 31, 2022 and 2021, respectively. A significant change in the liquidity or financial position of this customer could have a material adverse impact on the collectability of our accounts receivable and our future operating results. The allowance for doubtful accounts was $0.3 million and $1.1 million at December 31, 2022 and 2021, respectively. Management believes that the allowance is adequate; however, actual write-offs may exceed the recorded allowance.

A summary of our allowance for doubtful accounts is as follows:

	Year Ended December 31,	
($ in thousands)	**2022**	**2021**
Beginning balance	$ 1,129	$ 1,161
Accruals	—	65
Recoveries	—	8
Write-offs	(791)	(105)
Ending balance	$ 338	$ 1,129

Revenue Recognition Policy

Revenue is measured based on a consideration specified in a customer's contract, excluding any sale incentives and taxes collected on behalf of third parties (i.e. sales and property taxes). Revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration that we expect to receive for those goods or services. To recognize revenue, we (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when, or as, we satisfy the performance obligation(s). Shipping and handling costs incurred are accounted for as fulfillment costs and are included in cost of revenues in our Consolidated Statements of Operations.

Nature of Goods and Services

The following is a description of principal activities from which the Company generates its revenue:

Rental Revenue. The Company generates revenue from renting compressors and flare systems to our customers. These contracts, which all qualify as operating leases under ASC Topic 842, Leases (ASC 842), may also include a fee for servicing the compressor or flare during the rental contract. Our rental contracts typically range from six to 24 months, with our larger horsepower compressors having contract terms of up to 60 months. Our revenue is recognized over time, with equal monthly payments over the term of the contract. After the terms of the contract have expired, a customer may renew their contract or continue renting on a monthly basis thereafter. In accordance with ASC 842 – Leases, we have applied the practical expedient ASC 842-10-15-42A, which allows the Company to combine lease and non-lease components.

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

Custom/fabricated compressors and flare systems - The Company designs and fabricates compressors and flares based on the customer's specifications outlined in their contract. Though the equipment being built is customized by the customer, control under these contracts does not pass to the customer until the compressor or flare package is completed and shipped, or in accordance with a bill and hold arrangements the customer accepts title and assumes the risk and rewards of ownership. We request some of our customers to make progressive payments as the product is being built; these payments are recorded as a contract liability on the Deferred Income line on the consolidated balance sheet until control has been transferred. These contracts also may include an assurance warranty clause to guarantee the product is free from defects in material and workmanship for a set duration of time; this is a standard industry practice and is not considered a performance obligation.

From time to time, upon the customer's written request, we recognize revenue when manufacturing is complete and the equipment is ready for shipment. At the customer's request, we will bill the customer upon completing all performance obligations, but before shipment. The customer will formally request we ship the equipment per their direction from our manufacturing facility at a later specified date and that we segregate the equipment from our finished goods, such that they are not available to fill other orders. Per the customer's agreement change of control is passed to the customer once the equipment is complete and ready for shipment. We have operated using bill and hold agreements with certain customers for many years, with consistent satisfactory results for both the customer and us. The credit terms on these agreements are consistent with the credit terms on all other sales. All control is shouldered by the customer and there are no exceptions to the customer's commitment to accept and pay for the manufactured equipment. Revenues recognized related to bill and hold arrangements for the years ended December 31, 2022 and 2021 was approximately $0 and $20,000, respectively.

Parts - Revenue is recognized after the customer obtains control of the parts. Control is passed either by the customer taking physical possession or the parts being shipped. The amount of revenue recognized is not adjusted for expected returns, as our historical part returns have been de minimis.

Exchange or rebuilding customer owned compressors - Based on the contract, the Company will either exchange a new/rebuilt compressor for the customer's malfunctioning compressor or rebuild the customer's compressor. Revenue is recognized after control of the replacement compressor has transferred to the customer based on the terms of the contract, i.e., by physical delivery, delivery and installment, or shipment of the compressor.

Used compressors or flares - From time to time, a customer may request to purchase a used compressor or flare out of our rental fleet. Revenue from the sale of rental equipment is recognized when the control has passed to the customer based on the terms of the contract, i.e. when the customer has taken physical possession or the equipment has been shipped.

Service and Maintenance Revenue. The Company provides routine or call-out services on customer owned equipment. Revenue is recognized after services in the contract are rendered.

Payment terms for sales revenue and service and maintenance revenue discussed above are generally 30 to 60 days although terms for specific customers can vary. Also, the transaction prices are not subject to variable consideration constraints.

Disaggregation of Revenue

The following table shows the Company's revenue disaggregated by product or service type for the years ended:

	Year Ended December 31,			
	2022		2021	
	(in thousands)			
Compressors - sales	$	3,601	$	1,891
Flares - sales		239		365
Other (Parts/Rebuilds) - sales		4,728		4,626
Service and maintenance		1,792		1,914
Total revenue from contracts with customers		10,360		8,796
Add: ASC 842 rental revenue		74,465		63,624
Total revenue	$	84,825	$	72,420

Contract Balances

As of December 31, 2022 and 2021, we had the following receivables and deferred income from contracts with customers:

	December 31,			
	2022		2021	
	(in thousands)			
Accounts Receivable				
Accounts receivable - contracts with customers	$	4,353	$	3,354
Accounts receivable - ASC 842		10,653		8,164
Total Accounts Receivable		15,006		11,518
Less: Allowance for doubtful accounts		(338)		(1,129)
Total Accounts Receivable, net	$	14,668	$	10,389
Deferred income	$	37	$	1,312

The Company recognized $1.3 million in revenue for the year ended December 31, 2022 that was included in deferred income at the beginning of 2022. For the period ended December 31, 2021, the Company recognized revenue of $1.1 million from amounts related to sales that were included in deferred income at the beginning of 2021.

