

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, 2020**

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

(State or other jurisdiction of incorporation or organization)

404 Veterans Airpark Lane, Suite 300, Midland, Texas

(Address of principal executive offices)

Registrant's telephone number, including area code:

75-2811855

(I.R.S. Employer Identification No.)

79705

(Zip 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.

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2020 was approximately \$82,414,178 based on the closing price of the common stock on that date on the New York Stock Exchange.

At March 26, 2021, there were 13,605,803 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 17, 2021.

FORM 10-K
NATURAL GAS SERVICES GROUP, INC.
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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;
- conditions in the oil and natural gas industry, including the supply and demand for natural gas and wide fluctuations and possible prolonged depression in the prices of oil and natural gas;
- economic challenges presently faced by our customers in the oil and natural gas business that, in turn, could adversely affect our sales, rentals and collectability of our accounts receivable;
- 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;
- future capital requirements and availability of financing;
- fabrication and manufacturing costs;
- general economic conditions;
- acts of terrorism; and
- fluctuations in interest rates.

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 these scaled requirements.

The Company

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 has shifted its 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 45.0% of rental revenues in 2020), with the large 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.

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. As of December 31, 2020, our rental compression fleet was comprised of 2,224 natural gas compression units with 438,524 horsepower. Of this total, we had 1,274 natural gas compression units in service with 287,646 horsepower, resulting in horsepower utilization of 65.6%. We added 42 units with approximately 23,265 horsepower to our fleet during 2020. 24 of those units were 400 horsepower or larger (including 10 at 1,380 horsepower each), representing approximately 89% of the horsepower added.

Our revenue decreased 13.2% to \$68.1 million from \$78.4 million for the year ended December 31, 2020 compared to the year ended December 31, 2019. This decline was largely the result of our sales revenue decreasing 71.4% to \$5.7 million in 2020 from \$19.8 million in 2019. For the year ended December 31, 2020 the Company reported net income of \$1.8 million as compared to a net loss of \$13.9 million for the year ended December 31, 2019. In addition, the Company's adjusted earnings before interest, taxes, depreciation and amortization ("EBITDA") decreased 5.5% to \$22.7 million in 2020 from \$24.0 million in 2019. See "Item 6, Selected Financial Data, Non-GAAP Financial Measures" for a reconciliation of adjusted EBITDA to its closest GAAP financial measure, net (loss) income.

At December 31, 2020, current assets were \$72.7 million, which included \$28.9 million of cash and cash equivalents. Current liabilities were \$10.9 million at year end 2020, which included the full amount outstanding on our line of credit of \$417,000. Our stockholders' equity as of December 31, 2020 was \$251.5 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, Service and Maintenance and Corporate.

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, 2020, we had 2,224 natural gas compressors in our rental fleet totaling 438,524 horsepower. Of this total, we had 1,274 natural gas compressors totaling 287,646 horsepower rented to 80 customers. The utilization rate of our rental fleet as of December 31, 2020 was 57.3%, while our horsepower utilization for the same period was 65.6%.

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 39.1% of our sales revenue during 2020.
- **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 52.3% of our sales revenue during 2020.
- **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 may experience. 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 consolidate our operations in existing areas, as well as pursue focused expansion into new geographic regions as opportunities are identified. Company's largest rental area is the Permian Basin (approximately 45.0% of rental revenues in 2020), 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.
- **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. We also believe our rental fleet is one of the environmentally efficient in the industry.
- **Experienced management 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 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, capital expenditure budgets of energy companies have become significantly more constrained over the last several year 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. Oil and natural gas prices and the level of development and production activity have historically been characterized by significant volatility.

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 have led to significant weakness in oil prices and ensuing reductions of exploration and production company capital and operating budgets.

With the significant decline in oil prices as well as the general economic decline caused by the impacts of COVID-19, we expect utilization to continue to decline among our smaller horsepower and medium horsepower units during the remainder of 2021. In terms of sales, we expect minimal compressor sales for the year due to much lower capital expenditure budgets throughout the industry, including those of our major customers. Finally, we continue to experience pricing pressure from our customers and competitors until industry and economic conditions improve. We are currently experiencing no issues with potential workforce and supply chain disruptions. Our relationship with our major customer continues to be strong, and they have continued to pay our invoices in a timely, consistent manner. Nevertheless, if any of these circumstances change, our business could be adversely affected.

While management anticipates that the industry and economic impact of the pandemic will have a negative effect on its results of operations in 2021 and perhaps beyond, the degree to which these factors will impact our business remains uncertain. Please read Item 1A, Risk Factors, in this report.

Major Customers

Sales and rental income to Occidental Permian, LTD. (“Oxy”) for the years ended December 31, 2020 and 2019 amounted to 30% and 36% of our revenue, respectively. No other single customer accounted for more than 10% of our revenues in 2020 or 2019.

Oxy amounted to 35% of our accounts receivable as of December 31, 2020 and 35% of our accounts receivable as of December 31, 2019. No other customers amounted to more than 10% of our accounts receivable as of December 31, 2020 and 2019. 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, 2020, we had a sales backlog of approximately \$1.4 million compared to \$2.2 million as of December 31, 2019. 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 two to three months of lead time prior to delivery of the order.

Employees

As of December 31, 2020, we had 229 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, oilfield waste, and other waste materials.

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.

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, 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. Among these developments at the international level is the United Nations Framework Convention on Climate Change, which produced the "Kyoto Protocol". More recently, in December 2015, 195 countries adopted under the Framework Convention a resolution known as the "Paris Agreement" to reduce emissions of greenhouse gases with a goal of limiting global warming to below 2°C (36°F). The Paris Agreement does not establish enforceable emissions reduction targets, but countries may establish greenhouse gas reduction measures pursuant to the agreement. The agreement went into effect in November 2016. The United States ratified the Paris Agreement in September 2016 but withdrew in November 2020. President Biden has since signed an order to rejoin the Paris Agreement. The new President has also announced a focus on climate-related issues and a goal of setting the United States on the path to net-zero carbon emissions 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.

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. However, in a March 2017 executive order, President Trump directed the EPA to review the 2016 regulations and, if appropriate, to initiate a rulemaking to rescind or revise them consistent with the stated policy of promoting clean and safe development of the nation’s energy resources, while at the same time avoiding regulatory burdens that unnecessarily encumber energy production. In June 2017, the EPA published a proposed rule to stay for two years certain requirements of the 2016 regulations, including fugitive emission requirements. On September 11, 2018, the EPA proposed targeted improvements to the rule, including amendments to the rule’s fugitive emissions monitoring requirements, and expects to “significantly reduce” the regulatory burden of the rule in doing so. 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 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 poses 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. We have experienced no supply disruptions nor have we received any indications that our supplies will be disrupted during this stage of the COVID-19 outbreak. 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.ngsgl.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

The outbreak of COVID-19 and recent oil market developments could adversely impact our financial condition and results of operations.

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 have led to significant weakness in oil prices and ensuing reductions of E&P company capital and operating budgets. If economic and industry conditions do not improve, these events will adversely impact our financial condition and results of operations in 2021 and perhaps beyond, as further discussed in risk factors below.

In addition, the spread of the virus into our workforce could prevent us meeting the demands of our customers and adequately servicing existing compressors. Similarly, if our customers or suppliers experience adverse business consequences due to COVID-19, demand for our equipment and services could also be adversely affected. The magnitude and duration of potential social, economic and labor instability as a direct result of COVID-19 cannot be estimated at this time. Should any of these potential impacts continue for an extended period of time, the impact on our business could have an adverse effect on our financial position and results of operations.

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

As a result of the COVID-19 outbreak discussed above and other economic conditions in the United States and abroad, our revenue and profitability has been and will likely continue to be adversely affected. The condition of domestic and global financial markets, relatively low oil and natural gas prices, 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.

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 alternate energy sources;
- environmental regulation; and
- tax policies.

Because of the significant reductions in the market prices of oil and natural gas in 2020, many companies developing oil and natural gas reserves have curtailed or canceled their drilling programs, thereby reducing demand for our equipment and services. 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.

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. For example, oil and natural gas exploration and development activity and the number of well completions typically decline when there is a significant reduction in oil and natural gas prices such as have occurred in 2020. 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 cyclical nature 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 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.

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.

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 1,274 compressors rented at December 31, 2020, 948 were rented on a month-to-month basis. Given the current oil and gas price environment, 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.

The loss of one or more of our 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 30% of our revenue for the year ended December 31, 2020, and the same customer accounted for an aggregate of approximately 36% of our revenue for the year ended December 31, 2019. At December 31, 2020, this same customer accounted for an aggregate of 35% 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 may 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. We depend on the continued employment and performance of these three key members of our executive management team. In particular, we are significantly reliant upon the leadership and guidance of Stephen C. Taylor, who has been our President, Chief Executive Officer and Board member since 2004. In addition to his management duties, Mr. Taylor has been instrumental in our communications and standing with the investment community. If any of our key executives resign, such as the recent resignation of our Chief Financial Officer, or become unable to continue in his present role and is not adequately 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, such as now, 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, 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 2021. 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 2021, the amount we will spend on capital expenditures related to rental compression equipment will be determined primarily by the activity of our customers. 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. Although we believe that cash on hand and cash flows from our operations and/or potential bank borrowing from our anticipated line of credit (see below) will provide us with sufficient cash to fund our planned capital expenditures for 2021, 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 prior \$30.0 million line of credit with JP Morgan Chase Bank, under which we owed \$417,000 as of December 31, 2020, expired on March 31, 2021. On March 17, 2021, we repaid our outstanding principal balance and unpaid interest is due on March 31, 2021. We are in the process of negotiating a new line of credit and, although we believe that we will be able to obtain a new line of credit with another lender, we can provide no assurance that we will be successful in obtaining a new line. In addition, any creation of a new line of credit may be on terms less favorable than our existing line. For

instance, changes in the terms of a new line of credit may include, but not be limited to: a reduction in the borrowing amount, an increase in interest rate to be paid on borrowings under the line, or restrictive covenants that are more onerous than those on our existing line of credit.

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

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 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 are unable to service our debt, we will likely be forced to take remedial steps that are contrary to our business plan.

As noted above, our existing line of credit expired on March 31, 2021. Notwithstanding, we are in the process of negotiating a new line of credit which we anticipate will be in place by the end of April 2021, although we cannot guarantee that we will be successful in obtaining the new line of credit. We believe that our current cash position and anticipated cash flow from operations and the potential amount available under a new line of credit will be sufficient to meet our capital needs through 2021. However, if we are unable to obtain a new line of credit or were to materially increase our borrowings under a new 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.

We anticipate that any new credit agreement will contain covenants that limit our operating and financial flexibility and, if breached, could expose us to severe remedial provisions.

