NATURAL GAS SERVICES GROUP INC
Form 10-K
March 13, 2015

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

FORM 10-K
[ x ] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2014
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from_____to_____
Commission file number: 1-31398
NATURAL GAS SERVICES GROUP, INC.
(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| Colorado | 75-2811855 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 508 W. Wall St. Suite 550, Midland, Texas | 79701 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (432) 262-2700

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

| | |
|---|---|
| Title of each class | Name of each exchange on which registered |
| Common Stock, $.01 par value | 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 o No þ

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 o No þ
-
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 þ No o
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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

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.[]

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 þ Non-Accelerated Filer ¨ Smaller Reporting Company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ
The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2014 was approximately $404,885,655 based on the closing price of the common stock on that date on the New York Stock Exchange.

At February 13, 2015, there were 12,581,360 shares of 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 to be held on June 18, 2015.

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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, 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":

- conditions in the oil and natural gas industry, including the supply and demand for natural gas and wide fluctuations in the prices of oil and natural gas;
- 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.

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”, “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 8.

The Company

We are a leading provider of small to medium horsepower compression equipment to the natural gas industry. We focus primarily on the non-conventional natural gas and oil production business in the United States (such as coal bed methane, gas shale, tight gas and oil shales), which, according to data from the Energy Information Administration ("EIA"), is the single largest and fastest growing segment of U.S. energy production. We manufacture, fabricate and rent natural gas compressors that enhance the production of natural gas wells and provide maintenance services for those compressors. In addition, we sell custom fabricated natural gas compressors to meet customer specifications dictated by well pressures, production characteristics and particular applications. We also manufacture and sell flare systems for oil and gas plant and production facilities.

The vast majority of our rental operations are in non-conventional natural gas and oil regions, which typically have lower initial reservoir pressures, lower productions pressures and/or faster well decline rates. These areas usually require compression to be installed sooner and with greater frequency.

Natural gas compressors are used in a number of applications for the production and enhancement of gas wells and in gas transportation lines and processing plants. Compression equipment is often required to boost a well’s production to economically viable levels and enable gas to continue to flow in the pipeline to its destination.

We increased our revenue to $97.0 million in 2014 from $53.9 million in 2010. During the same period, income from operations increased to $22.0 million from $11.4 million. Our compressor rental fleet has grown to 2,879 compressors at December 31, 2014 from 1,909 compressors at the end of 2010.

Our revenue increased to $97.0 million from $89.2 million for the year ended December 31, 2014 compared to the year ended December 31, 2013.

Net income for the year ended December 31, 2014 decreased to $14.1 million ($1.11 per diluted share), as compared to $14.4 million ($1.15 per diluted share) for the year ended December 31, 2013.

At December 31, 2014, current assets were $55.9 million, which included $6.2 million of cash and cash equivalents. Current liabilities were $14.1 million, and our line of credit due in 2017 was $417,000. Our stockholders' equity as of December 31, 2014 was $210.6 million.

We were incorporated in Colorado on December 17, 1998 and maintain our principal offices at 508 W. Wall St., Suite 550, Midland, Texas 79701 and our telephone number is (432) 262-2700.

Overview and Outlook

The market for compression equipment and services is substantially dependent on the condition of the natural gas and oil industry. In particular, the willingness of natural gas and oil companies to make capital expenditures on exploration, drilling and production of natural gas and oil in the U.S. 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

factors, including the level of supply or demand for natural gas and oil and the impact on price of natural gas and oil, worldwide economic activity, interest rates and the cost of capital, environmental regulation, seasonal fluctuations and weather patterns. Natural gas and oil prices and the level of production activity have historically been characterized by significant volatility. Increasing oil and natural gas prices from 2005 through mid-2008 resulted in natural gas and oil operators increasing capital spending for exploration, development and production programs. However, in mid-2008, natural gas and oil prices began to decline. This decline resulted in reduced production and capital spending by some natural gas and oil companies, and had an impact on demand for compression equipment.

The reduction in capital expenditures and production in the natural gas and oil industry, combined with problems in the global economy, led to a downturn in the demand for our products and services in 2009 and 2010. In 2011 a slow recovery began which produced an improvement in the utilization rate on our rental fleet and stability in our sales backlog. In 2012 we saw growth in demand for our products and that growth continued in 2013 and 2014. Towards the end of 2014 oil prices began a steep decline which has resulted in capital budget cuts for many energy companies for 2015. These budget reductions will translate to fewer well completions and a softening of near-term demand for compression. See “Item 1 -- Business – Our Operating Units” and “Business – Backlog” for more information.

According to the U.S. Energy Information Administration (“EIA”), total consumption of natural gas in the United States increased 2.8% for the twelve months ended November 2014 compared to the same period 2013. This follows a 2.1% and a 5.1% increase in the periods from 2012 to 2013 and 2011 to 2012, respectively. EIA expects total natural gas consumption in the U.S. to increase slightly in 2015. While we anticipate long-term increased demand for natural gas, we expect our business to remain virtually flat or moderately decrease for 2015 due to the overall uncertainty in the combined oil and gas market.

Long-Term Industry Trends

Natural gas prices historically have been volatile, and this volatility is expected to continue. Oil and natural gas are linked commodities with many drilling projects producing both products. The recent oil price collapse may make some of those drilling projects uneconomic. Uncertainty continues to exist as to the direction of future natural gas and near-term crude oil price and oil trends are down in the United States and worldwide. Over the last several years gas prices have not shown the resiliency that crude oil prices have and now crude prices are also down sharply. We believe that natural gas is a more environmentally friendly source of energy which is likely to result in increases in demand over time. Being primarily a provider of services and equipment to natural gas producers, we are impacted by changes in natural gas, crude oil and condensate prices. Longer term natural gas prices will be determined by the supply and demand for natural gas as well as the prices of competing fuels, such as oil and coal.

We believe part of the growth of the rental compression capacity in the U.S. market has been driven by the trend toward outsourcing by energy producers and processors. Renting does not require the purchaser to make large capital expenditures for new equipment or to obtain financing through a lending institution. This allows the customer’s capital to be used for additional exploration and production of natural gas and oil.

Notwithstanding the slow rise in natural gas prices, we believe that there will continue to be a growing demand for natural gas. We expect long-term demand for our products and services will increase as a result of:

- the increasing demand for and limited supply of energy, both domestically and abroad;
- continued non-conventional gas exploration and production;
- environmental considerations which provide strong incentives to use natural gas in place of other carbon fuels;
- the cost savings of using natural gas rather than electricity for heat generation;
- implementation of international environmental and conservation laws;
- the aging of producing natural gas reserves worldwide;
- the extensive supply of undeveloped non-conventional natural gas reserves
- the increased drilling for shale oil and its associated gas production; and
- the use of our equipment for gas lift on oil wells.

Our Operating Units

We identify our operating units based upon major revenue sources as Gas Compressor Rental, Engineered Equipment Sales, Service and Maintenance and Corporate.

Gas Compressor Rental. Our rental business is primarily focused on non-conventional gas and oil production. We provide rental of small to medium horsepower compression equipment to customers under contracts typically having minimum initial terms of six to twenty four months. Historically, in our experience, most customers retain the equipment beyond the expiration of the initial term. By outsourcing their compression needs, we believe our customers are able to increase their revenues by producing a higher volume of natural gas due to greater equipment run-time. Outsourcing also 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 compressor equipment rented 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, 2014, we had 2,879 natural gas compressors in our rental fleet totaling 401,361 horsepower, as compared to 2,556 natural gas compressors totaling 351,187 horsepower at December 31, 2013. As of December 31, 2014, we had 2,189 natural gas compressors totaling 301,392 horsepower rented to 102 customers, compared to 2,038 natural gas compressors totaling 283,165 horsepower rented to 95 customers at December 31, 2013. As of December 31, 2014, the utilization rate of our rental fleet was 76.0% compared to 79.7% as of December 31, 2013.

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

- Compressor fabrication. Fabrication involves the 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 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.

- Compressor manufacturing. We design and manufacture our own proprietary line of reciprocating 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.

- 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, and we believe we are a leading supplier to this market.

- 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 screw compressors and maintain an inventory of new and used compressors to facilitate this part of our business.

Service and Maintenance. We service and maintain compressors owned by our customers on an “as needed” 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 wear-particle analysis on all packages and perform overhauls on a condition-based interval or a time-based schedule. Based on our past experience, these maintenance procedures maximize component life and unit availability and minimize downtime.

Business Strategy

During the downturn in the economy beginning in mid 2008, our strategy was to reduce expenses in line with the lower anticipated business activity, and fabricate compressor equipment only in direct response to market

requirements. As the economy recovered, we adjusted this strategy to ensure that we kept pace with growth while balancing appropriate business risk. As we again enter an industry downturn, our proven strategy of reducing expenses and fabricating on an as needed basis will be in place for 2015. See “Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations – Our Performance Trends and Outlook" for more information. Our long-term intentions to grow our revenue and profitability are based on the following business strategies:

- Expand rental fleet. We intend to increase the size of our rental fleet by fabricating compressor units in numbers that correspond to the growth of the market and in relation to market share gains we may experience. We believe our growth will continue to be primarily driven through our placement of small to medium horsepower wellhead natural gas compressors for non-conventional natural gas and oil production.