The increases (decreases) of accounts receivable and deferred income were primarily due to normal timing differences between our performance and the customers' payments.

Transaction Price Allocated to the Remaining Performance Obligations

As of December 31, 2022, the Company did not have revenue related to unsatisfied performance obligations.

Contract Costs

The Company recognizes the incremental costs of obtaining contracts as an expense when incurred if the amortization period of the assets that the Company otherwise would have recognized is one year or less. These costs are included in selling, general and administrative expense on our Consolidated Statements of Operations.

Leases

Accounting Standards Codification ("ASC") 842 requires all leases to be reported on the balance sheet as right-of-use ("ROU") assets and lease obligations. We determine if an arrangement is a lease at inception and determine lease classification and recognize ROU assets and liabilities on the lease commencement date based on the present value of lease payments over the lease term. As the discount rate implicit in the lease is rarely readily determinable, we estimate our incremental borrowing rate using information available at the commencement date in determining the present value of the lease payments. We, as a lessee, apply the practical expedient to not separate non-lease components from lease components, therefore, accounting for each separate lease component and its associated non-lease component, as a single lease component. For each lease that 1) contains the same timing and pattern of transfer for lease and non-lease components and 2) if the lease component, if accounted for separately, would be classified as an operating lease, the Company has elected to not separate non-lease components from lease components.

Major Customers and Concentration of Credit Risk

Sales and rental income from Occidental Permian, LTD. ("Oxy") in 2022 and 2021 amounted to 42% and 40% of revenue, respectively. No other single customer accounted for more than 10% of our revenues in 2022 and 2021. Oxy's accounts receivable balances amounted to 55% and 46% of our accounts receivable as of December 31, 2022 and 2021, respectively. No other customers amounted to more than 10% of our accounts receivable as of December 31, 2022 and 2021.

Inventory

Inventory (current and long-term) is valued at the lower of cost and net realizable value. The cost of inventories is determined by the weighted average method. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on current and anticipated customer demand and production requirements. The Company assesses anticipated customer demand based on current and upcoming capital expenditure budgets of its major customers as well as other significant companies in the industry, along with oil and natural gas price forecasts and other factors affecting the industry. In addition, our long-term inventory consists of raw materials and replacement parts that remain viable but which the Company does not expect to sell within the next year.

Rental Equipment and Property and Equipment

Rental equipment and property and equipment are recorded at cost less accumulated depreciation, except for work-in-progress on new rental equipment which is recorded at cost until it’s complete and added to the fleet. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Our rental equipment has an estimated useful life between 15 and 25 years, while our property and equipment has an estimate useful lives which range from 3 to 39 years. The majority of our property and equipment, including rental equipment, is a direct cost to generating revenue.

We assess the impairment of rental equipment and property and equipment whenever events or changes in circumstances indicate that the net recorded amount may not be recoverable. The following factors could trigger an impairment review: significant underperformance relative to historical or projected future cash flows; significant adverse changes in the extent or manner in which asset (or asset group) is being used or its condition, including a meaningful drop in fleet utilization over the prior four quarters; significant negative industry or company-specific trends or actions, including meaningful capital expenditure budget reductions by our major customers or other sizable exploration and production or midstream companies, as well as significant declines in oil and natural gas prices; legislative changes prohibiting us from leasing our units or flares; or poor general economic conditions. An impairment loss is recognized if the future undiscounted cash flows associated with the asset (or asset group) and the estimated fair value of the asset are less than the asset's carrying value.

Sales of equipment out of the rental fleet are included with sales revenue and cost of sales, while retirements of units are shown a separate operating expense. Gains and losses resulting from sales and dispositions of other property and equipment are included with other income. Maintenance and repairs are charged to cost of rentals as incurred.

Intangibles

At December 31, 2022 and 2021, NGS had intangible assets, which relate to developed technology and a trade name. Developed technology is amortized on a straight-line basis with a useful life of 20 years, with a weighted average remaining life of approximately four years as of December 31, 2022. NGS has an intangible asset related to the trade name of SCS which was acquired in our acquisition of Screw Compression Systems in January 2005. This asset is not being amortized as it has been deemed to have an indefinite life.

Our policy is to review intangibles that are being amortized for impairment when indicators of impairment are present. In addition, it is our policy to review indefinite-lived intangible assets for impairment annually or when indicators of impairment are present. We review intangibles through an assessment of the estimated future cash flows related to such assets. In the event that assets are found to be carried at amounts in excess of estimated undiscounted future cash flows, then the assets will be adjusted for impairment to a level commensurate with a discounted cash flow analysis of the underlying assets.

Warranty

When warranted, we accrue amounts for estimated warranty claims based upon current and historical product warranty costs and any other related information known. There was no warranty reserve as of December 31, 2022 and 2021.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases, and net operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the statutory enactment date. Valuation allowances are established to reduce deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

ASC Topic 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In order to record any financial statement benefit, we are required to determine, based on technical merits of the position, whether it is more likely than not (a likelihood of more than 50 percent) that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes. If that step is satisfied, then we must measure the tax position to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of the benefit that is greater than 50 percent likely of being realized upon ultimate settlement. We have no uncertain tax positions as of December 31, 2022.

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

Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. ASC Topic 820 established a fair value hierarchy, which requires an entity to maximize the use of observable inputs when measuring fair value. These inputs are categorized as follows:

Level 1- quoted prices in an active market for identical assets or liabilities;

Level 2- quoted prices in an active market for similar assets or liabilities, inputs other than quoted prices that are observable for similar assets or liabilities, inputs derived principally from or corroborated by observable market data by correlation or other means; and

Level 3- valuation methodology with unobservable inputs that are significant to the fair value measurement.