If we are successful in obtaining a new bank line of credit or similar borrowing arrangement, such arrangement will likely contain terms that require us to:

- comply 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 a new credit facility 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 potential covenants or requirements could permit the lending organization to accelerate outstanding amounts so that it is immediately due and payable. If a breach occurs, further borrowings will likely be unavailable under any such credit arrangement. If we are unable to repay any outstanding amounts, the lending organization could proceed against and foreclose on the assets we pledge as collateral to secure the loan, which will likely be a significant portion or substantially all of our assets.

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.

In its Section 404 assessments, management has noted a material weakness in internal control over financial reporting in each of the prior two years. During the year ended December 31, 2018, management noted a material weakness related to our accounting and reporting of income taxes. During the year ended December 31, 2019, management noted another material weakness related to our accounting and reporting of compressor "make-ready" jobs, as well as various other compressor maintenance jobs, that were not recorded in a timely manner. As of December 31, 2020, based upon our most recent assessment of internal controls, management believes it has remediated these material weaknesses. Please see Item 9A, Controls and Procedures, Material Weaknesses in Internal Control over Financial Reporting.

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 2021, an aggregate of approximately 27.9% of the outstanding shares of our common stock are owned by four institutional investors, each of which owns more than 5% of our outstanding shares as of the date of their respective filings in February 2021. 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 6.8% of the outstanding shares of our common stock as of March 26, 2021, 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;
- 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, 2020:

| 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 |
| Galeton, Colorado | Leased | 4,800 | 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 |
| Grapevine, Texas | Leased | 800 | Sales |

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 threatened litigation.

ITEM 4. MINE SAFETY DISCLOSURES

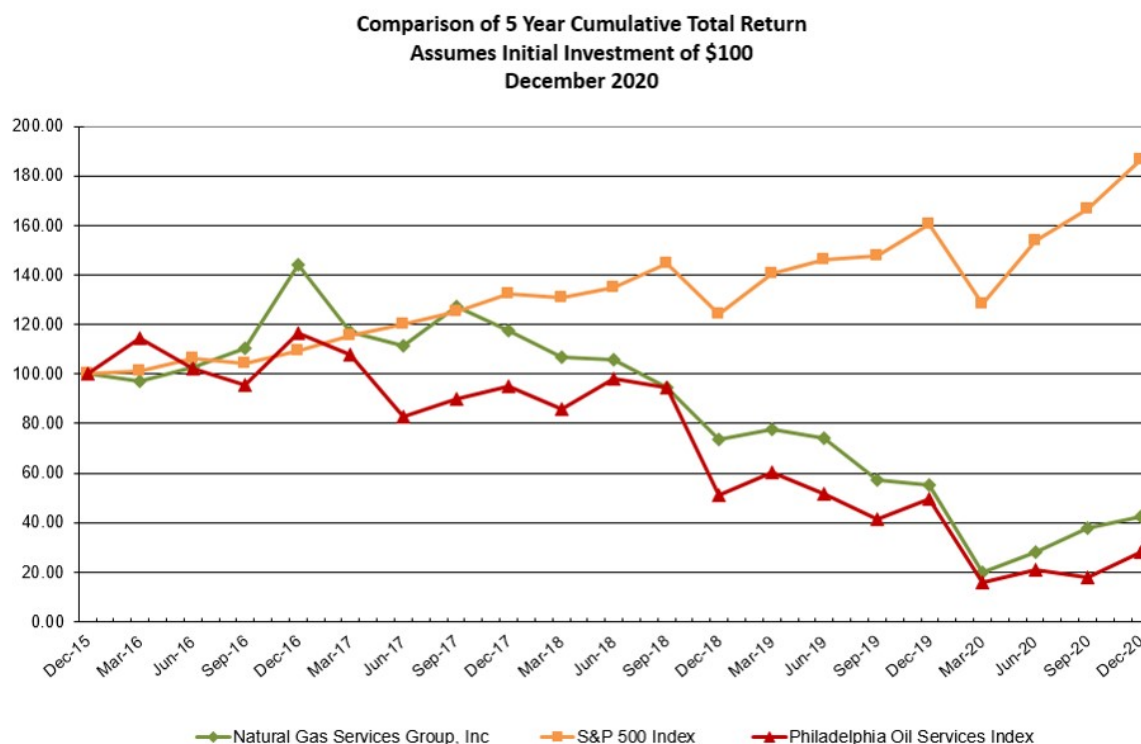
Not applicable.

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, 2020 as reflected by our transfer agent records, we had 16 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 26, 2021, the last reported sale price of our common stock as reported by the New York Stock Exchange was \$9.15 per share.

The following graph shows a five year comparison of the cumulative total stockholder return on our common stock as compared to the cumulative total return of two other indexes: a custom composite index of the Philadelphia Oil Service Index and the Standard & Poor's 500 Composite Stock Price Index. These comparisons assume an initial investment of \$100 and the reinvestment of dividends.



The performance graph shall not be deemed incorporated by reference by any general statement incorporating by reference this Annual Report on Form 10-K into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that we specifically incorporate this information by reference, and shall not otherwise be deemed filed under those Acts.

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, 2020:

| 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 | 161,334 ⁽¹⁾ | \$ 24.48 | 384,503 |
| Restricted Stock / Unit Plan ⁽²⁾ | 34,899 | \$ 24.55 | — |
| 2019 Equity Incentive Plan | 223,202 | \$ 11.04 | 200,141 |
| Total | 419,435 | | 584,644 |

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

(2) The Restricted Stock/Unit Plan expired on June 20, 2019. The outstanding shares/units as of December 31, 2020, will vest in 2021 assuming the participant remains employed up to the vesting date, subject to acceleration under certain circumstances.

Stock Repurchase Program

On August 12, 2019, the Company announced the Board of Directors had authorized the repurchase of up to \$10.0 million of its outstanding shares of common stock in the open market, block trades or privately negotiated transactions. The timing and extent of any repurchase is subject to the discretion of management and is dependent upon market pricing and conditions, business, legal, accounting and other considerations. The repurchase program does not obligate the Company to purchase any shares and was set to expire on September 30, 2020, subject to earlier termination of the program by the Board of Directors. On October 23, 2020, the Board of Directors authorized the extension of the repurchase program through September 30, 2021. The repurchase program may be modified, suspended or terminated at any time without notice, in the Company's discretion, based upon a number of factors, including market conditions, the cost of repurchasing shares, the availability of alternative investment opportunities, liquidity, the need for capital in the Company's operations and other factors deemed appropriate. The Company intends to finance the repurchases with existing liquidity and free cash flow. To date, the Company repurchased 37,936 of its outstanding shares of common stock with a value of \$490,000, at an average price of \$12.91. No repurchases were made during 2020. As of December 31, 2020, the Company had approximately \$9.5 million remaining under the repurchase authorization.

Sale of Unregistered Securities

We made no sales of unregistered securities during the year ended December 31, 2020.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

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, 2020 and 2019. 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, 2020, we had 1,274 natural gas compressors totaling 287,646 horsepower rented to 80 customers, compared to 1,419 natural gas compressors totaling 299,836 horsepower rented to 95 customers at December 31, 2019. Of the 1,274 compressors rented at December 31, 2020, 948 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 two to three 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 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, | |
|-------------------------|--------------------------------|------------------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Rental | \$ 60,826 | \$ 56,701 |
| Sales | 5,657 | 19,763 |
| Service and maintenance | 1,572 | 1,980 |
| Total | <u>\$ 68,055</u> | <u>\$ 78,444</u> |

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-50% 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 over the past two to three years and have shifted our cash and fabrication resources towards designing, fabricating and renting gas compressor packages that range from 400 horsepower up to 1,380 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. Activity levels of exploration and production companies have been and will 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 2021, our forecasted capital expenditures will be directly dependent upon our customers' compression requirements and are not anticipated to exceed our internally generated cash flows. 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 and cash flows from operations will be sufficient to satisfy our capital and liquidity requirements through 2021. 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, intangible assets and goodwill; 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, Intangible Assets and Goodwill

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.

Goodwill (Including Impairment During 2019)

Goodwill represents the cost in excess of fair value of the identifiable net assets acquired. Goodwill is tested annually for impairment or as needed upon the occurrence of certain events or substantive changes in circumstances that indicate goodwill is more likely than not impaired. During the third quarter of 2019, the Company examined various qualitative factors to determine if a quantitative goodwill impairment test was needed. As a result of our qualitative assessment, we proceeded to perform our quantitative goodwill impairment analysis, where we used an independent valuation specialist to assist us in determining the fair value of our net assets. In this impairment analysis, the estimated fair value of our net assets was determined utilizing market and income-based approaches. Determining fair value in this analysis required significant judgment, including judgments about appropriate comparable companies, appropriate discount rates and our estimated future cash flows, which are subject to change. As a result of our quantitative evaluation, we recorded a goodwill impairment charge of \$10.0 million in 2019.

Intangibles

At December 31, 2020 and 2019, NGS had intangible assets, which relate to developed technology and a trade name 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. Based upon our analysis, we experienced no impairment of intangible assets (excluding goodwill) during the years ended December 31, 2020 or 2019.

In addition, in conjunction with our quantitative assessment of goodwill, we used the services of an independent valuation specialist to assist us in determining the fair value of our trade name during the third quarter of 2019. In this impairment analysis, the estimated fair value of our trade name was determined utilizing an income-based approach that required significant judgment, including those about an appropriate royalty rate and discount rate. This analysis indicated no impairment of our trade name.

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 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. Given its concerns about the industry backdrop, Company management determined during 2019 that an increase of its inventory allowance was necessary. 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 rental equipment, management recorded a charge of \$3.8 million to write-off obsolete inventory from the balance sheet. For the year ended December 31, 2020, inventory allowance and write-off totaled \$0.3 million. We ended 2020 with an inventory allowance balance of \$221,000.

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 have led to significant weakness in oil prices and ensuing reductions of exploration and production company capital and operating budgets.

With the significant decline in oil prices as well as the general economic decline caused by the impacts of COVID-19, we expect utilization to continue to decline among our smaller horsepower and medium horsepower units during the remainder of 2021 after a minimal decline during 2020. In terms of sales, we expect minimal compressor sales for the year due to much lower capital expenditure budgets throughout the industry, including those of our major customers. Finally, we have recently experienced and expect to continue to experience pricing pressure from our customers and competitors until industry and economic conditions improve. We are currently experiencing no issues with potential workforce and supply chain disruptions. In addition, our relationship with our major customer continues to be strong, and they have continued to pay our invoices in a timely, consistent manner. Nevertheless, if any of these circumstances change, our business could be adversely affected.

While management anticipates that the industry and economic impact of the pandemic will have a negative effect on its results of operations in 2021 and perhaps beyond, the degree to which these factors will impact our business remains uncertain. Please read Item 1A, Risk Factors, in this report.