- 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. We presently provide our products and services to a customer base of oil and natural gas exploration and production companies operating in Colorado, Kansas, Michigan, New Mexico, North Dakota,Ohio, Oklahoma, Pennsylvania, Texas, Utah, West Virginia and Wyoming.
- Expand our ‘secondary’ product lines. In addition to our primary rental and engineered product business lines, we will emphasize the growth of our other products, e.g., flares, CiP compressor products and general compressor maintenance and repair services.
- Selectively pursue acquisitions. We will continue to evaluate potential acquisitions that would provide us with access to new markets or enhance our current market position.

Competitive Strengths

We believe our competitive strengths include:

- Superior customer service. Our emphasis on the small to medium horsepower markets has enabled us to effectively meet the evolving needs of our customers. We believe these markets have been under-serviced by our larger competitors which, 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 high and low pressure rotary screw and reciprocating packages. They are designed to meet a number of applications, including wellhead production, natural gas gathering, natural gas transmission, vapor recovery and gas and plunger lift. 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. Our "Flare King" product line provides flares and gas incineration devices to the industry for production maintenance and environmental compliance.
- 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 compact in design and are easy, quick and inexpensive to move, install and start-up. Our control systems are technically advanced and allow the operator to start and stop our units remotely and/or in accordance with well conditions. We believe our rental fleet is also one of the newest.
- Experienced management team. On average, each of our executive and operating team members have over 30 years of oilfield services 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 Colorado, Kansas, Michigan, New Mexico, North Dakota,Ohio, Oklahoma, Pennsylvania, Texas, Utah, West Virginia and Wyoming. Our footprint allows us to service many of the 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. We also sell engineered compression products to international customers.
- 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.

Major Customers

Sales and rental income to Devon Energy Production, Inc. ("Devon") and EOG Resources, Inc. ("EOG") for the year ended December 31, 2014 amounted to 18% and 15% of our revenue, respectively. Sales and rental income to EOG and Devon in the year ended December 31, 2013 amounted to 18% and 15% of our revenue, respectively. Sales and rental income to EOG and Devon in the year ended December 31, 2012 amounted to 32% and 12% of our revenue. No other single customer accounted for more than 10% of our revenues in 2014, 2013 or 2012.

EOG, Promatcon Tepatguna ("Promatcon") and Occidental Permian, LTD. ("Oxy") amounted to 20%, 18% and 14% of our accounts receivable as of December 31, 2014. EOG and Devon amounted to 18% and 14% of our accounts receivable as of December 31, 2013. No other customers amounted to more than 10% of our accounts receivable as of December 31, 2014 and 2013. The loss of any of the above customers could 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, 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, 2014, we had a sales backlog of approximately $5.8 million compared to $2.9 million as of December 31, 2013 . We expect to fulfill the backlog in the first half of 2015. 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 in many instances require three or four months of lead time prior to delivery of the order.

Employees

As of December 31, 2014, we had 353 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 gas industry, such as blowouts, explosions, craterings, 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, other waste materials and acids.

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.

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, solvents and abrasive blasting materials) 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 federal Water Pollution Control Act 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.

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. In addition, the EPA issued regulations in 2012 that require the reduction of emissions of volatile organic compounds, air toxics and methane, a greenhouse gas, at certain oil and gas operations. We are not currently aware of material impacts to our operations associated with these rules.
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.

In recent years, increased concern has been raised over the protection of the environment. Legislation to regulate emissions of greenhouse gases has been introduced in Congress, and there has been a wide-ranging policy debate, both nationally and internationally, regarding the impact of these gases and possible means for their regulation. In addition, efforts have been made and continue to be made in the international community toward the adoption of international treaties or protocols that would address global climate change issues, such as the United Nations Climate Change Conference in Copenhagen in 2009. Also, the EPA has undertaken new efforts to collect information regarding greenhouse gas emissions and their effects. Recently, the EPA declared that certain greenhouse gases represent a danger to human health and proposed to expand its regulations relating to those emissions. 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. We do not own any unexpired patents. Although we continue to use the

patented technology 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 four 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.

Available Information

We use our website as a channel of distribution for company information. We make available free of charge on the Investor Relations section of our website ( www.ngsgi.com ) our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K. We also make available through our website other reports filed with or furnished to the SEC under the Securities Exchange Act of 1934, as amended, including our proxy statements and reports filed by officers and directors under Section 16(a) of the Exchange Act, as well as our Code of Business Ethics and the charters to our various Committees of our Board of Directors. Paper copies of our filings are also available, without charge upon written request, at Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701. The information contained in our website is not part of this Report.

Glossary of Industry Terms

"CiP" - A branded, proprietary 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.

"coal bed methane" – A natural gas generated during coal formation and provided from coal seams or adjacent sandstones.

"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.

"gas shale" – Fine grained rocks where the predominant gas storage mechanism is absorption and gas is stored in volumes that are potentially economic.

"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.

"tight gas" – A gas bearing sandstone or carbonate matrix (which may or may not contain natural fractures) which exhibits a low-permeability (tight) reservoir.

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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

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

Economic conditions in the United States and abroad have, and will likely continue to, affect our revenue and profitability. The condition of domestic and global financial markets, continued low 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 become signifigant. 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 gas and oil 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 could 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, 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 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.

Depending on the market prices of oil and natural gas, companies exploring for oil and natural gas may cancel or curtail 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 reduction in drilling and production activities may materially erode both pricing and utilization rates for our equipment and services and adversely affects our financial results. As a result, 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.

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 may be required to enter into lower rate rental contracts in response to market conditions, and our rentals and sales may decrease as a result of such conditions. Due to the short-term nature of most of our rental contracts, changes in market conditions can quickly affect our business. As a result of the cyclicality of our industry, our results of operations may be volatile in the future.

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

Fracturing (frac) is a process that results in the creation of fractures in geological formations in order to stimulate production from oil and gas wells. Fracturing is also done to increase the rate and ultimate recovery of oil and natural gas. Hydraulic frac is the technique that has allowed domestic oil and natural gas exploration and production companies to produce massive shale deposits often referred to as unconventional plays. Concerns have been raised over possible environmental damages related to fluids used in the frac process. While the FRAC (Fracturing Responsibility and Awareness of Chemicals) Act has been introduced on multiple occasions in Congress, as of February 1, 2015 the Act has yet to be adopted. The FRAC Act seeks to amend the Safe Drinking Water Act so that hydraulic fracturing would be regulated on a federal level.

A ban of hydraulic fracing 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.

Risks Associated With Our Company

As of December 31, 2014, a significant majority of our compressor rentals were 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. 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 would 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.

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 expand our operations depends in part on our ability to 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 will require a substantial amount of capital to expand our compressor rental fleet and grow our business.

During 2015, the amount we will spend on capital expenditures related to rental compression equipment will be determined primarily by the activity of our customers. We do not anticipate demand for our products exceeding what we can fund with internally generated funds and additional bank borrowing with our current bank line. The amount and timing of any of these 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.

Historically, we have funded our capital expenditures through internally generated funds, borrowings under bank credit facilities. Although we believe that cash flows from our operations will provide us with sufficient cash to fund our planned capital expenditures for 2015, we cannot assure you that these sources will be sufficient. We may require additional capital to fund any unanticipated capital expenditures, including any acquisitions, and to fund our growth beyond 2015, and necessary capital 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.

Of our $30 million line of credit, we owe $417,000 as of December 31, 2014. All outstanding principal and unpaid interest is due on December 31, 2017. Although we believe that we will be able to renew our existing line of credit, or obtain a new line of credit with another lender, we can provide no assurance that we will be successful in renewing our line of credit or obtaining a new line. In addition, any renewal of our existing line of credit or creation of a new line of credit may be on terms less favorable that 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.

We believe that the lender participating in our current credit agreement has adequate capital and resources. If our current lender were to encounter difficulties, it is possible that the borrowing capacity under our credit agreement would be reduced or eliminated. In the event that the availability under our credit agreement was reduced significantly, we could be required to obtain capital from alternate sources in order to finance our capital needs. Our options for addressing such capital constraints would include, but not be limited to (1) obtaining commitments from other banks to fund increased amounts under the terms of our credit agreement, (2) accessing the public capital markets, or (3) delaying certain projects. If it became necessary to access additional capital, any alternatives at the time may be on terms less favorable than under our existing credit agreement terms, which could have a material effect on our consolidated financial position, results of operations and cash flows. If future financing is not available to us when required, as a result of limited access to the credit markets or otherwise, or is not available to us on acceptable terms, we may be unable take advantage of business opportunities or respond to competitive pressures, either of which could have a material adverse effect on our consolidated financial position, results of operations and cash flows.