Management believes that the fair value of our cash and cash equivalents, trade receivables, accounts payable and line of credit at December 31, 2022 and 2021 approximate their carrying values due to the short-term nature of the instruments or the use of prevailing market interest rates.

Segments and Related Information

ASC 280-10-50, "Operating Segments", define the characteristics of an operating segment as a) being engaged in business activity from which it may earn revenue and incur expenses, b) being reviewed by the company's chief operating decision maker (CODM) for decisions about resources to be allocated and assess its performance and c) having discrete financial information. Although we indeed look at our products to analyze the nature of our revenue, other financial information, such as certain costs and expenses, net income and EBITDA are not captured or analyzed by these categories. Our CODM does not make resource allocation decisions or access the performance of the business based on these categories, but rather in the aggregate. Based on this, management believes that it operates in one business segment.

We are engaged in the business of designing and manufacturing compressors and flares. Our compressors and flares are sold and rented to our customers. In addition, we provide service and maintenance on compressors in our fleet and to third parties. These business activities are similar in all geographic areas. Historically, our manufacturing process has been essentially the same for the entire Company and has been performed in house at our facilities in Midland, Texas and Tulsa, Oklahoma. Recently, however, we have contracted with third party fabricators to assemble our larger horsepower natural gas compressors. Our customers primarily consist of entities in the business of producing natural gas. The maintenance and service of our products is consistent across the entire Company and is performed via an internal fleet of vehicles. The regulatory environment is similar in every jurisdiction in that the most impacting regulations and practices are the result of federal energy policy.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses (ASC Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments to ASC Topic 326 require immediate recognition of estimated credit losses expected to occur over the remaining life of many financial assets, including trade receivables. For companies that qualify as smaller reporting companies, the amendments in this update are effective for interim and annual periods beginning after January 1, 2023. We are currently evaluating the impact of ASU 2016-13 on our consolidated financial statements and note disclosures.

3. Inventory

Our inventory, net of allowance for obsolescence of $120,000 and $64,000 at December 31, 2022 and 2021, respectively, consisted of the following:

	December 31,	
	2022	**2021**
	(in thousands)	
Raw materials - current	$ 21,354	$ 17,528
Work-in-process	2,060	1,801
Inventory - current	23,414	19,329
Raw materials - long term (net of allowances of $120 and $64, respectively)	1,557	1,582
Inventory - total	$ 24,971	$ 20,911

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

Inventory Allowance

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

A summary of our inventory allowance is as follows:

	Year Ended December 31,	
	2022	2021
	(in thousands)	
Beginning balance	$ 64	$ 221
Accruals	83	208
Write-offs	(27)	(365)
Ending balance	$ 120	$ 64

4. Rental Equipment, Property and Equipment

Rental Equipment

Our rental equipment and associated accumulated depreciation as of December 31, 2022 and 2021, respectively, consisted of the following:

	December 31,	
	2022	2021
	(in thousands)	
Compressor units	$ 387,145	$ 374,336
Work-in-progress	37,034	5,212
Rental equipment	424,179	379,548
Accumulated depreciation	(177,729)	(172,563)
Rental equipment, net of accumulated depreciation	$ 246,450	$ 206,985

Our rental equipment has an estimated useful life between 15 and 25 years. Depreciation expense for rental equipment was $21.9 million and $22.9 million for the years ended December 31, 2022 and 2021, respectively. During the year ended December 31, 2022 we added 45 units to our rental fleet.

Retirement of Rental Equipment

Company management routinely reviews its inventory of rental equipment for retirement or obsolescence. During 2022, management reviewed the rental fleet to determine which units were not of the type, configuration, make or model that our customers are demanding or that were not cost efficient to refurbish, maintain and/or operate. As a result of this review, we determined 124 units should be retired from our rental fleet. Accordingly, we recorded a $0.2 million loss on retirement of rental equipment during the year ended December 31, 2022.

During our review of our rental compressor units in 2021, we determined 263 units should be retired from our rental fleet. We recorded a $3.1 million loss on retirement of rental equipment.

Property and Equipment

Property and equipment consists of the following at December 31, 2022 and 2021:

	Useful Lives (Years)	December 31, 2022	December 31, 2021
		($ in thousands)	
Land	—	$ 1,680	$ 1,680
Building	39	19,166	18,977
Leasehold improvements	39	1,218	1,197
Office equipment and furniture	5	2,016	2,016
Software	5	573	573
Machinery and equipment	7	4,052	3,874
Vehicles	3	9,858	8,295
Work-in-progress		594	—
Total		39,157	36,612
Less accumulated depreciation		(16,981)	(15,784)
Total		$ 22,176	$ 20,828

Depreciation expense for property and equipment was $2.1 million and $2.4 million for the year ended December 31, 2022 and 2021, respectively.

Depreciation Expense by Product Line

The following table depicts annual depreciation expense associated with each product line as well as our corporate activities at December 31, 2022 and 2021:

	December 31, 2022	December 31, 2021
	(in thousands)	
Rentals	$ 23,243	$ 24,423
Sales	275	281
Service & Maintenance	33	49
Corporate	440	476
Total	$ 23,991	$ 25,229

5. Rental Activity

We rent natural gas compressor packages to entities in the petroleum industry. These rental arrangements are classified as operating leases and generally have original terms of six months to sixty months and continue on a month-to-month basis thereafter.