Results of Operations

Year Ended December 31, 2020 Compared to the Year Ended December 31, 2019

The table below shows our revenues and percentage of total revenues for each of our product lines for the years ended December 31, 2020 and 2019.

| | Revenue | | | |
|-----------------------|-------------------------------|--------|-------------------------|--------|
| | Year Ended December 31, | | Year Ended December 31, | |
| | 2020 | | 2019 | |
| | <i>(dollars in thousands)</i> | | | |
| Rental | \$ 60,826 | 89.4 % | \$ 56,701 | 72.3 % |
| Sales | 5,657 | 8.3 % | 19,763 | 25.2 % |
| Service & Maintenance | 1,572 | 2.3 % | 1,980 | 2.5 % |
| Total | <u>\$ 68,055</u> | | <u>\$ 78,444</u> | |

Total revenue decreased to \$68.1 million from \$78.4 million, or 13.2%, for the year ended December 31, 2020 compared to 2019. This decrease was mainly a result of lower sales revenue (71.4% decrease) primarily due to decreased compressor sales partially offset by increased rental revenue (7.3% increase) primarily due to a greater number of large horsepower units being rented.

Rental revenue increased to \$60.8 million from \$56.7 million for the year ended December 31, 2020 compared to 2019. As of December 31, 2020, we had 2,224 natural gas compressors in our rental fleet, down from 2,304 units at year end 2019. Despite this decrease, the Company's total unit horsepower increased by 2.1% to 438,524 at December 31, 2020 compared to 429,650 horsepower year end 2019, which reflects the addition of 24 high horsepower compressors with 20,600 horsepower to the Company's fleet during 2020. As of December 31, 2020, we had 1,274 natural gas compressors totaling 287,646 horsepower rented to 80 customers, compared to 1,419 natural gas compressors totaling 299,836 horsepower rented to 95 customers as of December 31, 2019. The rental fleet had a unit utilization as of December 31, 2020 and 2019, respectively, of 57.3% and 61.6% while our horsepower utilization for the same periods, respectively, was 65.6% and 69.8%. The decline in both utilization metrics was mainly the result of the decline in demand for our lower horsepower units.

Sales revenue decreased to \$5.7 million from \$19.8 million for the year ended December 31, 2020, compared to 2019. This decrease is largely attributable to a decrease in compressor sales primarily driven by reductions in capital spending from our customers due to a weakened oil and natural gas price environment during 2020. 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 balances 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 rental equipment, management recorded an increase of \$251,000 in the inventory allowance reserve for costs that may not be recoverable in the future. We ended 2020 with an inventory allowance balance of \$221,000.

Company management 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 216 units should be retired from our rental fleet. Accordingly, we recorded a \$291,000 loss on retirement of rental equipment during the year ended December 31, 2020.

Operating loss decreased to \$3.6 million for the year ended December 31, 2020 compared to an operating loss of \$15.2 million for the year ended December 31, 2019. The decrease in operating loss was mainly due to a \$10.0 million goodwill impairment charge in 2019 as well as lower losses on inventory allowance and write-off and reduced charges related to retirement of rental units. These decreases were partially offset by lower sales revenues.

Selling, general, and administrative expenses decreased to \$10.6 million for the year ended December 31, 2020, as compared to \$10.7 million for 2019. This 1.5% decrease was primarily the result of decreases in deferred compensation expense (approximately \$187,000) and expenses related to stock options (approximately \$100,000) partially offset by increased insurance costs (\$86,000).

Depreciation and amortization expense increased to \$25.2 million from \$23.3 million, or 8.3%, for the year ended December 31, 2020, compared to 2019. The increase is the result of higher capital expenditures for larger horsepower units being added to the fleet. We added 42 units (approximately 23,265 horsepower) to our fleet during the twelve month period ended December 31, 2020. Twenty-four of those units were 400 horsepower or larger (including 10 at 1,380 horsepower), representing approximately 89% of the horsepower added.

Income tax benefit increased to \$4.8 million from \$0.7 million for the year ended December 31, 2020 compared to 2019. 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 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 \$11.9 million on its consolidated balance sheet as of December 31, 2020. In addition, the Company recorded a current income tax benefit of \$4.8 million on its consolidated statement of operations for the year ended December 31, 2020. Our income tax benefit in 2019 was largely due to our net loss of \$13.7 million but was largely offset by a difference in goodwill impairment for tax purposes as well as an adjustment to our state tax rates that increased our deferred income tax expense by approximately \$0.8 million.

Adjusted Gross Margin Year Ended December 31, 2020 Compared to the Year Ended December 31, 2019

The table below shows our adjusted gross margin and related percentages for each of our product lines for the years ended December 31, 2020 and December 31, 2019. 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, | | | |
| | 2020 | | 2019 | |
| | <i>(dollars in thousands)</i> | | | |
| Rental | \$ 32,320 | 53.1 % | \$ 29,118 | 51.4 % |
| Sales | (554) | (9.8)% | 3,666 | 18.5 % |
| Service & Maintenance | 858 | 54.6 % | 1,350 | 68.2 % |
| Total | <u>\$ 32,624</u> | 47.9 % | <u>\$ 34,134</u> | 43.5 % |

(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 47.9% for the year ended December 31, 2020 compared to 43.5% for the year ended December 31, 2019, exclusive of depreciation and amortization. Our increase in gross margins is mainly due to an increase in total revenue related to our rental revenue. Rental revenues comprised 89% of our total revenues for the year ended December 31, 2020 compared to 72% of total revenues for the year ended December 31, 2019. As our rental activity inherently realizes higher adjusted gross margins, the increase in revenue concentrations will increase our overall adjusted gross margins. Sales margin decreased to (9.8)% in 2020 from 18.5% in 2019 due to significant declines in sales revenues (71.4%). 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 54.6% from 68.2% for the year ended December 31, 2020 compared to 2019. Service and maintenance only represents 2.3% of our revenue in 2019, 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 (loss) income) before interest, taxes, depreciation and amortization, as well as impairment of goodwill, an increase in inventory allowance and inventory write-offs, and retirement of rental equipment. This term, as used and defined by us, may not be comparable to similarly titled

measures employed by other companies and is not a measure of performance calculated in accordance with GAAP. Adjusted EBITDA should not be considered in isolation or as a substitute for operating income, net income or loss, cash flows provided by operating, investing and financing activities, or other income or cash flow statement data prepared in accordance with GAAP. However, management believes Adjusted EBITDA is useful to an investor in evaluating our operating performance because:

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

| | Year Ended December 31, | |
|--------------------------------|--------------------------------|------------------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Net income (loss) | \$ 1,808 | \$ (13,864) |
| Interest expense | 14 | 15 |
| Income tax (benefit) expense | (4,792) | (693) |
| Depreciation and amortization | 25,198 | 23,268 |
| Impairment of goodwill | — | 10,039 |
| Inventory allowance | 184 | 3,758 |
| Retirement of rental equipment | 291 | 1,512 |
| Adjusted EBITDA | <u>\$ 22,703</u> | <u>\$ 24,035</u> |

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, | |
|--|--------------------------------|------------------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Total revenue | \$ 68,055 | \$ 78,444 |
| Costs of revenue, exclusive of depreciation and amortization | (35,431) | (44,310) |
| Depreciation allocable to costs of revenue | (24,578) | (22,908) |
| Gross margin | 8,046 | 11,226 |
| Depreciation allocable to costs of revenue | 24,578 | 22,908 |
| Adjusted gross margin | <u>\$ 32,624</u> | <u>\$ 34,134</u> |

Liquidity and Capital Resources

Our working capital positions as of December 31, 2020 and 2019 are set forth below.

| | As of December 31, | |
|--------------------------------|-----------------------|-----------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 28,925 | \$ 11,592 |
| Trade accounts receivable, net | 11,884 | 9,106 |
| Inventory, net | 19,926 | 21,080 |
| Federal income tax receivable | 11,538 | — |
| Prepaid income taxes | 66 | 40 |
| Prepaid expenses and other | 379 | 597 |
| Total current assets | 72,718 | 42,415 |
| Current Liabilities: | | |
| Accounts payable | \$ 2,373 | \$ 1,975 |
| Accrued liabilities | 6,770 | 2,287 |
| Line of credit | 417 | 417 |
| Current operating leases | 198 | 189 |
| Deferred income | 1,103 | 640 |
| Total current liabilities | 10,861 | 5,508 |
| Net working capital | \$ 61,857 | \$ 36,907 |

For the year ended December 31, 2020, we invested approximately \$15.3 million in rental equipment, property and other equipment. During the year, the Company added \$13.0 million in new equipment to our rental fleet and \$2.2 million in other property and equipment. Our investment in property and 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 decreased by \$4.0 million during 2020. We financed our investment in rental equipment, property and other equipment with cash flows from operations during 2020.

Cash flows

At December 31, 2020, we had cash and cash equivalents of \$28.9 million compared to \$11.6 million at year end 2019. Our cash flow from operations of \$32.6 million was partially offset by capital expenditures of \$15.3 million during 2020. We also had working capital of \$61.9 million at December 31, 2020 compared to \$36.9 million at December 31, 2019. On December 31, 2020 and 2019, we had outstanding debt of \$417,000, which is all related to our line of credit. We had net cash flow from operating activities of \$32.6 million during 2020 compared \$29.4 million during 2019. Our cash flow from operating activities of \$32.6 million was primarily the result of our rental and sales revenues partially offset by associated costs of sales as well as a federal income tax refund of approximately \$4.1 million.

At December 31, 2019, we had cash and cash equivalents of \$11.6 million, working capital of \$36.9 million and total debt of \$417,000, under our credit agreement which was due on March 31, 2020. Our cash and cash equivalents decreased from 2018, due to an increase on our capital program for contracted new large horsepower compressor builds and the construction of our new corporate office. We had positive net cash flow from operating activities of approximately \$29.4 million during 2019. This was primarily from a net loss of \$0.5 million and non-cash items of depreciation and amortization of \$23.3 million, \$2.6 million related to stock-based compensation, a decrease in deferred income taxes of \$0.3 million and a decrease in cash flows related to working capital and other items of \$0.2 million.

Senior Bank Borrowings

We had a senior secured revolving credit agreement the ("Amended Credit Agreement") with JP Morgan Chase Bank, N.A (the "Lender") that expired on March 31, 2020. We have decided not to renew the Amended Credit Agreement and on March 17, 2021, we repaid the outstanding principal balance. No further amounts or obligations are owed on the Amended Credit Agreement. We are in the process of negotiating a new credit facility which we expect to complete by the end of April 2021, although no guarantee can be made that we will be successful in finalizing and securing a new credit facility.

Components of Our Principal Capital Expenditures

Capital expenditures for the two years ended December 31:

| Expenditure Category | 2020 | 2019 |
|---|-----------------------|-----------|
| | <i>(in thousands)</i> | |
| Rental equipment and property and equipment | \$ 15,257 | \$ 69,938 |

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 2021. 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 the COVID-19 pandemic. 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, 2020, we did not have any material off-balance sheet arrangements.