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 of December 31, 2014, we had an aggregate of approximately $417,000 of outstanding indebtedness, and accounts payable, accrued expenses and current income tax liability of approximately $12.5 million. 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:

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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 of December 31, 2014, we had $417,000 due under our Line of Credit agreement which allows us to borrow up to $30.0 million provided we maintain certain collateral and borrowing base requirements. We believe that our current cash position and the amount available under the current revolver are sufficient to meet our capital needs through 2015. However, if we were to materially increase our borrowings, it is possible that our business will not generate sufficient cash flow from operations to

meet our debt service requirements and the payment of principal when due depending on the amount of borrowings on the agreement at any given time. If this were to occur, we may be forced to:

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

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

Under the terms of our credit agreement, we must:

- comply with a minimum leverage ratio;
- comply with a commitment coverage ratio;
- not exceed specified levels of debt; and
- comply with limits on asset sales.

Our ability to meet the financial ratios and tests under our credit agreement can be affected by events beyond our control, and we may not be able to satisfy those ratios and tests. A breach of any one of these covenants could permit the bank to accelerate the debt so that it is immediately due and payable. If a breach occurred, no further borrowings would be available under our credit agreement. If we were unable to repay the debt, the bank could proceed against and foreclose on our assets, substantially all of which have been pledged as collateral to secure payment of our indebtedness.

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

As part of our business strategy, we intend to 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.

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 two customers that accounted for approximately 33% of our revenue for the year ended December 31, 2014, and two customers that accounted for approximately 33% of our revenue for the year ended December 31, 2013. At December 31, 2014, three customers accounted for 52% 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 one or more of these significant customers may negatively impact our cash flow and current assets.

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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 is limited to 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 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.

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

We have significantly expanded our operations since our formation in 1998 and anticipate that our growth will continue if we are able to execute our strategy, subject to the supply and demand for oil and natural gas. Future growth may place significant strain on our management and other resources. To manage our future growth, we must be able to, among other things:

- accurately assess the number of additional officers and employees we will require and the areas in which they will be required;
- attract, hire and retain additional highly skilled and motivated officers and employees;
- train and manage our work force in a timely and effective manner;
- upgrade and expand our office infrastructure so that it is appropriate for our level of activity; and
- improve our financial and management controls, reporting systems and procedures.

Liability to customers under warranties and indemnification provisions may materially and adversely affect our earnings.

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 earnings 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.

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.

A reduction in demand primarily for natural gas or prices for this commodity and credit markets could adversely affect our business.

Our results of operations depend upon the level of activity in the energy market, including natural gas development, production, processing 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 or significant instability in energy markets. As a result, the demand for our natural gas compression services could be adversely affected. A reduction in demand could also force us to reduce our pricing substantially. Additionally, our customers' production from unconventional natural gas sources such as tight sands, shale and coal beds constitute the majority percentage of our business. Such unconventional sources are generally less economically feasible to produce in lower natural gas price environments. These factors could in turn negatively impact the demand for our products and services. A decline in demand for oil and natural gas or prices for those commodities and credit markets generally have a material adverse effect on our business, financial condition, results of operations.

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 weaken, our customers are more likely to experience a downturn in their financial condition. Many of our customers' equity values substantially declined during the most recent recession, 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 flat or moderate growth in our customers' spending for our products and services in 2015. 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.

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 is 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.

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. An aggregate of 23.6% of the outstanding shares of our common stock are owned by three institutional investors, each of which own more than 5% of our outstanding shares as of March 2, 2015. 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 6.7% of the outstanding shares of our common stock as of March 2, 2015, could also have a negative impact on our stock price.

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. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

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 could be 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 as well 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.

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.

We do not intend to pay, and have restrictions upon our ability to pay, dividends on our common stock.

We have not paid cash dividends in the past and do not intend to pay dividends on our common stock in the foreseeable future. Net income from our operations, if any, will be used for the development of our business, including capital expenditures, and to retire debt. In addition, our credit agreement contains restrictions on our ability to pay cash dividends on our common stock.

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 and only 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 stockholders. 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 stockholders 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, 2014:

| 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 | Leased | 13,135 | Corporate offices |
| Bloomfield, New Mexico | Owned | 7,000 | Office and parts and services |
| Bridgeport, Texas | Leased | 4,500 | Office and parts and services |
| Midland, Texas | Owned | 4,100 | Parts and services |
| Godley, Texas | Leased | 5,000 | Parts and services |
| Vernal, Utah | Leased | 3,200 | Parts and services |
| Carrollton, Ohio | Leased | 2,600 | Parts and services |
| Loveland, Colorado | Leased | 2,400 | Parts and services |
| Wheeler, Texas | Leased | 2,160 | Parts and services |
| Grapevine, Texas | Leased | 800 | Sales |
| Total | | 222,035 | |

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". The following table sets forth for the periods indicated the high and low sales prices for our common stock as reported for 2014 and 2013.

| 2014 | Low | High |
|---|---|---|
| First Quarter | $26.19 | $34.81 |
| Second Quarter | 28.90 | 34.69 |
| Third Quarter | 23.80 | 33.36 |
| Fourth Quarter | 21.23 | 26.75 |
| 2013 | Low | High |
| First Quarter | $16.76 | $19.26 |
| Second Quarter | 18.82 | 23.86 |
| Third Quarter | 24.06 | 27.99 |
| Fourth Quarter | 25.26 | 30.52 |

As of December 31, 2014 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 6, 2015, the last reported sale price of our common stock as reported by the New York Stock Exchange was $18.35 per share.

The following graph shows a five year comparison of the cumulative total stockholder return on Natural Gas Services Group 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 the 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 any cash dividends in the foreseeable future 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.

Equity Compensation Plans

The following table summarizes certain information regarding our equity compensation plans as of December 31, 2014:

| Plan Category | (a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights | | (b) Weighted-average Exercise Price of Outstanding Options, Warrants and Rights | (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 | 432,269 | (1) | $ 17.55 | 186,419 |
| Restricted Stock / Unit Plan | 99,238 | | $ 28.22 | 473,717 |
| Equity compensation plans not approved by security holders | 20,000 | (2) | $ 18.15 | — |
| Total | 551,507 | | | 660,136 |

(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) Total number of shares to be issued upon exercise of options granted outside of our 1998 stock option plan to Stephen C. Taylor, our Chief Executive Officer, under the terms of his initial employment.

Repurchase of Equity Securities

No repurchases of our securities were made by us or on our behalf by any “affiliated purchaser” during the year ended December 31, 2014.

Sale of Unregistered Securities

We made no sales of unregistered securities during the year ended December 31, 2014.

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ITEM 6. SELECTED FINANCIAL DATA

In the table below, we provide you with selected historical financial data. We have derived this information from our audited financial statements for each of the years in the five-year period ended December 31, 2014. This information is only a summary and it is important that you read this information along with our audited financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" under Item 7 below, which discusses factors affecting the comparability of the information presented. The selected financial information provided is not necessarily indicative of our future results of operations or financial performance.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| | (in thousands, except per share amounts) | | | | |
| STATEMENTS OF INCOME AND OTHER INFORMATION: | | | | | |
| Revenues | $96,974 | $89,248 | $93,722 | $65,158 | $53,908 |
| Costs of revenues, exclusive of depreciation and amortization shown separately below | 43,147 | 40,943 | 49,907 | 30,394 | 24,750 |
| Gross margin(1) | 53,827 | 48,305 | 43,815 | 34,764 | 29,158 |
| Depreciation and amortization | 21,507 | 18,144 | 15,707 | 13,994 | 11,927 |
| Other operating expenses | 10,334 | 8,141 | 7,893 | 5,910 | 5,867 |
| Operating income | 21,986 | 22,020 | 20,215 | 14,860 | 11,364 |
| Total other income (expense) | 172 | 492 | (4) | 769 | (64) |
| Income before income taxes | 22,158 | 22,512 | 20,211 | 15,629 | 11,300 |
| Income tax expense | 8,030 | 8,122 | 7,526 | 5,869 | 4,272 |
| Net income | $14,128 | $14,390 | $12,685 | $9,760 | $7,028 |
| Net income per common share: | | | | | |
| Basic | $1.14 | $1.17 | $1.04 | $0.80 | $0.58 |
| Diluted | $1.11 | $1.15 | $1.03 | $0.80 | $0.58 |
| Weighted average shares of common stock outstanding: | | | | | |
| Basic | 12,434 | 12,324 | 12,220 | 12,148 | 12,108 |
| Diluted | 12,721 | 12,550 | 12,320 | 12,250 | 12,210 |
| EBITDA(2) | $43,675 | $40,712 | $35,936 | $29,678 | $23,421 |
| | | | | | |
| Cash flows from: | | | | | |
| Operating Activities | $34,564 | $39,244 | $35,418 | $33,623 | $28,798 |
| Investing Activities | (53,102) | (43,324) | (23,761) | (35,506) | (21,861) |
| Financing Activities | 276 | 437 | 39 | (864) | (10,817) |
| Net change in cash and cash equivalents | $(18,262) | $(3,643) | $11,696 | $(2,747) | $(3,880) |
| | As of December 31, | | | | |
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| BALANCE SHEET INFORMATION: | | (in thousands) | | | |
| Current assets | $55,927 | $60,645 | $62,036 | $49,503 | $48,338 |
| Total assets | 283,563 | 256,589 | 232,751 | 212,164 | 188,769 |
| Long-term debt (including current portion) | 417 | 577 | 897 | 1,017 | 2,000 |
| Stockholders' equity | 210,587 | 192,737 | 175,825 | 161,542 | 150,591 |

(1) Gross margin is defined, reconciled to net income and discussed immediately below under "-- Non-GAAP Financial Measures".