Future minimum rent payments for arrangements not on a month-to-month basis at December 31, 2022 are as follows:

Years Ending December 31,	*(in thousands)*
2023	$32,494
2024	19,098
2025	16,682
2026	7,835
2027	3,303
Thereafter	—
Total	$79,412

6. Leases

The Company determines if an arrangement is a lease at inception by assessing whether it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Company’s leases are primarily related to property leases for its field offices. The Company's leases have remaining lease terms of one to eight years. Renewal and termination options are included in the lease term when it is reasonably certain that the Company will exercise the option.

The Company's lease agreements do not contain any contingent rental payments, material residual guarantees or material restrictive covenants.

Right of use assets and lease liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. As substantially all of the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate, which is based on a fully collateralized loan over the lease term, to determine the present value of lease payments. The Company has no finance leases. The following table reflects the amounts related to leases that are recorded on our consolidated balance sheets as of December 31, 2022 and 2021:

	Classification on Consolidated Balance Sheets	**December 31,**	
		2022	**2021**
		($ in thousands)	
Operating lease assets	Right of use assets-operating leases	$ 349	$ 285
Current lease liabilities	Current operating leases	$ 155	$ 68
Noncurrent lease liabilities	Long-term operating leases	194	217
Total lease liabilities		$ 349	$ 285
Weighted average remaining lease term in years		4.5	6.6
Implicit Rate		5.2 %	3.4 %

Operating lease costs are recognized on a straight-line basis over the lease term. Total operating lease costs for the year ended December 31, 2022 was approximately $384,000.

	December 31,	
	2022	**2021**
	(in thousands)	
Cash paid for amounts included in the measurement of lease liabilities		
Operating lease cost (1) (2)	$ 384	$ 556

(1) Lease costs are classified on the Consolidated Statements of Operations in cost of sales, cost of compressors and selling, general and administrative expenses.

(2) Includes costs of $207,000 for leases with terms of 12 months or less and $177,000 for leases with terms greater than 12 months for the year ended December 31, 2022. Includes costs of $346,000 for leases with terms of 12 months or less and $210,000 for leases with terms greater than 12 months for the year ended December 31, 2021.

The following table shows the future maturities of lease liabilities:

Years Ending December 31,	**Lease Liabilities**
	(in thousands)
2023	$ 167
2024	41
2025	41
2026	40
2027	39
Thereafter	54
Total lease payments	382
Less: Imputed interest	(33)
Total	$ 349

Rent expense under such leases was $177,000 and $210,000 for the years ended December 31, 2022 and 2021, respectively.

7. Intangibles

At December 31, 2022 and 2021, the Company had intangible assets, which relate to developed technology and a trade name. Amortization expense recognized in each of the years ending December 31, 2022 and 2021 was $125,000. Estimated amortization expense for the years 2023-2025 is approximately $125,000 per year. The Company has an intangible asset with a gross carrying value of $654,000 at December 31, 2022 related to the trade name of SCS which was acquired in our acquisition of Screw Compression Systems in January 2005. This asset is not being amortized as it has been deemed to have an indefinite life.

The following table represents the identified intangible assets by major asset class (in thousands):

		December 31, 2022			**December 31, 2021**		
	Useful Life (years)	Gross Carrying Value	Accumulated Amortization	Net Book Value	Gross Carrying Value	Accumulated Amortization	Net Book Value
Developed Technology	20	$ 2,505	$ 2,259	$ 246	$ 2,505	$ 2,134	$ 371
Trade Name	Indefinite	654	—	654	654	—	654
Total		$ 3,159	$ 2,259	$ 900	$ 3,159	$ 2,134	$ 1,025

Our policy is to review intangibles that are being amortized for impairment when indicators of impairment are present. In addition, it is our policy to review indefinite-lived intangible assets for impairment annually or when indicators of impairment are present. We review intangibles through an assessment of the estimated future cash flows related to such assets. In the event that assets are found to be carried at amounts in excess of estimated undiscounted future cash flows, then the assets will be adjusted for impairment to a level commensurate with a discounted cash flow analysis of the underlying assets. Based upon our analysis, we experienced no impairment of intangible assets during the years ended December 31, 2022 or 2021.

8. Credit Facility

Previous Credit Agreement

We had a senior secured revolving credit agreement (the "Previous Credit Agreement") with JP Morgan Chase Bank, N.A (the "Lender") that matured on March 31, 2021. The Previous Credit Agreement had an aggregate commitment of $30 million, subject to collateral availability.

New Credit Agreement

On May 11, 2021, we entered into a five year senior secured revolving credit agreement ("New Credit Agreement") with Texas Capital Bank, National Association (the "Lender") with an initial commitment of $20 million and an accordion feature that would increase the maximum commitment to $30 million, subject to collateral availability. On December 12, 2022, we entered into a First Amendment to the New Credit Agreement (the "First Amendment") to increase the maximum commitment to $30 million. We also have a right to request from the Lender, on an uncommitted basis, an increase of up to $30 million on the aggregate commitment; provided, however, the aggregate commitment amount is not permitted to exceed $50 million. The maturity date of the New Credit Agreement is May 11, 2026. The obligations under the New Credit Agreement are secured by a first priority lien on a variety of our assets, including inventory and accounts receivable as well as a variable number of our leased compressor equipment. As of December 31, 2022, we were in compliance with all financial covenants in our New Credit Agreement. At December 31, 2022, we had $25.0 million outstanding under the New Credit Agreement with a weighted average interest rate of 7.32%. At December 31, 2022, we had $5 million of availability under the New Credit Agreement.