Recently Issued Accounting Pronouncements

In December 2019, the FASB issued ASU 2019-12, Income Taxes (ASC Topic 740), which simplifies accounting for income taxes by removing certain exceptions to various tax accounting principles and clarifies other existing guidance in order to improve consistency of application. These amendments are effective for public entities for interim and annual periods beginning after December 15, 2020. We are currently evaluating the impact of ASU 2019-12 on our consolidated financial statements and note disclosures.

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 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

An evaluation was carried out under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Vice President and Chief Financial Officer, of the effectiveness of the design of our “disclosure controls and procedures” (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended or, the “Exchange Act”) as of December 31, 2020, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the President and Chief Executive Officer and our Vice President and Chief Financial Officer concluded that our disclosure controls and procedures as of December 31, 2020, are effective to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our principal executive and financial officers as appropriate to allow timely decisions regarding required disclosures. Due to the inherent limitations of control systems, not all misstatements may be detected. Those inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Additionally, controls could be circumvented by the individual acts of some persons or by collusion of two or more people. Our controls and procedures can only provide reasonable, not absolute, assurance that the above objectives have been met.

Management’s Report on Internal Control Over Financial Reporting

Our management, including the President and Chief Executive Officer and our Principal Accounting Officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control system is designed 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. Our internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipt and expenditures are being made only in accordance with authorizations of management and our Board of Directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

All internal control systems, no matter how well designed, have inherent limitations. A system of internal control may become inadequate over time because of changes in conditions or deterioration in the degree of compliance with the policies or procedures. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, 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, including our President and Chief Executive Officer and our Vice President and Chief Financial Officer, assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2020. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework (2013). Based on this assessment, management has concluded that our internal control over financial reporting was effective as of December 31, 2020. For the year ended December 31, 2019, management determined that our internal control over financial reporting was not effective due to the material weaknesses noted below.

Material Weaknesses in Internal Control over Financial Reporting

During the fourth quarter of fiscal year 2018, we identified a material weakness in internal controls over financial reporting related to our accounting and reporting of income tax (expense) benefit and consolidated balance sheet and the consolidated operations statement accounts. We did not design and maintain an effective control environment with formal accounting policies and controls to adequately provide sufficient information for the preparation of our tax provision to our third party tax professionals and did not provide an appropriate level or sufficient review of the tax provision. The material weakness created a reasonable possibility that there could be a material misstatement of our annual or interim financial statements.

This material weakness resulted in an immaterial misstatement in the provision for income taxes in our consolidated financial statement as of and for the years ended December 31, 2017, 2016 and 2015. Consolidated financial statements included in our Annual Report on Form 10-K issued as of December 31, 2018 reflect the correction of this misstatement of income tax (expense) benefit, the related consolidated balance sheet and the consolidated operations statement accounts.

We have undergone evaluations, enhancements and implementation in our internal controls over financial reporting to address the identified material weakness. We have implemented various changes and enhancements to improve our controls related to the material weakness. After testing, our revised controls were not considered remediated at year end 2019, so further changes were implemented. Changes made include timely submittal of tax input data to our preparer, tie-out of key inputs and review meetings with financial management and our preparer to confirm assumptions and results. We have re-assessed our internal controls at the end of 2020 and have concluded that the changes made sufficiently remediate the material weakness.

During the fourth quarter of fiscal year 2019, we identified another material weakness in internal controls over financial reporting related to our accounting and reporting of compressor "make-ready" jobs, as well as various other compressor maintenance jobs, that were inappropriately capitalized, resulting in immaterial increases to the Company's cost of rentals and, to a much lesser extent, depreciation expense in prior periods. These increases in operating costs and expenses were immaterial to all prior annual and interim periods, but would have been material to the fourth quarter of 2019 if these cumulative operating costs and expenses were taken as an out-of-period adjustment.

We did not design and maintain an effective control environment with formal accounting policies and controls to adequately provide sufficient information to report these expenses in a timely manner. The material weakness created a reasonable possibility that there could be a material misstatement of our annual or interim financial statements.

Management reviewed its procedures around the activity that led to this material weakness during 2019. We have completed our review and changed the treatment of make-ready jobs to expense the cost at the time the job occurs and have made changes to our capitalization policy and review procedures. We believe these changes have been in place for a sufficient period to conclude that the material weakness has been remediated by the end of 2020.

Changes in Internal Control Over Financial Reporting

Except for the remediation of control deficiencies discussed above, there were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2020, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. We will continue to review and document our disclosure controls and procedures, including our internal control over financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

ITEM 9B. OTHER INFORMATION

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, 2020 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, 2020 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, 2020 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, 2020 or as such period may be extended by action of the Securities and Exchange Commission.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item is incorporated herein by reference to the section "Principal Accounting Fees and Services" in our definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2020 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:

| <u>Exhibit No.</u> | <u>Description</u> |
|----------------------|---|
| 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 3.11 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 21, 2016.) |
| 10.1 | 2009 Restricted Stock/Unit Plan, as amended (Incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K dated June 3, 2014 and filed with the Securities and Exchange Commission on June 6, 2014.) |
| 10.2 | Stock Option Plan, as amended and restated (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 21, 2016.) |
| 10.3 | Credit Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated December 10, 2010 (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 24, 2014.) |
| 10.4 | Fifth Amendment of Credit Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated August 31, 2017 (Incorporated by reference to Exhibit 10.2 of the Registrant's Current report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.) |
| 10.5 | Security Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated December 10, 2010 (Incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 16, 2011.) |
| 10.6 | Fourth Security Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated August 31, 2017 (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.) |
| 10.7 | Promissory Note in the aggregate amount of \$30,000,000 issued to JPMorgan Chase Bank, N.A., dated August 31, 2017, in connection with the revolving credit line under the Credit Agreement with JPMorgan Chase Bank, N.A. (Incorporated by reference to Exhibit 10.3 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.) |
| 10.8 | Amended and restated Employment Agreement dated April 27, 2015 between Natural Gas Services Group, Inc. and Stephen C. Taylor (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 29, 2015.) |
| 10.9 | 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.) |

| | |
|-----------------------|--|
| 10.10 | Annual Incentive Bonus Plan (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 18, 2012.) |
| *21.1 | Subsidiaries of the registrant |
| *23.1 | Consent of BDO USA, LLP |
| *23.2 | Consent of Moss Adams, LLP |
| *31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| *31.2 | Certification of Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| *32.1 | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| *32.2 | Certification of Principal Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

* Filed herewith.

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, 2021

By: /s/ Stephen C. Taylor
Stephen C. Taylor
Chairman of the Board, President and Chief Executive Officer
(Principal Executive Officer)

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 |
|---|---|----------------|
| <u>/s/ Stephen C. Taylor</u> Stephen C. Taylor | Chairman of the Board of Directors, Chief Executive Officer and President (Principal Executive Officer) | March 31, 2021 |
| <u>/s/ G. Larry Lawrence</u> G. Larry Lawrence | Vice President and Chief Financial Officer (Principal Accounting Officer) | March 31, 2021 |
| <u>/s/ Leslie A. Beyer</u> Leslie A. Beyer | Director | March 31, 2021 |
| <u>/s/ William F. Hughes, Jr.</u> William F. Hughes, Jr. | Director | March 31, 2021 |
| <u>/s/ David L. Bradshaw</u> David L. Bradshaw | Director | March 31, 2021 |
| <u>/s/ John W. Chisholm</u> John W. Chisholm | Director | March 31, 2021 |

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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, 2020, the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years 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, 2020, 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

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Estimation of Undiscounted Cash Flows in Assessment of Long-Lived Asset Impairment

As described in Notes 1 and 4, the Company assesses long-lived assets, including rental equipment, for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. The Company's evaluation of possible triggering events uses both internal and external data, including the following key indicators and internally developed assumptions: i) significant underperformance relative to historical or projected cash flows; ii) significant adverse changes in the extent or manner an asset group is being used or its condition, including meaningful drop in fleet utilization over the prior period quarters, and iii) significant negative industry or company specific trends or actions.

We identified the estimation of undiscounted cash flows in the assessment of long-lived asset impairment as a critical audit matter. The estimation of undiscounted cash flows uses inputs that require significant management judgment, including estimating future anticipated revenues and expenses. Assessing these assumptions require a high degree of subjective auditor

judgment to perform procedures due to the nature and extent of audit evidence and effort required to appropriately address these matters.

The primary procedures we performed to address this critical audit matter included:

- Obtaining an understanding of the design of the Company's process and controls over the identification of possible long-lived asset impairment triggering events, including the process to develop the indicators and assumptions listed above.
- Evaluating management's identification of events or changes in circumstances that indicate the carrying amounts may not be recoverable.
- Evaluating management's estimate of useful lives of rental equipment, and anticipated rental rates of units, net returns or sets, and estimated gross margins utilized in the estimate of discounted cash flows by comparison to historical rates and performing sensitivity analysis.
- Evaluating the Company's ability to forecast future rental revenue and related assumptions by comparing to historical results of operations.

/s/ Moss Adams LLP

Dallas, Texas
March 31, 2021

We have served as the Company's auditor since 2020.

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Natural Gas Services Group, Inc.
Midland, Texas

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheet of Natural Gas Services Group, Inc. (the “Company”) as of December 31, 2019, the related consolidated statements of operations, stockholders’ equity, and cash flows for the year ended December 31, 2019, 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 financial position of the Company at December 31, 2019, and the results of its operations and its cash flows for each of the year ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 31, 2020 expressed an adverse opinion thereon.

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 audits. We are a public accounting firm registered with the 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 audits 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.

Our audits 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 audits 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 audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Company’s auditor from 2010 to 2020.