(2) EBITDA is defined, reconciled to net income and discussed immediately below under "-- Non-GAAP Financial Measures".

Non-GAAP Financial Measures

Our definition and use of EBITDA

"EBITDA" is a non-GAAP financial measure that we define as earnings (net income) from operations before interest, taxes, depreciation, and amortization. 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. 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 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 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.

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:

- EBITDA does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
- EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- 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 EBITDA does not reflect any cash requirements for such replacements.

There are other material limitations to using 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 EBITDA reconciles to our net income, the most directly comparable GAAP financial measure.

Definition and use of gross margin

We define gross margin as total revenue less costs (excluding depreciation and amortization expense). 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. Gross margin differs from gross profit, in that gross profit includes depreciation expense. We believe 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, the indirect costs associated with our selling, general and administrative activities, the impact of our financing methods and income taxes. Depreciation expense may 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.

Gross margin has certain material limitations associated with its use as compared to net income. These limitations are primarily due to the exclusion of certain expenses. Each of these excluded expenses 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 and selling, general and administrative expense is a necessary cost to support our operations and required corporate activities. 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, gross margin should not be considered an alternative to, or more meaningful than, net income as determined in accordance with GAAP. Our gross margin may not be comparable to a similarly titled measure of another company because other entities may not calculate gross margin in the same manner.

Reconciliation

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

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| | (in thousands) | | | | |
| Net Income | $14,128 | $14,390 | $12,685 | $9,760 | $7,028 |
| Interest expense, net | 10 | 56 | 18 | 55 | 194 |
| Income taxes | 8,030 | 8,122 | 7,526 | 5,869 | 4,272 |
| Depreciation and amortization | 21,507 | 18,144 | 15,707 | 13,994 | 11,927 |
| EBITDA | 43,675 | 40,712 | 35,936 | 29,678 | 23,421 |
| Other operating expenses | 10,334 | 8,141 | 7,893 | 5,910 | 5,867 |
| Other expenses (income) | (182) | (548) | (14) | (824) | (130) |
| Gross Margin | $53,827 | $48,305 | $43,815 | $34,764 | $29,158 |

## 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, 2014, 2013, and 2012. 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 24 months. 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 paid monthly in advance and include maintenance of the rented compressors. As of December 31, 2014, we had 2,189 natural gas compressors totaling 301,392 horsepower rented to 102 customers, compared to 2,038 natural gas compressors totaling 283,165 horsepower rented to 95 customers at December 31, 2013. Of the 2,189 compressors rented at December 31, 2014, 1,784 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 the purchase by us of engines, compressors, coolers and other components, and then assembling 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 three to four 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 proprietary line of compressor frames, cylinders and parts, known as our CiP (Cylinder-in-Plane) product line. We use finished CiP component products in the fabrication of compressor units for sale or rental by us or sell the finished component products to other compressor fabricators. We also design, fabricate, sell, install and service flare stacks

and related ignition and control devices for onshore and offshore incineration of gas compounds such as hydrogen sulfide, carbon dioxide, natural gas and liquefied petroleum gases. To provide customer support for our compressor and flare sales businesses, we stock varying levels of replacement parts at our Midland, Texas facility and at field service locations. We also provide an exchange and rebuild program for screw compressors and maintain an inventory of new and used compressors to facilitate this business.

We provide service and maintenance to our customers under written maintenance contracts or on an as required basis in the absence of a service contract. 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, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | (in thousands) | | |
| Rental | $78,983 | $69,062 | $56,477 |
| Sales | 17,200 | 19,479 | 36,375 |
| Service and maintenance | 791 | 707 | 870 |
| Total | $96,974 | $89,248 | $93,722 |

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 high 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 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 natural gas and oil and the corresponding changes in commodity prices. As demand and prices increase, oil and natural gas producers increase their capital expenditures for drilling, development and production activities. Generally, the 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 natural gas industry, with changes in domestic natural gas production and consumption levels and prices more significantly affecting our business than changes in crude oil and condensate production and consumption levels and prices. We also believe that demand for compression services and products is driven by declining reservoir pressure in maturing natural gas producing fields and, more recently, by increased focus by producers on non-conventional natural gas production, such as coal bed methane, gas shale and tight gas, which typically requires more compression than production from conventional natural gas reservoirs.

Demand for our products and services was strong throughout most of 2008, but in 2009 the demand declined due to lower natural gas prices, decreased demand for natural gas and the economic recession. During 2010, the economy began to recover and demand for our products began to strengthen. This recovery has continued through 2014 due to increasing oil prices, in spite of continued low natural gas prices. Towards the end of 2014 crude oil prices collapsed, placing uncertainty on the growth in demand for our products and services.

For fiscal year 2015, 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 flows from operations will be sufficient to satisfy our capital and liquidity requirements through 2015. We may require

additional capital to fund any unanticipated expenditures, including any acquisitions of other businesses, although that capital may not be available to us when we need it or on acceptable terms.

Notwithstanding the continued uncertain economy and low energy price environment, we believe the long-term trend in our market is favorable.

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.

Our critical accounting policies are as follows:
- revenue recognition;
- estimating the allowance for doubtful accounts receivable;
- accounting for income taxes;
- valuation of long-lived and intangible assets and goodwill; and
- valuation of inventory.

Revenue Recognition

Revenue from the sales of custom and fabricated compressors and flare systems is recognized when title passes to the customer, the customer assumes risks and rewards of ownership, collectability is reasonably assured and delivery occurs as directed by our customer. However, in certain circumstances customers request a bill and hold arrangement, in which case sales revenue is recognized before delivery occurs. Under these bill and hold arrangements, the compressor or flare is available for shipment, the Company has fulfilled all of its pre-delivery performance obligations and the customer has completed and signed a bill and hold agreement. Revenue from sale of rental units is included in sales revenue when equipment is shipped or title is transferred to the customer. Exchange and rebuild compressor revenue is recognized when both the replacement compressor has been delivered and the rebuild assessment has been completed. Revenue from compressor services is recognized upon providing services to the customer. Maintenance agreement revenue is recognized as services are rendered. Rental revenue is recognized over the terms of the respective rental agreements. Deferred income represents payments received before a product is shipped.

Allowance for Doubtful Accounts Receivable

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer’s current credit worthiness, as determined by our review of their current credit information. 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. At December 31, 2014, three customers accounted for approximately 20%, 18% and 14% of our accounts receivable, and at December 31, 2013, two customers accounted for approximately 18% and 14% of our accounts receivable. A significant change in the liquidity or financial position of these customers could have a material adverse impact on the collectability of our accounts receivables and our future operating results. At December 31, 2014, our allowance for doubtful accounts balance was $507,000 and $436,000 at December 31, 2013.

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 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 operations.

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.

Valuation of Long-Lived and Intangible Assets and Goodwill

We assess the impairment of identifiable intangibles, long-lived assets and related goodwill annually or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends; and
- significant decline in the market value of our stock.

When we determine that the carrying value of intangibles, long-lived assets and related goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model.

We completed a review of goodwill for impairment during the fourth quarter of 2014 under the guidance of Accounting Standards Update 2012-02. Our analysis considered multiple qualitative factors to determine whether events and circumstances indicate a low likelihood that we have experienced impairment to the stated value of goodwill. Our assessment included a review of changes in key company financial metrics, stock performance and other measures that are important to the company's success. The other measure included demand for our products and services, maintenance of customers and cost of producing our product. Based on the analysis we concluded that it is more likely than not that we have not incurred impairment and are not required to take further action. As a result, no impairment of goodwill was recorded in the year ending at December 31, 2014. Future impairment tests could result in impairments of our intangible assets or goodwill.

Inventories

We value our inventory at the lower of the actual cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and production requirements. At December 31, 2014, an adjustment to the allowance of $298,000 was made to remove obsolete inventory which represents 1.1% of inventory. This adjustment was the result of our obsolescence review which is conducted each year. We ended 2014 with a balance of $225,000.

Our Performance Trends and Outlook

Given the current economic environment in North America and anticipated impact of continued low natural gas and oil prices and potentially cautious capital spending by customers, we expect the overall activity levels to remain flat or drop in 2015. Currently, we believe that weak commodity prices will continue throughout 2015. In addition, credit and capital markets could show signs of stress resulting from the weakness of commodity prices and will impact the level of capital spending by our customers in the near term. We believe that the recovery from the recent market uncertainty will continue to be slow. The result will likely be lagging capital spending by our customers and therefore slow growth in demand for our products and services and price pressure from competitors. We anticipate industry capital spending will be greatly decreased in 2015 compared to 2014 levels, and we believe our fabrication business will likely reflect this in our production level though 2015. We believe our rental operations business will be virtually flat or moderately down.