Amended and Restated Credit Agreement

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

Borrowing Base. At any time before the maturity of the Amended and Restated Credit Agreement, we may draw, repay and re-borrow amounts available under the borrowing base up to the maximum aggregate availability discussed above. Generally, the borrowing base equals the sum of (a) 85% of eligible accounts receivable owed to the Company, plus (b) 50% of the eligible inventory, valued at the lower of cost or market value at such time, subject to a cap of this component not to exceed $2.5 million, plus (c) the lesser of (i) 95% of the net book value of the compressors that the Lender has determined are eligible for the extension of credit, valued at the lower of cost or market value with depreciation not to exceed 25 years, at such time and (ii) 80% of the net liquidation value percentage of the net book value of the eligible compressors that the Lender has determined are eligible for the extension of credit, valued at the lower of cost or market value with depreciation not to exceed 25 years, at such time, plus (d) 80% of the net book value, valued at the lower of cost (excluding any costs for capitalized interest or other noncash capitalized costs) or market of the eligible new compressor fleet, minus (e) any required availability reserves determined by the Lender in its sole discretion. The Lender may adjust the borrowing base components if material deviations in the collateral are discovered in future audits of the collateral.

Interest and Fees. Under the terms of the Amended and Restated Credit Agreement, we have the option of selecting the applicable variable rate for each revolving loan, or portion thereof, of either (a) the Base Rate (as defined below) plus the Applicable Margin, or (b) in the case of a Term SOFR (“Secured Overnight Financing Rate”) Loan, the Adjusted Term SOFR rate plus the Applicable Margin. "Base Rate" means, for any day, a rate of interest per annum equal to the highest of (a) the prime rate for such day; (b) the sum of the federal funds rate for such day plus 0.50%; and (c) the Adjusted Term SOFR for such day plus 1.00%. The Applicable Margin is determined based upon the leverage ratio as set forth in the most recent compliance certificate received by the Lender for each fiscal quarter from time to time pursuant to the Amended and Restated Credit Agreement. Depending on the leverage ratio, the Applicable Margin can be 2.00% to 2.75% for Base Rate Loans (as defined in the Amended and Restated Credit Agreement) and 3% to 3.75% for Term SOFR Loans and for requested letters of credit. In addition, we are required to pay a monthly commitment fee on the daily average unused amount of the commitment while the Amended and Restated Credit Agreement is in effect at an annual rate equal to 0.50% of the unused commitment amount. Accrued interest is payable monthly on outstanding principal amounts and unused commitment fee, provided that accrued interest on Term SOFR Loans is payable at the end of each interest period, but in no event less frequently than quarterly.

Covenants. The Amended and Restated Credit Agreement contains customary representations and warranties, as well as covenants which, among other things, condition or limit our ability to incur additional indebtedness and liens; enter into transactions with affiliates; make acquisitions in excess of certain amounts; pay dividends; redeem or repurchase capital stock or senior notes; make investments or loans; make negative pledges; consolidate, merge or effect asset sales; or change the nature of our business. In addition, we are subject to certain financial covenants in the Amended and Restated Credit Agreement that require us to maintain (i) a leverage ratio, as defined, lesser than or equal to 3.50 to 1.00 as of the last day of each fiscal quarter ending on or prior to December 31, 2024 and 3.25 to 1.00 for the fiscal quarter ending March 31, 2025 and for each fiscal quarter thereafter and (ii) a fixed charge coverage ratio greater than or equal to 1.25 to 1.00 as of the last day of each fiscal quarter.

Events of Default and Acceleration. The Amended and Restated Credit Agreement contains customary events of default for credit facilities of this size and type, and includes, without limitation, payment defaults; defaults in performance of covenants or other agreements contained in the Amended and Restated Credit Agreement and the other transaction documents; inaccuracies in representations and warranties; certain defaults, termination events or similar events; certain defaults with respect to any other Company indebtedness in excess of $1.0 million; certain bankruptcy or insolvency events; the rendering of certain judgments in excess of $1 million; certain ERISA events; certain change in control events and the defectiveness of any liens under the secured revolving credit agreement. Obligations outstanding under the Amended and Restated Credit Agreement may be accelerated upon the occurrence of an event of default.

9. Income Taxes

The (provision for) benefit from income taxes for the years ended December 31, 2022 and 2021, consists of the following (in thousands):

	2022	2021
Current (expense) benefit		
Federal benefit	$ —	$ —
State (expense) benefit	(17)	1
Total current (expense) benefit	(17)	1
Deferred (expense) benefit:		
Federal (expense) benefit	(857)	1,991
State (expense) benefit	346	611
Total deferred (expense) benefit	(511)	2,602
Total (expense) benefit	$ (528)	$ 2,603

The effective tax rate for the years ended December 31, 2022 and 2021, differs from the statutory rate as follows:

	2022	2021
Statutory rate	21.0 %	21.0 %
State and local taxes	812.2 %	5.2 %
Stock based compensation	(58.5)%	(0.7)%
Nondeductible compensation	(1846.3)%	(3.6)%
Other	(217.1)%	0.2 %
Effective rate	(1288.7)%	22.1 %

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted in response to the economic impact caused by the COVID-19 pandemic. The CARES Act, among other things, permits federal income tax net operating loss ("NOL") carryovers and carrybacks to offset 100% of taxable income for taxable years beginning before 2021. In addition, the CARES Act allows NOLs incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid federal income taxes. The Company generated significant NOLs during 2018 and 2019 and filed carryback claims for these losses to the preceding five years. Accordingly, as of March 31, 2020, the Company recorded a federal income tax receivable of $15.0 million and an increase to its deferred tax liability of $10.1 million on its condensed balance sheet. During the third quarter of 2020, the Company received refunds corresponding to the 2018 NOL carryback, leaving a balance in the federal income tax receivable of $11.5 million at December 31, 2022.