Austin, Texas
March 31, 2020

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

| | December 31, | |
|---|---------------------|-------------|
| | 2020 | 2019 |
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 28,925 | \$ 11,592 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$1,161 and \$918, respectively | 11,884 | 9,106 |
| Inventory | 19,926 | 21,080 |
| Federal income tax receivable | 11,538 | — |
| Prepaid income taxes | 66 | 40 |
| Prepaid expenses and other | 379 | 597 |
| Total current assets | 72,718 | 42,415 |
| Long-Term Inventory, net of allowance for obsolescence of \$221 and \$24, respectively | 1,065 | 1,068 |
| Rental equipment, net of accumulated depreciation of \$175,802 and \$162,348, respectively | 207,585 | 217,742 |
| Property and equipment, net of accumulated depreciation of \$13,916 and \$12,847, respectively | 21,749 | 21,869 |
| Right of use assets - operating leases, net of accumulated amortization \$356 | 483 | 604 |
| Intangibles, net of accumulated amortization of \$2,008 and \$1,883, respectively | 1,151 | 1,276 |
| Other assets | 2,050 | 1,603 |
| Total assets | \$ 306,801 | \$ 286,577 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 2,373 | \$ 1,975 |
| Accrued liabilities | 6,770 | 2,287 |
| Line of credit | 417 | 417 |
| Current operating leases | 198 | 189 |
| Deferred income | 1,103 | 640 |
| Total current liabilities | 10,861 | 5,508 |
| Deferred income tax liability | 41,890 | 31,243 |
| Long-term operating leases | 285 | 415 |
| Other long-term liabilities | 2,221 | 1,718 |
| Total liabilities | 55,257 | 38,884 |
| Commitments and contingencies (Notes 6 and 17) | | |
| Stockholders' Equity: | | |
| Preferred stock, 5,000 shares authorized, no shares issued or outstanding | — | — |
| Common stock, 30,000 shares authorized, par value \$0.01; 13,296 and 13,178 shares issued, respectively | 133 | 132 |
| Additional paid-in capital | 112,615 | 110,573 |
| Retained earnings | 139,286 | 137,478 |
| Treasury shares, at cost, 38 shares | (490) | (490) |
| Total stockholders' equity | 251,544 | 247,693 |
| Total liabilities and stockholders' equity | \$ 306,801 | \$ 286,577 |

See accompanying notes to these consolidated financial statements.

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

| | For the Years Ended December 31, | |
|--|---|--------------------|
| | 2020 | 2019 |
| Revenue: | | |
| Rental income | \$ 60,826 | \$ 56,701 |
| Sales | 5,657 | 19,763 |
| Service and maintenance income | 1,572 | 1,980 |
| Total revenue | 68,055 | 78,444 |
| Operating costs and expenses: | | |
| Cost of rentals, exclusive of depreciation stated separately below | 28,506 | 27,583 |
| Cost of sales, exclusive of depreciation stated separately below | 6,211 | 16,097 |
| Cost of service and maintenance, exclusive of depreciation stated separately below | 714 | 630 |
| Selling, general and administrative expenses | 10,550 | 10,710 |
| Depreciation and amortization | 25,198 | 23,268 |
| Impairment of goodwill | — | 10,039 |
| Inventory allowance | 184 | 3,758 |
| Retirement of rental equipment | 291 | 1,512 |
| Total operating costs and expenses | 71,654 | 93,597 |
| Operating loss | (3,599) | (15,153) |
| Other income (expense): | | |
| Interest expense | (14) | (15) |
| Other income | 629 | 611 |
| Total other income, net | 615 | 596 |
| Loss before income taxes: | (2,984) | (14,557) |
| (Provision for) benefit from income taxes: | | |
| Current | 15,438 | 31 |
| Deferred | (10,646) | 662 |
| Total income tax benefit | 4,792 | 693 |
| Net income (loss) | \$ 1,808 | \$ (13,864) |
| Earnings (loss) per share: | | |
| Basic | \$ 0.14 | \$ (1.06) |
| Diluted | \$ 0.14 | \$ (1.06) |
| Weighted average shares outstanding: | | |
| Basic | 13,224 | 13,114 |
| Diluted | 13,261 | 13,114 |

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, 2018 | — | \$ — | 13,005 | \$ 130 | \$ 107,760 | \$ 151,342 | — | \$ — | \$ 259,232 |
| Exercise of common stock options | — | — | 56 | 1 | 505 | — | — | — | 506 |
| Compensation expense on common stock options | — | — | — | — | 124 | — | — | — | 124 |
| Issuance of restricted stock | — | — | 117 | — | — | — | — | — | — |
| Compensation expense on restricted common stock | — | — | — | 1 | 2,457 | — | — | — | 2,458 |
| Taxes paid related to net shares settlement of equity awards | — | — | — | — | (273) | — | — | — | (273) |
| Purchase of treasury shares | — | — | — | — | — | — | 38 | (490) | (490) |
| Net loss | — | — | — | — | — | (13,864) | — | — | (13,864) |
| BALANCES, December 31, 2019 | — | — | 13,178 | 132 | 110,573 | 137,478 | 38 | (490) | 247,693 |
| Compensation expense on common stock options | — | — | — | — | 19 | — | — | — | 19 |
| Issuance of restricted stock | — | — | 118 | — | — | — | — | — | — |
| Compensation expense on restricted common stock | — | — | — | 1 | 2,175 | — | — | — | 2,176 |
| Taxes paid related to net shares settlement of equity awards | — | — | — | — | (152) | — | — | — | (152) |
| Net loss | — | — | — | — | — | 1,808 | — | — | 1,808 |
| BALANCES, December 31, 2020 | — | \$ — | 13,296 | \$ 133 | \$ 112,615 | \$ 139,286 | 38 | \$ (490) | \$ 251,544 |

See accompanying notes to these consolidated financial statements.

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

| | For the Years Ended December 31, | |
|---|---|------------------|
| | 2020 | 2019 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net (loss) income | \$ 1,808 | \$ (13,864) |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | |
| Depreciation and amortization | 25,198 | 23,268 |
| Deferred taxes | 10,646 | (662) |
| Gain on disposal of assets | (284) | (55) |
| Retirement of rental equipment | 291 | 1512 |
| Bad debt allowance (recovery) | 329 | 664 |
| Inventory allowance | 184 | 3,758 |
| Impairment of goodwill | — | 10,039 |
| Stock-based compensation | 2,195 | 2,582 |
| (Gain) loss on company owned life insurance | (168) | (219) |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivables | (3,107) | (2,550) |
| Inventory | 1,033 | 8,256 |
| Prepaid income taxes and prepaid expenses | (11,346) | 3,288 |
| Accounts payable and accrued liabilities | 4,880 | (7,225) |
| Deferred income | 463 | 559 |
| Other | 527 | 61 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 32,649 | 29,412 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of rental equipment, property and other equipment | (15,257) | (69,938) |
| Purchase of company owned life insurance | (296) | (302) |
| Proceeds from insurance claim | — | 35 |
| Proceeds from sale of property and equipment | 394 | 30 |
| NET CASH USED IN INVESTING ACTIVITIES | (15,159) | (70,175) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds of other long-term liabilities | (5) | (16) |
| Proceeds from exercise of stock options | — | 506 |
| Purchase of treasury shares | — | (490) |
| Taxes paid related to net share settlement of equity awards | (152) | (273) |
| NET CASH USED IN FINANCING ACTIVITIES | (157) | (273) |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 17,333 | (41,036) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 11,592 | 52,628 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 28,925 | \$ 11,592 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Interest paid | \$ 14 | \$ 39 |
| Income taxes paid | 105 | 275 |
| NON-CASH TRANSACTIONS | | |
| Transfer of rental equipment to inventory | — | 836 |
| Transfer of inventory to rental equipment | — | 1,184 |
| Transfer of prepaids to rental equipment and inventory | — | 958 |
| Right of use asset acquired through an operating lease | 77 | 762 |

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 12. 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. We believe that the risk to our cash balance is minimal because we have chosen a large bank with strong long-term ratings of Aa2/A+.

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 35% of our accounts receivable as of December 31, 2020 and 2019. 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 \$1.2 million and \$0.9 million at December 31, 2020 and 2019, 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:

| (\$ in thousands) | Year Ended December 31, | |
|-------------------|-------------------------|----------|
| | 2020 | 2019 |
| Beginning balance | \$ (918) | \$ (291) |
| Accruals | (329) | (664) |
| Recoveries | — | — |
| Write-offs | 86 | 37 |
| Ending balance | \$ (1,161) | \$ (918) |

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 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, 2020 and 2019 was approximately \$0.9 million and \$11.6 million, 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, | |
|---|--------------------------------|------------------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Compressors - sales | \$ 2,211 | \$ 15,185 |
| Flares - sales | 489 | 959 |
| Other (Parts/Rebuilds) - sales | 2,957 | 3,619 |
| Service and maintenance | 1,572 | 1,980 |
| Total revenue from contracts with customers | 7,229 | 21,743 |
| Add: ASC 842 rental revenue | 60,826 | 56,701 |
| Total revenue | <u>\$ 68,055</u> | <u>\$ 78,444</u> |

Contract Balances

As of December 31, 2020 and 2019, we had the following receivables and deferred income from contracts with customers:

| | December 31, | |
|--|-----------------------|---------------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Accounts Receivable | | |
| Accounts receivable - contracts with customers | \$ 3,243 | \$ 3,061 |
| Accounts receivable - ASC 842 | 9,802 | 6,963 |
| Total Accounts Receivable | 13,045 | 10,024 |
| Less: Allowance for doubtful accounts | (1,161) | (918) |
| Total Accounts Receivable, net | <u>11,884</u> | <u>9,106</u> |
| Deferred income | <u>\$ 1,103</u> | <u>\$ 640</u> |

The Company recognized \$73,000 in revenue for the year ended December 31, 2020 that was included in deferred income at the beginning of 2020. For the period ended December 31, 2019, the Company recognized revenue of \$48,000 from amounts related to sales that were included in deferred income at the beginning of 2019.

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, 2020, 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

On January 1, 2019, we adopted ASC 842 using the modified retrospective method. We recognized the cumulative effect of initially applying the new lease standard and had no adjustments to retained earnings. The comparative information has not been restated and continues to be reported under the lease accounting standard in effect for those periods.

The new lease standard requires all leases to be reported on the balance sheet as right-of-use assets and lease obligations. We elected the practical expedients permitted under the transition guidance of the new standard that retained the lease classification and initial direct costs for any leases that existed prior to adoption of the standard. We did not reassess whether any contracts or land easements entered into prior to adoption are leases or contain leases.

The cumulative effect of the changes made to our consolidated balance sheet at January 1, 2019, for the adoption of ASC 842 was as follows:

| | Balance at December 31, 2018 | Adjustments due to ASC 842 | Balance at January 1, 2019 |
|---------------------------------------|---|---------------------------------------|---------------------------------------|
| | <i>(in thousands)</i> | | |
| Balance Sheet | | | |
| Assets | | | |
| Right of use assets | \$ — | \$ 451 | \$ 451 |
| Liabilities | | | |
| Current portion of operating leases | \$ — | \$ 126 | \$ 126 |
| Long term portion of operating leases | — | 325 | 325 |
| Total lease liabilities | \$ — | \$ 451 | \$ 451 |

The Company, as a lessee, applies 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.

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 elects 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 2020 and 2019 amounted to 30% and 36% of revenue, respectively. No other single customer accounted for more than 10% of our revenues in 2020 and 2019. Oxy's accounts receivable balances amounted to 35% and 35% of our accounts receivable as of December 31, 2020 and 2019, respectively. No other customers amounted to more than 10% of our accounts receivable as of December 31, 2020 and 2019.

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 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.