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Results of Operations

Year Ended December 31, 2014 Compared to the Year Ended December 31, 2013

The table below shows our revenues, percentage of total revenues, gross margin, exclusive of depreciation and amortization, and gross margin percentage of each of our operating units for the years ended December 31, 2014 and December 31, 2013. Gross margin is the difference between revenue and cost of revenues, exclusive of depreciation and amortization expense.

| | Revenue | | | | | | Gross Margin, Exclusive of Depreciation and Amortization (1) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | | | Year Ended December 31, | | | | | |
| | 2014 | | | 2013 | | | 2014 | | | 2013 | | |
| | (dollars in thousands) | | | | | | | | | | | |
| Rental | $78,983 | 81.5 | % | $69,062 | 77.4 | % | $47,461 | 60.1 | % | $40,045 | 58.0 | % |
| Sales | 17,200 | 17.7 | % | 19,479 | 21.8 | % | 5,903 | 34.3 | % | 7,897 | 40.5 | % |
| Service & Maintenance | 791 | 0.8 | % | 707 | 0.8 | % | 463 | 58.5 | % | 363 | 51.3 | % |
| Total | $96,974 | | | $89,248 | | | $53,827 | 55.5 | % | $48,305 | 54.1 | % |

(1) For a reconciliation of gross margin to its most directly comparable financial measure calculated and presented in accordance with GAAP, please read “Item 6. Selected Financial Data – Non-GAAP Financial Measures” in this Report.

Total revenue increased to $97.0 million from $89.2 million, or 8.7%, for the year ended December 31, 2014, compared to 2013. This was the result of a 11.7% decrease in sales revenue offset by a 14.4% increase in rental revenue and a 11.9% increase in service and maintenance revenue.

Rental revenue increased to $79.0 million from $69.1 million, or 14.4%, for the year ended December 31, 2014, compared to 2013. This increase was the result of improved rental pricing of our units and our ability to place additional units in service. As of December 31, 2014, we had 2,879 natural gas compressors in our rental fleet totaling 401,361 horsepower, as compared to 2,556 natural gas compressors totaling 351,187 horsepower at December 31, 2013. As of December 31, 2014, we had 2,189 natural gas compressors totaling 301,392 horsepower rented to 102 customers, compared to 2,038 natural gas compressors totaling 283,165 horsepower rented to 95 customers at December 31, 2013. The rental fleet had a utilization of 76.0% as of December 31, 2014 as compared to 79.7% at year end 2013.

Sales revenue decreased to $17.2 million from $19.5 million, or 11.7%, for the year ended December 31, 2014, compared to 2013. Our normal sales activity continues to reflect demand from our customers' continued investment in non-conventional shale plays which require compression for produced natural gas. The price of natural gas on December 31, 2014 was $3.14/MMBtu, down from $4.31/MMBtu one year ago. The price of natural gas remains at levels that are considered depressed. Because of lagging natural gas prices, along with economic uncertainty and continued tight credit markets, the energy industry continues to encounter reduced capital spending, particularly for goods and services with respect to natural gas activities. This has caused capital project funding to shift from gas projects to oil projects as the price of oil was not as volatile as gas, and oil prices have rebounded from its lows compared to natural gas prices. Since our compressors are increasingly used in the production of natural gas from shale plays which are driven by oil economics, we have been able to increase our sales. Our strategy over time has been to increase our rental revenues so that they are a larger component of total revenue, but we intend to maintain our ability to build and sell custom fabricated equipment. In support of this, we have continued to cultivate new

sales-oriented customers and are entertaining requests for bids on larger reciprocating compressors instead of being solely focused on screw-type equipment. Sales included: (1) compressor unit sales, (2) flare sales, (3) parts sales and (4) compressor rebuilds.

The overall gross margin percentage increased to 55.5% for the twelve months ended December 31, 2014, from 54.1% for the same period ended December 31, 2013, exclusive of depreciation and amortization. This increase is the result of the relatively higher margin rentals comprising a larger share of total revenue. Rental revenue increased by 14.4% while sales revenue declined. Rental margins increased for the year ended December 31, 2014 compared to 2013 from 58.0% to 60.1%. Sales margin decreased to 34.3% from 40.5% for the year ended 2014 compared to 2013. Third party service and maintenance margins increased to 58.5% from 51.3% for the year ended December 31, 2014 compared to 2013. Service and maintenance represents less than 1% of our revenue providing minimal impact on our overall gross margin.

Selling, general, and administrative expense increased to $10.3 million for the year ended December 31, 2014, as compared to $8.1 million for 2013. This 26.9% increase is primarily due to our need to maintain consistent staffing levels, salary increases for existing staff ($243,000) and non-cash expenses related to stock compensation ($1.5 million).

Depreciation and amortization expense increased to $21.5 million from $18.1 million, or 18.5%, for the year ended December 31, 2014, compared to 2013. This increase was the net result of 323 new gas compressor rental units being added to the rental fleet in 2014, thus increasing the depreciable base.

Provision for income tax decreased to $8.0 million from $8.1 million, or 1.1%, and is the result of the decrease in taxable income. Our effective tax rate was 36.2% for 2014 and 36.1% for 2013.

Year Ended December 31, 2013 Compared to the Year Ended December 31, 2012

The table below shows our revenues, percentage of total revenues, gross margin, exclusive of depreciation and amortization, and gross margin percentage of each of our operating units for the years ended December 31, 2013 and December 31, 2012. Gross margin is the difference between revenue and cost of sales, exclusive of depreciation and amortization expense.

| | Revenue | | | | Gross Margin, Exclusive of Depreciation and Amortization (1) | | | |
|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31, | | | | Year Ended December 31, | | | |
| | 2013 | | 2012 | | 2013 | | 2012 | |
| | (dollars in thousands) | | | | | | | |
| Rental | $ 69,062 | 77.4 % | $ 56,477 | 60.3 % | $ 40,045 | 58.0 % | $ 32,740 | 58.0 % |
| Sales | 19,479 | 21.8 % | 36,375 | 38.8 % | 7,897 | 40.5 % | 10,559 | 29.0 % |
| Service & Maintenance | 707 | 0.8 % | 870 | 0.9 % | 363 | 51.3 % | 516 | 59.3 % |
| Total | $ 89,248 | | $ 93,722 | | $ 48,305 | 54.1 % | $ 43,815 | 46.7 % |

(1) For a reconciliation of gross margin to its most directly comparable financial measure calculated and presented in accordance with GAAP, please read “Item 6. Selected Financial Data – Non-GAAP Financial Measures” in this Report.

Total revenue decreased to $89.2 million from $93.7 million, or 4.8%, for the year ended December 31, 2013, compared to 2012. This was the result of a 46.4% decrease in sales revenue, a 22.3% increase in rental revenue and a 18.7% decrease in service and maintenance revenue. The sales decrease was primarily due to a large non-recurring sale of rental units from our fleet to a single customer in 2012.

Rental revenue increased from $56.5 million to $69.1 million, or 22.3%, for the year ended December 31, 2013, compared to 2012. This increase was the result of improved rental pricing of our units and the achievement of higher fleet utilization. As of December 31, 2013, we had 2,556 natural gas compressors in our rental fleet totaling 351,187 horsepower, as compared to 2,279 natural gas compressors totaling 311,401 horsepower at December 31, 2012. As of December 31, 2013, we had 2,038 natural gas compressors totaling 283,165 horsepower rented to 95 customers, compared to 1,756 natural gas compressors totaling 245,340 horsepower rented to 100 customers at December 31, 2012. The rental fleet had a utilization of 79.7% as of December 31, 2013 as compared to 77.1% at year end 2012.

Sales revenue decreased to $19.5 million from $36.4 million, or 46.4%, for the year ended December 31, 2013, compared to 2012. This decrease was the result of the large one time sale from our fleet in 2012. Our normal sales activity continues to reflect demand from our customers' continued investment in non-conventional shale plays which require compression for produced natural gas. The price of natural gas on December 31, 2013 was $4.31/MMBtu, up from $3.43/MMBtu one year earlier. Despite this increase in natural gas prices, the price of natural gas remained at levels that are considered depressed. Because of lagging natural gas prices, along with economic uncertainty and continued tight credit markets, the energy industry continues to encounter reduced capital spending, particularly for goods and services with respect to natural gas activities. This has caused capital project funding to shift from gas projects to oil projects as the price of oil was not as volatile as gas, and oil prices have rebounded from its lows compared to natural gas prices. Since our compressors are increasingly used in the production of natural gas from shale plays which are driven by oil economics, we have been able to increase our sales. Our strategy over time has been to increase our rental

revenues so that they are a larger component of total revenue, but we intend to maintain our ability to build and sell custom fabricated equipment. In support of this, we have continued to cultivate new sales-oriented customers and are entertaining requests for bids on larger reciprocating compressors instead of being solely focused on screw-type equipment. Sales included: (1) compressor unit sales, (2) flare sales, (3) parts sales and (4) compressor rebuilds.