In conjunction with the $11.5 million income tax refund claim, on March 8, 2023, the Company received a notice from the Internal Revenue Service that its 2015, 2016, 2017 and 2019 income tax returns were selected for examination.

The income tax effects of temporary differences that give rise to significant portions of deferred income tax assets and (liabilities) as of December 31, 2022 and 2021, are as follows (in thousands):

	2022	2021
Deferred income tax assets:		
Net operating loss	$ 6,391	$ 5,355
Research and development credits	1,338	1,363
Stock compensation	121	114
Deferred compensation	617	632
Other	354	515
Total deferred income tax assets	8,821	7,979
Deferred income tax liabilities:		
Property and equipment	(48,427)	(47,044)
Goodwill and other intangible assets	(192)	(223)
Total deferred income tax liabilities	(48,619)	(47,267)
Net deferred income tax liabilities	$ (39,798)	$ (39,288)

As of December 31, 2022, the Company had NOL carryforwards for federal income tax purposes of $25.4 million, which may be carried forward indefinitely and can offset up to 80% of future taxable income in any given year. Future changes in ownership, as defined by Section 382 of the Internal Revenue Code ("IRC"), could limit the amount of NOL carryforwards used in any one year. In general, under Section 382 and 383 of the IRC, a corporation that undergoes an "ownership change" is subject to limitations on its ability to utilize its pre-change NOLs and certain tax credits, to offset future taxable income and tax. In general, an ownership change occurs if the aggregate stock ownership of certain stockholders changes by more than 50 percentage points over such stockholders' lowest percentage of ownership during the testing period (generally three years).

We account for uncertain tax positions in accordance with guidance in FASB ASC 740, which prescribes the minimum recognition threshold a tax position taken or expected to be taken in a tax return is required to meet before being recognized in the financial statements. The Company assessed whether it had any uncertain tax positions related to open tax years and concluded there were none. Accordingly, no reserve for uncertain tax positions has been recorded as of December 31, 2022 and 2021.

Our policy regarding income tax interest and penalties is to expense those items as incurred. During the years ended December 31, 2022 and 2021, there were no significant income tax interest or penalty items in the statement of operations.

We file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, we are no longer subject to U.S. federal or state income tax examination by tax authorities for years before 2015.

10. Deferred Compensation Plans

Effective January 1, 2016, the Company established a non-qualified deferred compensation plan for executive officers, directors and certain eligible employees. The assets of the deferred compensation plan are held in a rabbi trust and are subject to additional risk of loss in the event of bankruptcy or insolvency of the Company. The plan allows for deferral up to 90% of a participant's base salary, bonus, commissions, director fees and restricted stock awards. A Company owned life insurance policy held in a rabbi trust is utilized as a source of funding for the plan. The cash surrender value of the life insurance policy is $2.4 million and $2.5 million as of December 31, 2022 and 2021, respectively, with a gain/(loss) related to the policy of $(389,000) and $298,000 reported in other income in our consolidated statement of operations for the year ended December 31, 2022 and 2021, respectively.

For deferrals of base salary, bonus, commissions and director fees, settlement payments are made to participants in cash, either in a lump sum or in periodic installments. The deferred obligation to pay the deferred compensation and the deferred director fees is adjusted to reflect the positive or negative performance of investment measurement options selected by each participant and was $2.8 million and $2.8 million as of December 31, 2022 and 2021, respectively. The deferred obligation is included in other long-term liabilities in the consolidated balance sheets.

For deferrals of restricted stock units, the plan does not allow for diversification, therefore, distributions are paid in shares of our common stock and the obligation is carried at grant value. As of December 31, 2022 and 2021, respectively, we have 3,138 and 17,248 unvested restricted stock units being deferred. As of December 31, 2022 and 2021, respectively we have released and issued 188,562 and 174,452 shares to the deferred compensation plan with a value of $2.6 million and $2.5 million, respectively.

11. Stockholders' Equity

Preferred Stock

We have a total of 5.0 million authorized preferred shares which may be issued in series with rights and preferences as designated by the Board of Directors. As of December 31, 2022 and 2021, there were no issued or outstanding preferred shares.

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

Restricted Stock

On June 20, 2019, at our annual meeting of shareholders, our shareholders approved an Equity Incentive Plan for restricted shares/units, stock options and other equity awards. The Equity Incentive Plan allows issuance up to 500,000 shares of common stock. On June 16, 2022, at our annual meeting of shareholders, our shareholders approved an amendment to the Equity Incentive Plan to increase the number of shares available for issuance under the plan by 650,000 shares of common stock. As of December 31, 2022, we had 250,847 shares outstanding under the Equity Incentive Plan that will vest over the next three years. As of December 31, 2022, 570,473 shares were still available for issuance under the Equity Incentive Plan.

On April 26, 2022, 4,212 shares of restricted common stock were awarded to each of our four independent Board members. The restricted stock issued to our directors vests in one year from the date of grant. On August 15, 2022, the Compensation Committee awarded 32,040 shares of restricted common stock to two executive officers that vest ratably over three years, beginning on April 25, 2023. In addition, on August 15, 2022, the Compensation Committee awarded 60,839 shares of restricted common stock to Mr. Stephen Taylor, our Interim Chief Executive Officer. The restricted shares granted to Mr. Taylor will vest in full on June 30, 2023.