Goodwill

Goodwill represents the cost in excess of fair value of the identifiable net assets acquired. Goodwill is tested annually for impairment or as needed upon the occurrence of certain events or substantive changes in circumstances that indicate goodwill is more likely than not impaired. As further described in Note 7 of these financial statements, we fully impaired the Company's goodwill during the third quarter of 2019, resulting in a goodwill impairment charge of \$10.0 million for the year ended December 31, 2019.

Intangibles

At December 31, 2020 and 2019, 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 five years as of December 31, 2020. 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

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, 2020. The warranty reserve was \$74,000 for December 31, 2019, and is included in accrued liabilities on the consolidated balance sheet.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases, and operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We 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 establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we include an expense in the tax provision in the statement of income.

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.

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

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. We have no uncertain tax positions as of December 31, 2020.

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, 2020 and 2019 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 assess the performance of the business based on these categories, but rather in the aggregate. Based on this, management believes that it operates in one business segment.

In their analysis of product lines as potential operating segments, management also considered ASC 280-10-50-11, "Aggregation Criteria", which allows for the aggregation of operating segments if the segments have similar economic characteristics and if the segments are similar in each of the following areas:

- The nature of the products and services;
- The nature of the production processes;
- The type or class of customer for their products and services;
- The methods used to distribute their products or provide their services; and
- The nature of the regulatory environment, if applicable.

We are engaged in the business of designing and manufacturing compressors and flares. Our compressors and flares are sold and rented to our customers. In addition, we provide service and maintenance on compressors in our fleet and to third parties. These business activities are similar in all geographic areas. Our manufacturing process is essentially the same for the entire Company and is performed in house at our facilities in Midland, Texas and Tulsa, Oklahoma. Our customers primarily consist of entities in the business of producing natural gas. The maintenance and service of our products is consistent across the entire Company and is performed via an internal fleet of vehicles. The regulatory environment is similar in every jurisdiction in that the most impacting regulations and practices are the result of federal energy policy. In addition, the economic characteristics of each customer arrangement are similar in that we maintain policies at the corporate level.

Recently Issued Accounting Pronouncements

In March 2020, the FASB issued ASU 2020-04, Reference Rate Reform, which provides temporary optional guidance to companies impacted by the transition away from the London Interbank Offered Rate ("LIBOR"). The guidance provides certain expedients and exceptions to applying GAAP in order to lessen the potential accounting burden when contracts, hedging relationships and other transactions that reference LIBOR as a benchmark rate are modified. This guidance is effective upon issuance and expires on December 31, 2022. We are currently evaluating the impact of the LIBOR transition and this ASU 2020-04 on our consolidated financial statements.

In December 2019, the FASB issued ASU 2019-12, Income Taxes (ASC Topic 740), which simplifies accounting for income taxes by removing certain exceptions to various tax accounting principles and clarifies other existing guidance in order to improve consistency of application. These amendments are effective for public entities for interim and annual periods beginning after December 15, 2020. We are currently evaluating the impact of ASU 2019-12 on our consolidated financial statements and note disclosures.

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 \$221,000 and \$24,000 at December 31, 2020 and 2019, respectively, consisted of the following:

| | December 31, | |
|---|-----------------------|------------------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Raw materials - current | \$ 18,026 | \$ 19,388 |
| Work-in-process | 1,900 | 1,692 |
| Finished goods | — | — |
| Inventory - current | 19,926 | 21,080 |
| Raw materials - long term (net of allowances of \$221 and \$24, respectively) | 1,065 | 1,068 |
| Inventory - total | <u>\$ 20,991</u> | <u>\$ 22,148</u> |

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

Given its concerns about the industry backdrop, Company management determined during 2019 that an increase of its inventory allowance was necessary. Due to the slow moving nature or obsolescence of a portion of its long-term inventory and inventory related to the retirement of rental equipment, management recorded a charge of \$3.8 million to write off inventory that will not be recoverable in the future. For the year ended December 31, 2020, inventory allowance totaled \$0.3 million. We ended 2020 with an inventory allowance balance of \$221,000.

A summary of our inventory allowance is as follows:

| | Year Ended December 31, | |
|-------------------|--------------------------------|-------------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Beginning balance | \$ (24) | \$ (19) |
| Accruals | (251) | (3,758) |
| Write-offs | 54 | 3,753 |
| Ending balance | <u>(221)</u> | <u>(24)</u> |

4. Rental Equipment, Property and Equipment

Rental Equipment

Our rental equipment and associated accumulated depreciation as of December 31, 2020 and 2019, respectively, consisted of the following:

| | December 31, | |
|---|-----------------------|-------------------|
| | 2020 | 2019 |
| | <i>(in thousands)</i> | |
| Compressor units | \$ 379,623 | \$ 370,961 |
| Work-in-progress | 3,764 | 9,129 |
| Rental equipment | 383,387 | 380,090 |
| Accumulated depreciation | (175,802) | (162,348) |
| Rental equipment, net of accumulated depreciation | <u>\$ 207,585</u> | <u>\$ 217,742</u> |

Our rental equipment has an estimated useful life between 15 and 25 years. Depreciation expense for rental equipment was \$22.7 million and \$21.4 million for the year ended December 31, 2020 and 2019, respectively.

Retirement of Rental Equipment

Company management routinely reviews its inventory of rental equipment for retirement or obsolescence. During 2020, 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 216 units should be retired from our rental fleet. Accordingly, we recorded a \$0.3 million loss on retirement of rental equipment during the year ended December 31, 2020.

During our review of our rental compressor units in 2019, we determined 327 units should be retired from our rental fleet. We recorded a \$1.5 million loss on retirement of rental equipment.

Property and Equipment

Property and equipment consists of the following at December 31, 2020 and 2019:

| | Useful Lives (Years) | December 31, | |
|-------------------------------------|-------------------------|-------------------|-----------|
| | | 2020 | 2019 |
| | | (\$ in thousands) | |
| Land | — | \$ 1,680 | \$ 1,290 |
| Building | 39 | 18,977 | 18,632 |
| Building and leasehold improvements | 39 | 1,168 | 1,168 |
| Office equipment and furniture | 5 | 2,016 | 2,001 |
| Software | 5 | 573 | 573 |
| Machinery and equipment | 7 | 3,653 | 3,492 |
| Vehicles | 3 | 7,598 | 7,560 |
| Total | | 35,665 | 34,716 |
| Less accumulated depreciation | | (13,916) | (12,847) |
| Total | | \$ 21,749 | \$ 21,869 |

Depreciation expense for property and equipment was \$2.3 million and \$1.7 million for the year ended December 31, 2020 and 2019, 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, 2020 and 2019:

| | December 31, | |
|-----------------------|----------------|-----------|
| | 2020 | 2019 |
| | (in thousands) | |
| Rentals | \$ 24,255 | \$ 22,596 |
| Sales | 281 | 275 |
| Service & Maintenance | 42 | 37 |
| Corporate | 495 | 235 |
| Total | \$ 25,073 | \$ 23,143 |

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, 2020 are as follows:

| Years Ending December 31, | <i>(in thousands)</i> | |
|---------------------------|-----------------------|---------------|
| 2021 | \$ | 21,565 |
| 2022 | | 15,084 |
| 2023 | | 13,763 |
| 2024 | | 8,590 |
| 2025 | | 5,845 |
| Thereafter | | 13,880 |
| Total | \$ | <u>78,727</u> |

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 nine 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. Based on the present value of lease payments for the Company's existing leases, the Company recorded net lease assets and lease liabilities of approximately \$451,000, respectively, upon adoption. The Company had no finance leases. The new lease standard did not materially impact the Company's consolidated statements of income and had no impact on the Company's consolidated statements of cash flows. The impact of the new lease standard on the December 31, 2020 and 2019 consolidated balance sheet was as follows:

| | Classification on Consolidated Balance Sheet | December 31, | |
|--|---|---------------|---------------|
| | | 2020 | 2019 |
| <i>(\$ in thousands)</i> | | | |
| Operating lease assets | Right of use assets-operating leases | \$ 483 | \$ 604 |
| Current lease liabilities | Current operating leases | \$ 198 | \$ 189 |
| Noncurrent lease liabilities | Long-term operating leases | 285 | 415 |
| Total lease liabilities | | <u>\$ 483</u> | <u>\$ 604</u> |
| Weighted average remaining lease term in years | | 1.5 | 2.6 |
| Implicit Rate | | 3.2 % | 3.1 % |

Operating lease costs are recognized on a straight-line basis over the lease term. Total operating lease costs for the year ended December 31, 2020 was approximately \$550,000.

| | December 31, | |
|--|---------------|---------------|
| | 2020 | 2019 |
| <i>(in thousands)</i> | | |
| Cash paid for amounts included in the measurement of lease liabilities | | |
| Operating lease cost ⁽¹⁾⁽²⁾ | <u>\$ 550</u> | <u>\$ 548</u> |

(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 \$333,000 for leases with terms of 12 months or less and \$217,000 for leases with terms greater than 12 months for the year ended December 31, 2020. Includes costs of \$350,000 for leases with terms of 12 months or less and \$198,000 for leases with terms greater than 12 months for the year ended December 31, 2019.

The following table shows the future maturities of lease liabilities:

| Years Ending December 31, | Lease Liabilities |
|----------------------------------|--------------------------|
| | <i>(in thousands)</i> |
| 2021 | \$ 211 |
| 2022 | 76 |
| 2023 | 38 |
| 2024 | 38 |
| 2025 | 38 |
| Thereafter | 130 |
| Total lease payments | 531 |
| Less: Imputed interest | (48) |
| Total | <u>\$ 483</u> |

Rent expense under such leases was \$217,000 and \$198,000 for the years ended December 31, 2020 and 2019, respectively.

7. Goodwill

Goodwill represents the cost in excess of fair value of the identifiable net assets acquired. Goodwill is tested annually for impairment or as needed upon the occurrence of certain events or substantive changes in circumstances that indicate goodwill is more likely than not impaired. During the third quarter of 2019, the Company examined various qualitative factors to determine if a quantitative goodwill impairment test was needed. For several months prior to the end of the third quarter of 2019, the Company experienced a significant decline in stock price, which was reflective of the significant deterioration of stock prices of companies throughout the oilfield services sector. In addition, the Company noted its largest customer as well as several other exploration and production companies had announced significant reductions to their 2020 capital expenditures budgets compared to those in 2019. These reductions clearly indicated lower demand for oilfield services, including compression services, in 2020 compared to 2019. In addition, the reductions reflected the deteriorated equity markets for energy companies and demands from institutional investors that energy companies keep capital spending within operating cash flow. After considering these factors and various other industry, economic and company-specific factors, we calculated our market capitalization (based on our closing stock price) as of September 30, 2019, and compared it to the carrying value of our net assets. Since the carrying value of our net assets exceeded our market capitalization and after considering all of the aforementioned qualitative factors, Company management determined that it was more likely than not that the fair value of the Company's net assets was less than its carrying amount.