The overall gross margin percentage increased to 54.1% for the twelve months ended December 31, 2013, from 46.7% for the same period ended December 31, 2012, exclusive of depreciation and amortization. This increase is the result of the relatively higher margin rentals comprising a larger share of total revenue. Rental revenue increased by 22.3% while sales revenue declined. Rental margins were relatively flat for the year ended December 31, 2013 compared to 2012 at 58.0%. Sales margin increased to 40.5% from 29.0% for the year ended 2013 compared to 2012. Third party service and maintenance margins decreased to 51.3% from 59.3% for the year ended December 31, 2013 compared to 2012. Service and maintenance represents less than 1% of our revenue providing minimal impact on our overall gross margin.

Selling, general, and administrative expense increased to $8.1 million for the year ended December 31, 2013, as compared to $7.9 million for 2012. This 3.1% increase was primarily due to increases in staffing levels, salary increases for existing staff and expenses related to vesting of restricted shares.

Depreciation and amortization expense increased to $18.1 million from $15.7 million, or 15.5%, for the year ended December 31, 2013, compared to 2012. This increase was the net result of 277 new gas compressor rental units being added to the rental fleet in 2013, thus increasing the depreciable base.

Provision for income tax increased to $8.1 million from $7.5 million, or 7.9%, and was the result of the increase in taxable income. Our effective tax rate was 36.1% for 2013 and 37.2% for 2012.

Liquidity and Capital Resources

Our working capital positions as of December 31, 2014 and 2013 are set forth below.

| | 2014 | 2013 |
|---|---|---|
| | (in thousands) | |
| Current Assets: | | |
| Cash and cash equivalents | $6,181 | $24,443 |
| Trade accounts receivable, net | 10,408 | 6,750 |
| Inventory, net | 32,624 | 26,832 |
| Prepaid income taxes | 6,242 | 2,281 |
| Prepaid expenses and other | 472 | 339 |
| Total current assets | 55,927 | 60,645 |
| Current Liabilities: | | |
| Line of credit | — | 577 |
| Accounts payable | 4,990 | 3,904 |
| Accrued liabilities | 6,624 | 6,487 |
| Current income tax liability | 851 | 350 |
| Deferred income | 1,635 | 873 |
| Total current liabilities | 14,100 | 12,191 |
| Net working capital | $41,827 | $48,454 |

Historically, we have funded our operations through public and private offerings of our equity securities, subordinated debt, bank borrowings and cash flow from operations. Proceeds of financings have been primarily used to repay debt, to fund the manufacture and fabrication of additional units for our rental fleet of natural gas compressors and for acquisitions. In recent years, we have primarily funded our operations through cash flow from operations and, to a lesser extent, borrowings under our bank line of credit, which is described below. For the year ended December 31, 2014, we invested approximately $53.3 million in equipment for our rental fleet and service vehicles. We financed this activity with funds from operations.

Cash flows

At December 31, 2014, we had cash and cash equivalents of $6.2 million and working capital of $41.8 million, and total debt of $417,000 under our credit agreement, all which is due in 2017. Our cash and cash equivalent decreased from 2013 due to an increase in demand from our customers for additional rental compression.We had positive net cash flow from operating activities of approximately $34.6 million during 2014. This was primarily from net income of $14.1 million plus depreciation and amortization of $21.5 million.

At December 31, 2013, we had cash and cash equivalents of $24.4 million, working capital of $48.5 million and total debt of $577,000, under our line of credit. We had positive net cash flow from operating activities of approximately $39.2 million during 2013. This was primarily from net income of $14.4 million plus depreciation and amortization of $18.1 million, and an increase in deferred taxes of $7.7 million.

Raw materials and work in progress inventory increased to $32.6 million as of the end of 2014, as compared to $26.8 million as of the end of 2013. This increase is mainly a reflection of inventory management activity and the timing of jobs closing from work in progress to finished goods.

Contractual Obligations and Commitments

We have contractual obligations and commitments that affect our results of operations, financial condition and liquidity. The following table is a summary of our significant cash contractual obligations (in thousands):

| Cash Contractual Obligations | 2015 | 2016 | 2017 | 2018 | Thereafter | Total |
|---|---|---|---|---|---|---|
| Line of credit | $— | $— | $417 | $— | $— | $417 |
| Interest on line of credit | 17 | 17 | 17 | — | — | 51 |
| Purchase obligations | 620 | 620 | 620 | 612 | — | 2,472 |
| Other long term liabilities | — | — | — | 155 | — | 155 |
| Facilities and office leases | 288 | 261 | 241 | 113 | 15 | 918 |
| Equipment leases | 13 | 7 | 2 | — | — | 22 |
| Total | $938 | $905 | $1,297 | $880 | $15 | $4,035 |

Senior Bank Borrowings

On November 19, 2014, we amended and renewed our $30 million Credit Agreement with JP Morgan Chase Bank, N.A. ("the Amended Credit Agreement"). The Amended Credit Agreement was extended to December 31, 2017, and the interest rate terms were amended. We also have a right to request from the lender, on an uncommitted basis, an increase of up to $20 million on the aggregate commitment (which could potentially increase the commitment amount to $50 million). As of December 31, 2014, we owed $417,000 on the line of credit under the Credit Agreement.

Borrowing Base. At any time before the maturity of the Amended Credit Agreement, we may draw, repay and re-borrow amounts available under the borrowing base up to the maximum aggregate availability discussed above. Generally, the borrowing base equals the sum of (a) 80% of our eligible accounts receivable plus (b) 50% of the book value of our eligible general inventory (not to exceed 50% of the commitment amount at the time) plus (c) 75% of the book value of our eligible equipment inventory. JPMorgan Chase Bank (the “Lender”) may adjust the borrowing base components if material deviations in the collateral are discovered in future audits of the collateral.

Interest and Fees. Under the terms of the Amended Credit Agreement, we have the option of selecting the applicable variable rate for each revolving loan, or portion thereof, of either (a) LIBOR multiplied by the Statutory Reserve Rate (as defined in the Amended Credit Agreement), with respect to this rate, for Eurocurrency funding, plus the

Applicable Margin (“LIBOR-based”), or (b) CB Floating Rate, which is the Lender’s Prime Rate less the Applicable Margin; provided, however, that no more than three LIBOR-based borrowings under the agreement may be outstanding at any one time. For purposes of the LIBOR-based interest rate, the Applicable Margin is 1.50%. For purposes of the CB Floating Rate, the Applicable Margin is 1.25%. Accrued interest is payable monthly on outstanding principal amounts, provided that accrued interest on LIBOR-based loans is payable at the end of each interest period, but in no event less frequently than quarterly. In addition, fees and expenses are payable in connection with

our requests for letters of credit (generally equal to the Applicable Margin for LIBOR-related borrowings multiplied by the face amount of the requested letter of credit) and administrative and legal costs.

Maturity. The maturity date of the Amended Credit Agreement is December 31, 2017, at which time all amounts borrowed under the agreement will be due and outstanding letters of credit must be cash collateralized. The agreement may be terminated early upon our request or the occurrence of an event of default.

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

Covenants. The Amended Credit Agreement contains customary representations and warranties, as well as covenants which, among other things, limit our ability to incur additional indebtedness and liens; enter into transactions with affiliates; make acquisitions in excess of certain amounts; pay dividends; redeem or repurchase capital stock or senior notes; make investments or loans; make negative pledges; consolidate, merge or effect asset sales; or change the nature of our business.

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

As of December 31, 2014, we were in compliance with all covenants in our Amended Credit Agreement. A default under our Amended Credit Agreement could trigger the acceleration of our bank debt so that it is immediately due and payable. Such default would have a material adverse effect on our liquidity, financial position and operations.

Shelf Registration Statement

We have an effective $150 million “universal” shelf registration statement on Form S-3 on file with the Securities and Exchange Commission, which we filed in late 2012 and became effective in February 2013. This shelf registration statement enables us to sell, from time to time, the securities covered by the registration statement in one or more public offerings. The securities covered by the registration statement include common stock, preferred stock, depositary shares, debt securities, rights to purchase common stock, units consisting of two or more of any of the registered securities and warrants to purchase any of the registered securities. We may offer any of these securities independently or together in any combination with other securities. 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. We have no immediate plans to issue securities under the shelf registration statement, but our management believes that it may facilitate access to additional liquidity in the future. However, there is no assurance that equity or debt capital would be available to us in the public markets should we determine to issue securities under the shelf registration statement.