Compensation expense related to the restricted shares was approximately $1.7 million and $1.7 million for the years ended December 31, 2022 and 2021, respectively. As of December 31, 2022, there was a total of approximately $1.0 million of unrecognized compensation expense related to the unvested portion of these restricted shares/units. This expense is expected to be recognized over the next three years.

A summary of all restricted stock activity as of December 31, 2021 and 2022 and changes during the years then ended are presented below.

	Number of Shares	Grant Date Fair Value	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value *(in thousands)*
Outstanding, December 31, 2020	258,101	$ 12.87	8.61	$ 2,447
Granted	156,339	$ 8.99	—	$ 1,406
Vested	(134,788)	$ 14.94	—	$ 1,258
Canceled/Forfeited	(3,333)	12.26	—	31
Outstanding, December 31, 2021	276,319	$ 9.67	1.77	$ 2,893
Granted	126,662	$ 10.21	—	$ 1,294
Vested	(152,134)	$ 10.99	—	$ 1,778
Canceled/Forfeited	—	$ —	—	$ —
Outstanding, December 31, 2022	250,847	$ 9.14	1.42	$ 2,681

Other Long-Term Incentive Compensation

On April 28, 2020, the Compensation Committee issued a long-term incentive award of $1.1 million to an executive officer that vests in equal, annual tranches over three years. At the time of vesting, each tranche will be payable in cash or common stock at the discretion of the Compensation Committee. On March 18, 2021, the Compensation Committee issued a long-term incentive award of $1.0 million to an executive officer that vests in equal, annual tranches over three years. On March 18, 2021, we issued a $50,000 award to each of our three independent Board members. On April 1, 2021, we issued a $50,000 award to a newly appointed independent Board member. These awards vest one year from the date of grant and are payable in cash upon vesting. On April 26, 2022, we issued a $50,000 award to each of our four independent Board members. These awards vest one year from the date of grant and are payable in cash upon vesting. The Company accounts for these other long-term incentive awards as liabilities under accrued liabilities on our condensed consolidated balance sheet. The vesting of these awards is subject to acceleration upon certain events, such as (i) death or disability of the recipient, (ii) certain circumstances in connection with a change of control of the Company, (iii) for executive officers, termination without cause (as defined in the agreement), and (iv) for executive officers, resignation for good reason (as defined). Total compensation expense related to these other long-term incentive awards was approximately $1.0 million for the year ended December 31, 2022. As of December 31, 2022 there was a total of $0.7 million of unrecognized compensation expense related to these other long-term incentive awards which is expected to be recognized over the next year.

Stock Option Plan

Our Stock Option Plan, which is stockholder approved, permits the granting of stock options to its employees for up to 1.0 million shares of common stock. We believe that such awards align the interests of our employees with our stockholders. Option awards are generally granted with an exercise price equal to the market price of our stock at the date of grant; those option awards generally vest in equal increments over three years of continuous service and have ten-year contractual terms. Certain option and share awards provide for accelerated vesting if there is a change in control of the Company (as defined in the Stock Option Plan). The last date that grants can be made under the Stock Option Plan is February 28, 2026. As of December 31, 2022, 344,253 shares were still available to be granted under the Stock Option Plan.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model that uses the assumptions noted in the following table. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life of options granted is based on the vesting period and historical exercise and post-vesting employment termination behavior for similar grants. We use historical data to estimate option exercise and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes.

Weighted average Black -Scholes fair value assumption during the year ended December 31, are as follows:	**2022**
Risk free rate	2.99 %
Expected life	2.67
Expected volatility	54.5 %
Expected dividend yield	— %

During the year ended December 31, 2022, 215,000 stock option grants were made.

A summary of all option activity as of December 31, 2021 and 2022 and changes during the years then ended are presented below:

	Number of Shares		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)		Aggregate Intrinsic Value
						(in thousands)
Outstanding, December 31, 2020	161,334	$	24.48	3.48	$	—
Granted	55,500	$	10.58	—		—
Exercised	—		—	—		—
Canceled/Forfeited	—	$	—	—	$	—
Expired	(16,000)	$	17.81	—		—
Outstanding, December 31, 2021	200,834	$	21.17	4.83		—
Granted	215,000	$	16.07	—		—
Exercised	—		—	—		—
Canceled/Forfeited	(200,750)	$	(18.09)	—		—
Expired	(13,500)	$	13.29	—		—
Outstanding, December 31, 2022	201,584	$	19.32	3.90	$	—
Exercisable, December 31, 2022	160,084	$	21.48	2.55	$	—

The weighted average grant date fair value of options granted during 2022 was $4.24 per option. We had 55,500 grants of stock options in 2021 with a weighted average grant date fair value of $5.15. There were no option exercises in either 2022 or 2021.

The following table summarizes information about our stock options outstanding at December 31, 2022:

	Options Outstanding				Options Exercisable		
Range of Exercise Prices	**Shares**	**Weighted Average Remaining Contractual Life (years)**		**Weighted Average Exercise Price**	**Shares**		**Weighted Average Exercise Price**
$0.01-$18.00	106,000	5.58	$	13.30	64,500	$	14.78
$18.01-$22.00	13,000	0.22		18.75	13,000	$	18.75
$22.01-$26.00	29,667	2.28		22.90	29,667	$	22.90
$26.01-$30.00	20,750	4.13		28.15	20,750	$	28.15
$30.01-$34.00	32,167	1.22		30.41	32,167	$	30.41
	201,584	3.90	$	19.32	160,084	$	21.48

The summary of the status of our unvested stock options as of December 31, 2022 and changes during the year then ended is presented below.