As a result of our qualitative assessment, we proceeded to perform our quantitative goodwill impairment analysis, where we used an independent valuation specialist to assist us in determining the fair value of our net assets. In this impairment analysis, the estimated fair value of our net assets was determined utilizing market and income-based approaches. Determining fair value in this analysis required significant judgment, including judgments about appropriate comparable companies, appropriate discount rates and our estimated future cash flows, which are subject to change. As a result of our quantitative evaluation, we recorded a goodwill impairment charge of \$10.0 million in 2019 eliminating our goodwill balance at that date.

8. Intangibles

At December 31, 2020 and 2019, the Company had intangible assets, which relate to developed technology and a trade name. The carrying amount net of accumulated amortization at December 31, 2020 and 2019 was \$1.2 million and \$1.3 million, respectively. Amortization expense recognized in each of the years ending December 31, 2020 and 2019 was \$125,000. Estimated amortization expense for the years 2021-2024 is \$125,000 per year. The Company has an intangible asset with a gross carrying value of \$654,000 at December 31, 2020 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):

| | Useful Life (years) | December 31, 2020 | | | December 31, 2019 | | |
|----------------------|------------------------|----------------------------|-----------------------------|-------------------|----------------------------|-----------------------------|-------------------|
| | | Gross Carrying Value | Accumulated Amortization | Net Book Value | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| Developed Technology | 20 | \$ 2,505 | \$ 2,008 | \$ 497 | \$ 2,505 | \$ 1,883 | \$ 622 |
| Trade Name | Indefinite | 654 | — | 654 | 654 | — | 654 |
| Total | | \$ 3,159 | \$ 2,008 | \$ 1,151 | \$ 3,159 | \$ 1,883 | \$ 1,276 |

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 (excluding goodwill) during the years ended December 31, 2020 or 2019.

In addition, in conjunction with our quantitative assessment of goodwill, we used the services of an independent valuation specialist to assist us in determining the fair value of our trade name during the third quarter of 2019. In this impairment analysis, the estimated fair value of our trade name was determined utilizing an income-based approach that required significant judgment, including those about an appropriate royalty rate and discount rate. This analysis indicated no impairment of our trade name.

9. Credit Facility

We had a senior secured revolving credit agreement with JP Morgan Chase Bank, N.A (the "Amended Credit Agreement") that matured on March 31, 2021. Please see Note 18 - Subsequent Events for further discussion of the maturity event. The Amended Credit Agreement had an aggregate commitment of \$30 million, subject to collateral availability. We also had a right to request from the Lender, on an uncommitted basis, an increase of up to \$20 million on the aggregate commitment (which could have potentially increased the commitment amount to \$50 million).

Borrowing Base. At any time before the maturity of the Amended Credit Agreement, we could draw, repay and re-borrow amounts available under the borrowing base up to the maximum aggregate availability discussed above. Generally, the borrowing base equaled the sum of (a) 80% of our eligible accounts receivable plus (b) 50% of the book value of our eligible general inventory (not to exceed 50% of the commitment amount at the time) plus (c) 75% of the book value of our eligible equipment inventory. JPMorgan Chase Bank (the "Lender") could adjust the borrowing base components if material deviations in the collateral were discovered in audits of the collateral. We had \$29.5 million borrowing base availability at December 31, 2020 under the terms of our Amended Credit Agreement.

Interest and Fees. Under the terms of the Amended Credit Agreement, we had the option of selecting the applicable variable rate for each revolving loan, or portion thereof, of either (a) LIBOR multiplied by the Statutory Reserve Rate (as defined in the Amended Credit Agreement), with respect to this rate, for Eurocurrency funding, plus the Applicable Margin ("LIBOR-based"), or (b) CB Floating Rate, which is the Lender's Prime Rate less the Applicable Margin; provided, however, that no more than three LIBOR-based borrowings under the agreement could be outstanding at any one time. For purposes of the LIBOR-based interest rate, the Applicable Margin is 1.50%. For purposes of the CB Floating Rate, the Applicable Margin is 1.25%.

Accrued interest was payable monthly on outstanding principal amounts, provided that accrued interest on LIBOR-based loans was payable at the end of each interest period, but in no event less frequently than quarterly. In addition, fees and expenses were payable in connection with our requests for letters of credit (generally equal to the Applicable Margin for LIBOR-related borrowings multiplied by the face amount of the requested letter of credit) and administrative and legal costs.

Maturity. The maturity date of the Amended Credit Agreement, originally scheduled for December 31, 2020, was extended to March 31, 2021 on December 29, 2020, at which time all amounts borrowed under the agreement will be due and outstanding letters of credit must be cash collateralized. The agreement could be terminated early upon our request or the occurrence of an event of default.

Security. The obligations under the Amended Credit Agreement were secured by a first priority lien on all of our inventory and accounts and lease receivables, along with a first priority lien on a variable number of our leased compressor equipment the book value of must be maintained at a minimum of 2.00 to 1.00 commitment coverage ratio (such ratio being equal to (i) the amount of the borrowing base as of such date to (ii) the amount of the commitment as of such date.)

Covenants. The Amended Credit Agreement contained customary representations and warranties, as well as covenants which, among other things, limited our ability to incur additional indebtedness and liens; enter into transactions with affiliates; make acquisitions in excess of certain amounts; pay dividends; redeem or repurchase capital stock or senior notes; make investments or loans; make negative pledges; consolidate, merge or effect asset sales; or change the nature of our business. In addition, we also had certain financial covenants that required us to maintain a leverage ratio less than or equal to 2.50 to 1.00 as of the last day of each fiscal quarter.

Events of Default and Acceleration. The Amended Credit Agreement contained customary events of default for credit facilities of this size and type, and included, without limitation, payment defaults; defaults in performance of covenants or other agreements contained in the loan documents; inaccuracies in representations and warranties; certain defaults, termination events or similar events; certain defaults with respect to any other Company indebtedness in excess of \$50,000; certain bankruptcy or insolvency events; the rendering of certain judgments in excess of \$150,000; certain ERISA events; certain change in control events and the defectiveness of any liens under the secured revolving credit facility. Obligations under the Amended Credit Agreement could be accelerated upon the occurrence of an event of default.

As of December 31, 2020, we were in compliance with all covenants in our Amended Credit Agreement. A default under our Credit Agreement would trigger the acceleration of our bank debt so that it is immediately due and payable. Such default would likely limit our ability to access other credit. At December 31, 2020 our balance on the line of credit was \$417,000. Our weighted average interest rate for the year ended December 31, 2020 was 2.75%.

10. CARES Act Loan

On April 10, 2020, the Company entered into a promissory note (the "Loan") for an unsecured loan in the amount of \$4.6 million through the Paycheck Protection Program ("PPP") established by the CARES Act and administered by the U.S. Small Business Administration ("SBA"). The Loan was made for the purpose of securing funding for salaries and wages of employees that may have otherwise been displaced by the outbreak of COVID-19 and the resulting detrimental impact on the Company's business. JPMorgan Chase Bank, N.A. (the "Lender") processed and funded the Loan.

On April 23, 2020, the SBA advised that companies that applied for and received PPP loans that had other sufficient sources of liquidity that would not be "significantly detrimental" to their businesses may be subject to increased scrutiny and potential liability unless these companies repaid their loans in full by May 7, 2020. While the Company believes it was justified in seeking the Loan and the funds received were earmarked for the purposes set forth in the original PPP regulations, the Company voluntarily repaid the Loan, with accrued interest, to the Lender on May 4, 2020.

11. Income Taxes

The (provision for) benefit from income taxes for the years ended December 31, 2020 and 2019, consists of the following (in thousands):

| | <u>2020</u> | <u>2019</u> |
|-----------------------------------|-----------------|---------------|
| Current benefit (provision): | | |
| Federal benefit (expense) | \$ 15,587 | \$ 86 |
| State (expense) benefit | (149) | (55) |
| Total current benefit (provision) | <u>15,438</u> | <u>31</u> |
| Deferred benefit (provision): | | |
| Federal benefit (expense) | (10,234) | 662 |
| State | (412) | — |
| Total deferred benefit (expense) | <u>(10,646)</u> | <u>662</u> |
| Total benefit (provision) | <u>\$ 4,792</u> | <u>\$ 693</u> |

The effective tax rate for the years ended December 31, 2020 and 2019, differs from the statutory rate as follows:

| | <u>2020</u> | <u>2019</u> |
|---|----------------|--------------|
| Statutory rate | 21.0 % | 21.0 % |
| State and local taxes | (17.0)% | (3.7)% |
| Uncertain tax position | — % | — % |
| Goodwill impairment | — % | (13.7)% |
| Research and development credit | — % | 1.4 % |
| Stock based compensation | (13.1)% | (0.8)% |
| Nondeductible compensation | (11.6)% | (0.3)% |
| Effect of CARES Act | 180.3 % | — % |
| Other | 0.5 % | 0.9 % |
| Effective rate | <u>160.1 %</u> | <u>4.8 %</u> |
| Deferred re-measurement for rate change | — % | — % |
| Effective rate | <u>160.1 %</u> | <u>4.8 %</u> |

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, 2020.

The income tax effects of temporary differences that give rise to significant portions of deferred income tax assets and (liabilities) as of December 31, 2020 and 2019, are as follows (in thousands):

| | <u>2020</u> | <u>2019</u> |
|---------------------------------------|--------------------|--------------------|
| Deferred income tax assets: | | |
| Net operating loss | \$ 3,361 | \$ 1,519 |
| Research and development credits | 1,363 | 161 |
| Stock compensation | 175 | 580 |
| Deferred compensation | 705 | 389 |
| Other | 398 | 160 |
| Total deferred income tax assets | <u>6,002</u> | <u>2,809</u> |
| Deferred income tax liabilities: | | |
| Property and equipment | (47,626) | (33,761) |
| Goodwill and other intangible assets | (266) | (291) |
| Total deferred income tax liabilities | <u>(47,892)</u> | <u>(34,052)</u> |
| Net deferred income tax liabilities | <u>\$ (41,890)</u> | <u>\$ (31,243)</u> |

As of December 31, 2020, the Company had NOL carryforwards for federal income tax purposes of \$11.6 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, 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, 2020 and 2019.

Our policy regarding income tax interest and penalties is to expense those items as incurred. During the years ended December 31, 2020 and 2019, there were no significant income tax interest or penalty items in the statement of income.

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.

12. 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 \$2.0 million and \$1.5 million as of December 31, 2020 and 2019, respectively, with a gain related to the policy of \$168,000 and \$218,800 reported in other income in our consolidated income statement for the year ended December 31, 2020 and 2019, 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 \$2.2 million and \$1.7 million as of December 31, 2020 and 2019, respectively. The deferred obligation is included in other long-term liabilities in the consolidated balance sheet.