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Components of Our Principal Capital Expenditures

Capital expenditures for the three years ended December 31, 2014:

| Expenditure Category | 2014 | 2013 | 2012 |
|---|---|---|---|
| | (in thousands) | | |
| Rental equipment, vehicles and shop equipment | $53,342 | $43,419 | $23,766 |

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 operating cash flow and additional bank borrowings are adequate to fully fund our net capital expenditures requirements for 2015. We also believe we have significant flexibility with respect to our financing alternatives and adjustment of our expenditure plans if circumstances warrant. When considered in relation to our total financial capacity, we do not have any material continuing commitments associated with expenditure plans related to our current operations can be met.

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, 2014, the off-balance sheet arrangements and transactions that we have entered into include operating lease agreements and purchase agreements. We do not believe that these arrangements are reasonably likely to materially affect our liquidity or availability of, or requirements for, capital resources.

We entered into a purchase agreement with a vendor in July 2008 pursuant to which we agreed to purchase up to $4.8 million of our paint and coating requirements exclusively from the vendor. In connection with the execution of the agreement, the vendor paid us a $300,000 fee which is considered to be a discount toward future purchases from the vendor. As of December 31, 2014 we had met $2.3 million of this obligation. The $300,000 payment we received is recorded as a long-term liability and will decrease as the purchase commitment is fulfilled. The long-term liability remaining as of December 31, 2014 was $155,000.

Recently Issued Accounting Pronouncements

On May 28, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), as part of a joint project with the International Accounting Standards Board (IASB) to clarify revenue-recognizing principles and develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards (IFRS). ASU No. 2014-09 finalizes Proposed ASU Nos. 1820-100, 2011-230 and 2011-250 and is expected, among other things, to remove inconsistencies and weaknesses in revenue requirements and improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. In particular, the amendments in this ASU will be added to the FASB Accounting Standards Codification (FASB ASC) as Topic 606, Revenue from Contracts with Customers, and will supersede the revenue recognition requirements in FASB ASC 605, Revenue Recognition, as well as some cost guidance in FASB ASC Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. The core principle of this ASU is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this core principle, the guidance provides that an entity should apply the following steps: (1) identify the contract(s) with a customer; (2) identify the performance obligation in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. For public entities, the amendments in ASU No. 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is prohibited. Additionally, an entity should apply the amendments either retrospectively to each prior

reporting period presented or retrospectively with the cumulative effect of initially applying this ASU recognized at the date of initial application. If an entity elects the latter, transition method, then it must also provide the additional disclosures in reporting periods that include the date of initial application of (1) the amount by which each financial statement line item is affected in the current reporting period, as compared to the guidance that was in effect before the change, and (2) an explanation of the reasons for significant changes. The new standard will be effective during our first quarter ending March 31, 2017. We are currently evaluating the new standard to determine which reporting option allows us to report the most meaningful information and are still evaluating the potential impact this new standard may have on our financial statements.

Environmental Regulations

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Commodity Risk

Our commodity risk exposure is the pricing applicable primarily to natural gas production and to lesser extent oil production. Realized commodity prices received for such production are primarily driven by the prevailing worldwide price for crude oil and spot prices applicable to natural gas. Depending on the market prices of oil and natural gas, companies exploring for such resources may cancel or curtail their drilling programs, thereby reducing demand for our equipment and services.

Financial Instruments and Debt Maturities

Our financial instruments consist of cash and cash equivalents, trade receivables, accounts payable and our line of credit. The carrying amounts of cash and cash equivalents, trade receivables, and accounts payable approximate fair value because of the short-term nature of the instruments. The fair value of our bank borrowings approximate the carrying amounts as of December 31, 2014 and 2013, and were determined based upon interest rates currently available to us.

Customer Credit Risk

We are exposed to the risk of financial non-performance by our customers. Our ability to collect on rentals and sales to our customers is dependent on the liquidity of our customer base. To manage customer credit risk, we monitor credit ratings of our customers. 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. At December 31, 2014, three customers accounted for 52% of our accounts receivable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our audited 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, 2014, pursuant to Exchange Act Rule 13a-15. Based upon

that evaluation, the President and Chief Executive Officer and our Principal Accounting Officer have concluded that our disclosure controls and procedures as of December 31, 2014, 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.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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.

Our management assessed the effectiveness of our internal control over financial reporting as December 31, 2014 using the criteria set forth by the Commission of Sponsoring Organizations of the Treadway Commission (COSO) in their 2013 Internal Control-Integrated Framework. Based on this assessment, our management concluded that, as of December 31, 2014, our internal control over financial reporting was effective.

Pursuant to the Section 404 of the Sarbanes-Oxley Act of 2002, we have included a report of management's assessment of the effectiveness of our internal controls as part of this annual report on Form 10-K for the fiscal year December 31, 2014. BDO USA, LLP, our independent registered public accounting firm, has issued an attestation report dated March 13, 2015 on the effectiveness of internal control over financial reporting. That report is included herein.

ITEM 9B. OTHER INFORMATION

None.

Report of Independent Registered Public Accounting Firm

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

We have audited Natural Gas Services Group, Inc.'s (the "Company") internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Item 9A. Management's Report on Internal Control Over Financial Reporting." Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Natural Gas Services Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of Natural Gas Services Group, Inc. as of December 31, 2014 and 2013 and the related statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2014 and our report dated March 13, 2015 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Houston, Texas
March 13, 2015

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, 2014.

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 to Natural Gas Services Group, Inc., Attn: Investor Relations, 508 W. Wall Street, Suite 550 Midland, Texas 79701.

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, 2014.

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, 2014.

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, 2014.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated herein by reference to the section “Principal Accountant Fees and Services” in our definitive proxy statement which will be filed with the Securities and Exchange Commission within 120 days after December 31, 2014.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENTS

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

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

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

(a)(3) Exhibits

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

| Exhibit No. | Description |
|---|---|
| 3.1 | Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3.1 of the 10-QSB filed and dated November 10, 2004) |
| 3.2 | Bylaws (Incorporated by reference to Exhibit 3.4 of the Registrant's Registration Statement on Form SB-2, No. 333-88314) |
| 4.1 | Non-Statutory Stock Option Agreement (Incorporated by reference to Exhibit 10.2 to Form 8-K filed with the SEC on August 30, 2005) |
| 4.2 | Form of Senior Indenture (Incorporated by reference to Exhibit 4.1 of the Registrant’s Registration Statement on Form S-3 (No. 333-161346) and filed on August 14, 2009) |

| | |
|---|---|
| 10.1 | Lease Agreement, dated March 26, 2008, between WNB Tower, LTD and Natural Gas Services Group, Inc. (Incorporated by reference to Exhibit 10.15 of the Registrant's Form 10-K for the fiscal year ended December 31, 2008 and filed with the Securities and Exchange Commission on March 9, 2009) |
| 10.2 | 2009 Restricted Stock/Unit Plan (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K dated September 18, 2009 and filed with the Securities and Exchange Commission on September 18, 2009.) |
| 10.3 | 1998 Stock Option Plan, as amended (Incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K dated September 18, 2009 and filed with the Securities and Exchange Commission on September 18, 2009.) |
| 10.4 | Lease Agreement, dated December 11, 2008, between Klement-Wes Partnership, LTD and Natural Gas Services Group, Inc. and commencing on January 1, 2009 |
| 10.5 | 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.) |
| 10.6 | Third Amendment of Credit Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated November 19, 2014 (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 January 9, 2012.) |
| 10.7 | 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.) |
| 10.8 | First Amendment of Security Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated December 31, 2011 (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 January 9, 2012.) |
| 10.9 | Promissory Note in the aggregate amount of $30,000,000 issued to JPMorgan Chase Bank, N.A., dated December 31, 2014, in connection with the revolving credit line under the Credit Agreement with JPMorgan Chase Bank, N.A. (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 November 24, 2014.) |
| 10.10 | Employment Agreement between Natural Gas Services Group, Inc. and Stephen C. Taylor dated October 23, 2013 (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 October 25, 2013) |
| *23.1 | Consent of BDO USA, 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.

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.