Unvested stock options:	**Shares**		**Weighted Average Grant Date Fair Value**
Unvested at December 31, 2021	55,500	$	10.58
Granted	215,000	$	16.07
Vested	(69,500)		14.48
Canceled/Forfeited	(159,500)		16.17
Unvested at December 31, 2022	41,500	$	11.01

We recognized stock compensation expense from stock options of $255,000 and $728 for the years ended December 31, 2022 and 2021, respectively. As of December 31, 2022, there was $188,000 of unamortized compensation cost related to unvested stock options.

13. Loss per Share

Basic loss per common share is computed using the weighted average number of common shares outstanding during the period. Diluted loss per common share is computed using the weighted average number of common stock and common stock equivalent shares outstanding during the period.

The following table sets forth the computation of basic and diluted loss per share (in thousands, except per share amounts):

	Year Ended December 31,	
	2022	**2021**
Numerator:		
Net loss	$ (569)	$ (9,183)
Denominator for basic net loss per common share:		
Weighted average common shares outstanding	12,305	13,100
Denominator for diluted net loss per share:		
Weighted average common shares outstanding	12,305	13,100
Dilutive effect of stock options and restricted shares	—	—
Diluted weighted average shares	12,305	13,100
Loss per common share:		
Basic	$ (0.05)	$ (0.70)
Diluted	$ (0.05)	$ (0.70)

In the year ended December 31, 2022, 250,847 restricted stock/units and 201,584 stock options were not included in the computation of dilutive income per share, due to their anti-dilutive effect. In the year ended December 31, 2021, 276,319 restricted stock/units and 200,834 stock options were not included in the computation of diluted loss per share due to their antidilutive effect.

14. Accrued Liabilities

Accrued liabilities consists of the following as of December 31, 2022 and 2021 (in thousands):

	2022	**2021**
Accrued purchases	$ 17,763	$ 9,667
Accrued compensation	4,472	2,369
Accrued other	1,491	2,067
Total	$ 23,726	$ 14,103

15. Commitments and Contingencies

Legal Proceedings

From time to time, we are a party to various legal proceedings in the ordinary course of our business. While management is unable to predict the ultimate outcome of these actions, it believes that any ultimate liability arising from these actions will not have a material effect on our financial position, results of operations or cash flow. We are not currently a party to any bankruptcy, receivership, reorganization, adjustment or similar proceeding, and we are not aware of any other threatened litigation.

16. Related Party

During the year ended December 31, 2022, we sold $0.6 million of compressor components to N-G Joint Venture, LLC our 50% joint venture. As of December 31, 2022, we had accounts receivable of $6,000 with N-G.

17. Subsequent Events

On February 28, 2023, we entered into an Amended and Restated Credit Agreement. See Note 8.

Exhibit 21.1

Subsidiaries of the Registrant

Listed below are subsidiaries of Natural Gas Services Group, Inc. with their jurisdiction of organization shown in parenthesis:

NGSG Properties, LLC (Colorado)
Rabbi Trust associated with the Company's Non-qualified Deferred Compensation Plan (Texas)

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

Natural Gas Services Group, Inc.
Midland, Texas

We consent to the incorporation by reference in the Registration Statements (Form S-3 No. 333-261091 and Form S-8 Nos. 333-232269, 333-212411, 333-160063, 333-147311, and 333-110954) of our report dated March 31, 2023, relating to the consolidated financial statements of Natural Gas Services Group, Inc. which report expresses an unqualified opinion, appearing in this Annual Report (Form 10-K) for the year ended December 31, 2022.

/s/ Ham, Langston & Brezina L.L.P

Houston, Texas
March 31, 2023

Exhibit 23.2

Consent of Independent Registered Public Accounting Firm

Natural Gas Services Group, Inc.
Midland, Texas

We consent to the incorporation by reference in the Registration Statements on Form S-3 No. (333-261091) and Form S-8 (No. 333-232269, 333-212411, 333-160063, 333-147311, 333-110954 and 333-266100) of Natural Gas Services Group, Inc. (the Company), of our our report dated March 31, 2023, relating to the consolidated financial statements of the Company as of and for the year ended December 31, 2021 (which report expresses an unqualified opinion), appearing in this Annual Report (Form 10-K) for the year ended December 31, 2022.

/s/ Moss Adams LLP

Dallas, Texas
March 31, 2023

Exhibit 31.1

Certifications

I, Stephen C. Taylor, certify that:

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

1. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 31, 2023

Natural Gas Services Group, Inc.

By: /s/ Stephen C. Taylor

Stephen C. Taylor,
Interim President, CEO and Chairman of the Board of Directors
(Principal Executive Officer)

Exhibit 31.2

Certifications

I, James D. Faircloth, certify that:

1. I have reviewed this Annual Report on Form 10-K of Natural Gas Services Group, Inc;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 31, 2023

Natural Gas Services Group, Inc.

By: /s/ James D. Faircloth
James D. Faircloth
Interim Vice President and Chief Financial Officer
(Principal Accounting Officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO

18 U.S.C. §1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Natural Gas Services Group, Inc. (the "Company") on Form 10-K for the period ended December 31, 2022 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Stephen C. Taylor, Interim Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Dated: March 31, 2023

Natural Gas Services Group, Inc.

By: /s/ Stephen C. Taylor

Stephen C. Taylor,
Interim President, CEO and Chairman of the Board of Directors
(Principal Executive Officer)

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

Exhibit 32.2

CERTIFICATION PURSUANT TO

18 U.S.C. §1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Natural Gas Services Group, Inc. (the "Company") on Form 10-K for the period ended December 31, 2022 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James D. Faircloth, Interim Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Dated: March 31, 2023

Natural Gas Services Group, Inc.

By: /s/ James D. Faircloth

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

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