For deferrals of restricted stock units, the plan does not allow for diversification, therefore, distributions are paid in shares of common stock and the obligation is carried at grant value. As of December 31, 2020 and 2019, respectively, we have 45,998 and 85,565 unvested restricted stock units being deferred. As of December 31, 2020 and 2019, respectively we have released and issued 145,702 and 89,187 shares to the deferred compensation plan with a value of \$2.2 million and \$1.7 million, respectively.

13. Stockholders' Equity

Preferred Stock

We have a total of 5.0 million authorized preferred shares with rights and preferences as designated by the Board of Directors. As of December 31, 2020 and 2019, there were no issued or outstanding preferred shares.

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

Restricted Stock/Units

On June 18, 2014, at our annual meeting of shareholders, our shareholders approved a proposed amendment to the 2009 Restricted Stock/Unit Plan (the "2009 Plan") to add additional 500,000 shares of common stock to the Plan, thereby authorizing the issuance of up to 800,000 shares of common stock under the Plan. The 2009 Plan expired on June 16, 2019. At December 31, 2020 we had 34,899 shares outstanding under the 2009 Plan that will vest over the next one year.

On June 20, 2019, at our annual meeting of shareholders, our shareholders approved a new proposed Equity Incentive Plan for restricted shares/units and stock options. The Equity Incentive Plan allows issuance up to 500,000 share of common stock. As of December 31, 2020, we had 223,202 shares outstanding under the Equity Incentive Plan that will vest over the next three years.

In accordance with the Company's employment agreement with Stephen Taylor, the Company's Chief Executive Officer, the Compensation Committee reviewed his performance in determining the issuance of restricted common stock. Based on this review which included consideration of the Company's 2019 performance, Mr. Taylor, was awarded 94,133 restricted shares/units on April 28, 2020, which vest over three years, in equal installments beginning April 28, 2021. On April 28, 2020, the Compensation Committee awarded 10,000 restricted shares/units to James Hazlett, our Vice President of Technical Services. The restricted shares/units to Mr. Hazlett vest over three years, in equal installments, beginning April 28, 2021. We also awarded and issued 4,432 shares of restricted common stock/units to each of our four independent Board members as partial payment for 2020 directors' fees. The restricted stock/units issued to our directors vests in one year from the date of grant.

Compensation expense related to the restricted shares/units was approximately \$2.2 million and \$2.5 million for the years ended December 31, 2020 and 2019, respectively. As of December 31, 2020, there was a total of approximately \$1.8 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. As of December 31, 2020, 200,141 shares were still available for issuance under the Equity Incentive Plan.

A summary of all restricted stock/units activity as of December 31, 2019 and 2020 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, 2018 | 214,630 | \$ 25.51 | 8.85 | \$ 3,529 |
| Granted | 199,810 | 17.16 | — | 3,433 |
| Vested | (134,674) | 24.26 | — | 2,807 |
| Canceled/Forfeited | — | — | — | — |
| Outstanding, December 31, 2019 | 279,766 | \$ 20.15 | 8.77 | \$ 3,430 |
| Granted | 123,185 | 5.68 | — | 700 |
| Vested | (144,850) | 20.82 | — | 946 |
| Canceled/Forfeited | — | — | — | — |
| Outstanding, December 31, 2020 | 258,101 | \$ 12.87 | 8.61 | \$ 2,447 |

Other Long-Term Incentive Compensation

On April 28, 2020, based on its review of Mr. Taylor's 2019 performance, the Compensation Committee also issued a long-term incentive award of \$1.1 million to Mr. Taylor 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. In addition, on April 28, 2020, we issued a \$50,000 award to each of our four independent members of our Board of Directors as partial payment for their services in 2020. 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 to Mr. Taylor and our independent Board members 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 \$0.4 million for the year ended December 31, 2020. As of December 31, 2020 there was a total of \$0.8 million of unrecognized compensation expense related to these other long-term incentive awards which is expected to be recognized over the next 2.25 years.

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 under the Stock Option Plan. 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 based on 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, 2020, 384,503 shares were still available for issue 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:

| | 2020 |
|-------------------------|---------|
| Risk free rate | 0.48 % |
| Expected life | 6.59 |
| Expected volatility | 42.33 % |
| Expected dividend yield | — % |

There were no stock option grants made in 2019.

A summary of all option activity as of December 31, 2019 and 2020 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, 2018 | 283,686 | \$ 20.46 | 3.58 | \$ 434 |
| Granted | — | — | — | — |
| Exercised | (56,352) | 8.97 | — | 474 |
| Canceled/Forfeited | (8,000) | 21.60 | — | — |
| Expired | (11,000) | 17.74 | — | — |
| Outstanding, December 31, 2019 | 208,334 | \$ 23.67 | 3.66 | \$ — |
| Granted | 5,000 | 4.91 | — | — |
| Exercised | — | — | — | — |
| Canceled/Forfeited | (12,000) | 20.20 | — | 23,750 |
| Expired | (40,000) | 19.11 | — | — |
| Outstanding, December 31, 2020 | 161,334 | \$ 24.48 | 3.48 | \$ — |
| Exercisable, December 31, 2020 | 161,334 | \$ 24.48 | 3.48 | \$ — |

The weighted average grant date fair value of options granted during 2020 was \$2.07. We had no grants in 2019. The total intrinsic value, or the difference between the exercise price and the market price on the date of exercise, of options exercised during the years ended December 31, 2019 was approximately \$474,000. There were no option exercises in 2020. Cash received from stock options exercised during the years ended December 31, 2019 was approximately \$506,000.

The following table summarizes information about our stock options outstanding at December 31, 2020:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | |
|--------------------------|---------------------|---|--|---------------------|--|
| | Shares | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| \$0.01-18.00 | 24,500 | 0.41 | \$ 16.80 | 24,500 | \$ 16.80 |
| \$18.01-22.00 | 20,500 | 2.22 | 18.75 | 20,500 | 18.75 |
| \$22.01-26.00 | 42,167 | 4.28 | 22.90 | 42,167 | 22.90 |
| \$26.01-30.00 | 30,000 | 6.13 | 28.15 | 30,000 | 28.15 |
| \$30.01-34.00 | 44,167 | 3.22 | 30.41 | 44,167 | 30.41 |
| | 161,334 | 3.48 | \$ 24.48 | 161,334 | \$ 24.48 |

The summary of the status of our unvested stock options as of December 31, 2020 and changes during the year then ended is presented below.

| Unvested stock options: | Shares | Weighted Average Grant Date Fair Value |
|--------------------------------|---------------|---|
| Unvested at December 31, 2019 | 10,433 | \$ 11.93 |
| Granted | 5,000 | 2.07 |
| Vested | (10,433) | 11.93 |
| Canceled/Forfeited | (5,000) | 2.07 |
| Unvested at December 31, 2020 | <u>—</u> | <u>\$ —</u> |

We recognized stock compensation expense from stock options vesting of \$19,366 and \$124,000 for the years ended December 31, 2020 and 2019, respectively. As of December 31, 2020, there was no unamortized compensation cost related to unvested stock options.

15. (Loss) Earnings per Share

Basic (loss) earnings per common share is computed using the weighted average number of common shares outstanding during the period. Diluted (loss) earnings 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) earnings per share (in thousands, except per share amounts):

| | Year Ended December 31, | |
|--|--------------------------------|-------------|
| | 2020 | 2019 |
| Numerator: | | |
| Net (loss) income | \$ 1,808 | \$ (13,864) |
| Denominator for basic net (loss) income per common share: | | |
| Weighted average common shares outstanding | 13,224 | 13,114 |
| Denominator for diluted net (loss) income per share: | | |
| Weighted average common shares outstanding | 13,224 | 13,114 |
| Dilutive effect of stock options and restricted shares | 37 | — |
| Diluted weighted average shares | 13,261 | 13,114 |
| (Loss) earnings per common share: | | |
| Basic | \$ 0.14 | \$ (1.06) |
| Diluted | \$ 0.14 | \$ (1.06) |

In the year ended ended December 31, 2020, 221,061 restricted stock/units and 161,334 stock options were not included in the computation of dilutive income per share, due to their anti-dilutive effect. In the year ended ended December 31, 2019, 279,766 restricted stock/units and 208,334 stock options were not included in the computation of diluted loss per share due to their antidilutive effect.

16. Related Party

In 2016, we entered into a joint venture partnership, N-G, LLC ("N-G"), with Genis Holdings, LLC ("Genis") to explore new technologies for wellhead compression. NGS and Genis both share 50% ownership of N-G. We account for this investment under the equity method. In 2018, we ordered some compressor packages from Genis, totaling \$1.0 million. The compressors were completed and paid in full at December 31, 2019.

17. 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.

18. Subsequent Events

On March 31, 2021 our Amended Credit Agreement expired and we have decided not to renew the Amended Credit Agreement. On March 17, 2021 all outstanding indebtedness was repaid. We are in the process of negotiating a new credit facility which we expect to complete by the end of April 2021, although no guarantee can be made that we will be successful in finalizing and securing a new credit facility.

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)

Consent of Independent Registered Public Accounting Firm

Natural Gas Services Group, Inc.
Midland, Texas

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-212411, 333-196578, 333-160068, 333-160063, 333-147311, and 333-110954) of Natural Gas Services Group, Inc. of our reports dated March 31, 2020, relating to the consolidated financial statements and the effectiveness of Natural Gas Services Group, Inc.'s internal control over financial reporting, which appear in this Annual Report on Form 10-K. Our report on the effectiveness of internal control over financial reporting expresses an adverse opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2019.

/s/ BDO USA, LLP

Austin, Texas
March 31, 2021

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-8 (Nos. 333-212411, 333-196578, 333-160068, 333-160063, 333-147311, and 333-110954) of Natural Gas Services Group, Inc. of our report dated March 31, 2021, 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, 2020.

/s/ Moss Adams LLP

Dallas, Texas
March 31, 2021

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, 2021

Natural Gas Services Group, Inc.

By: /s/ Stephen C. Taylor

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

Certifications

I, G. Larry Lawrence, 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, 2021

Natural Gas Services Group, Inc.

By: /s/ G. Larry Lawrence
G. Larry Lawrence
Vice President and Chief Financial Officer
(Principal Accounting Officer)

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

In connection with the Annual Report of Natural Gas Services Group, Inc. (the "Company") on Form 10-K for the period ended December 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Stephen C. Taylor, 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, 2021

Natural Gas Services Group, Inc.

By: /s/ Stephen C. Taylor

Stephen C. Taylor,
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.

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, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, G. Larry Lawrence, 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, 2021

Natural Gas Services Group, Inc.

By: /s/ G. Larry Lawrence

G. Larry Lawrence
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.