Date: March 13, 2015

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 |
|---|---|---|
| /s/ Stephen C. Taylor<br>Stephen C. Taylor | Chairman of the Board of Directors, Chief Executive Officer and President (Principal Executive Officer) | March 13, 2015 |
| /s/ G. Larry Lawrence<br>G. Larry Lawrence | Vice President and Chief Financial Officer (Principal Accounting Officer) | March 13, 2015 |
| /s/ Charles G. Curtis<br>Charles G. Curtis | Director | March 13, 2015 |
| /s/ William F. Hughes, Jr.<br>William F. Hughes, Jr. | Director | March 13, 2015 |
| /s/ David L. Bradshaw<br>David L. Bradshaw | Director | March 13, 2015 |
| /s/ John W. Chisholm<br>John W. Chisholm | Director | March 13, 2015 |

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying balance sheets of Natural Gas Services Group, Inc. (the "Company") as of December 31, 2014 and 2013 and the related statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Natural Gas Services Group, Inc. as of December 31, 2014 and 2013 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, 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), Natural Gas Services Group, Inc.'s, internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 13, 2015 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Houston, Texas
March 13, 2015

NATURAL GAS SERVICES GROUP, INC.
BALANCE SHEETS
(in thousands, except per share amounts)

| | December 31, 2014 | 2013 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $6,181 | $24,443 |
| Trade accounts receivable, net of allowance for doubtful accounts of $507 and $436, respectively | 10,408 | 6,750 |
| Inventory, net of allowance for obsolescence of $225 and $128, respectively | 32,624 | 26,832 |
| Prepaid income taxes | 6,242 | 2,281 |
| Prepaid expenses and other | 472 | 339 |
| Total current assets | 55,927 | 60,645 |
| Rental equipment, net of accumulated depreciation of $106,179 and $86,533, respectively | 208,292 | 176,420 |
| Property and equipment, net of accumulated depreciation of $10,830 and $9,692 respectively | 7,362 | 7,429 |
| Goodwill | 10,039 | 10,039 |
| Intangibles, net of accumulated amortization of $1,257 and $1,132, respectively | 1,902 | 2,027 |
| Other assets | 41 | 29 |
| Total assets | $283,563 | $256,589 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Line of credit | $— | $577 |
| Accounts payable | 4,990 | 3,904 |
| Accrued liabilities | 6,624 | 6,487 |
| Current income tax liability | 851 | 350 |
| Deferred income | 1,635 | 873 |
| Total current liabilities | 14,100 | 12,191 |
| Line of credit, non-current | 417 | — |
| Deferred income tax liability | 58,304 | 51,464 |
| Other long-term liabilities | 155 | 197 |
| Total liabilities | 72,976 | 63,852 |
| Commitments and contingencies (Note 9) | | |
| Stockholders’ Equity: | | |
| Preferred stock, 5,000 shares authorized, no shares issued or outstanding | — | — |
| Common stock, 30,000 shares authorized, par value $0.01; 12,466 and 12,366 shares issued and outstanding, respectively | 124 | 123 |
| Additional paid-in capital | 95,065 | 91,344 |
| Retained earnings | 115,398 | 101,270 |
| Total stockholders' equity | 210,587 | 192,737 |
| Total liabilities and stockholders' equity | $283,563 | $256,589 |

See accompanying notes to these financial statements.

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

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Revenue: | | | |
| Rental income | $78,983 | $69,062 | $56,477 |
| Sales | 17,200 | 19,479 | 36,375 |
| Service and maintenance income | 791 | 707 | 870 |
| Total revenue | 96,974 | 89,248 | 93,722 |
| Operating costs and expenses: | | | |
| Cost of rentals, exclusive of depreciation stated separately below | 31,522 | 29,017 | 23,737 |
| Cost of sales, exclusive of depreciation stated separately below | 11,297 | 11,582 | 25,816 |
| Cost of service and maintenance, exclusive of depreciation stated separately below | 328 | 344 | 354 |
| Selling, general, and administrative expenses | 10,334 | 8,141 | 7,893 |
| Depreciation and amortization | 21,507 | 18,144 | 15,707 |
| Total operating costs and expenses | 74,988 | 67,228 | 73,507 |
| Operating income | 21,986 | 22,020 | 20,215 |
| Other income (expense): | | | |
| Interest expense | (10) | (56) | (18) |
| Other income | 182 | 548 | 14 |
| Total other income (expense) | 172 | 492 | (4) |
| Income before provision for income taxes | 22,158 | 22,512 | 20,211 |
| Provision for income taxes: | | | |
| Current | 1,190 | 399 | 554 |
| Deferred | 6,840 | 7,723 | 6,972 |
| Total income tax expense | 8,030 | 8,122 | 7,526 |
| Net income | $14,128 | $14,390 | $12,685 |
| Earnings per share: | | | |
| Basic | $1.14 | $1.17 | $1.04 |
| Diluted | $1.11 | $1.15 | $1.03 |
| Weighted average shares outstanding: | | | |
| Basic | 12,434 | 12,324 | 12,220 |
| Diluted | 12,721 | 12,550 | 12,320 |

See accompanying notes to these financial statements.

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

| | Preferred Stock | | Common Stock | | Additional Paid-In Capital | Retained Earnings | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | |
| BALANCES, December 31, 2011 | — | $— | 12,179 | $122 | $87,225 | $74,195 | $161,542 |
| Exercise of common stock options and warrants | — | — | 23 | — | 180 | — | 180 |
| Compensation expense on common stock options | — | — | — | — | 440 | — | 440 |
| Issuance of restricted stock | — | — | 39 | — | — | — | — |
| Compensation expense on restricted common stock | — | — | — | — | 978 | — | 978 |
| Net income | — | — | — | — | — | 12,685 | 12,685 |
| BALANCES, December 31, 2012 | — | $— | 12,241 | $122 | $88,823 | $86,880 | $175,825 |
| Exercise of common stock options | — | — | 53 | — | 829 | — | 829 |
| Compensation expense on common stock options | — | — | — | — | 198 | — | 198 |
| Issuance of restricted stock | — | — | 72 | — | — | — | — |
| Tax benefit of equity compensation | | | — | — | 10 | — | 10 |
| Compensation expense on restricted common stock | — | — | — | 1 | 1,484 | — | 1,485 |
| Net income | — | — | — | — | — | 14,390 | 14,390 |
| BALANCES, December 31, 2013 | — | $— | 12,366 | $123 | $91,344 | $101,270 | $192,737 |
| Exercise of common stock options | — | — | 3 | — | 59 | — | 59 |
| Compensation expense on common stock options | — | — | — | — | 426 | — | 426 |
| Issuance of restricted stock | — | — | 97 | — | — | — | — |
| Tax benefit of equity compensation | — | — | — | — | 419 | — | 419 |
| Compensation expense on restricted common stock | — | — | — | 1 | 2,817 | — | 2,818 |
| Net income | — | — | — | — | — | 14,128 | 14,128 |
| BALANCES, December 31, 2014 | — | $— | 12,466 | $124 | $95,065 | $115,398 | $210,587 |

See accompanying notes to these financial statements.

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

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | $14,128 | $14,390 | $12,685 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 21,507 | 18,144 | 15,707 |
| Deferred taxes | 6,840 | 7,723 | 6,972 |
| Gain on extinguishment of liability | — | (223) | — |
| Gain on disposal of assets | (160) | (48) | — |
| Inventory allowance | 395 | — | — |
| Stock based compensation | 3,244 | 1,682 | 1,418 |
| Changes in current assets (increase) decrease in: | | | |
| Trade accounts receivables | (3,658) | (59) | (1,012) |
| Inventory | (6,112) | (323) | 456 |
| Prepaid income taxes and prepaid expenses | (3,997) | (1,870) | (281) |
| Changes in current liabilities increase (decrease) in: | | | |
| Accounts payable and accrued liabilities | 1,126 | 1,154 | 1,863 |
| Current income tax liability | 920 | (162) | 447 |
| Deferred income | 762 | (1,154) | (2,836) |
| Other | (12) | — | (1) |
| Tax benefit from equity compensation | (419) | (10) | — |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 34,564 | 39,244 | 35,418 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchases of rental, property and equipment | (53,342) | (43,419) | (23,766) |
| Proceeds from sale of property and equipment | 240 | 95 | 5 |
| NET CASH USED IN INVESTING ACTIVITIES | (53,102) | (43,324) | (23,761) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Payments of other long-term liabilities, net | (42) | (82) | (21) |
| Repayments of line of credit, net | (160) | (320) | (120) |
| Tax benefit from equity compensation | 419 | 10 | — |
| Proceeds from exercise of stock options | 59 | 829 | 180 |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 276 | 437 | 39 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | (18,262) | (3,643) | 11,696 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 24,443 | 28,086 | 16,390 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $6,181 | $24,443 | $28,086 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | | |
| Interest paid | $10 | $56 | $18 |
| Income taxes paid | $4,108 | $2,590 | $267 |
| NON-CASH TRANSACTIONS | | | |
| Transfer of rental equipment to inventory | $131 | $207 | $8,690 |
| Property and equipment purchases included in accounts payable | $218 | $251 | $31 |

See accompanying notes to these financial statements.

NATURAL GAS SERVICES GROUP INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization and Principles of Consolidation

These notes apply to the financial statements of Natural Gas Services Group, Inc. (the "Company", “NGSG”, "Natural Gas Services Group", "we" or "our") (a Colorado corporation). Natural Gas Services Group, Inc. was formed on December 17, 1998 for the purposes of combining the operations of certain manufacturing, service and leasing entities.

Nature of Operations

Natural Gas Services Group, Inc. is a leading provider of small to medium horsepower compression equipment to the natural gas industry. We focus primarily on the non-conventional natural gas production business in the United States (such as coal bed methane, gas shale, tight gas and oil shale). We manufacture, fabricate and rent natural gas compressors that enhance the production of natural gas wells. NGSG provides maintenance services for its natural gas compressors. In addition, we sell custom fabricated natural gas compressors to meet customer specifications dictated by well pressures, production characteristics and particular applications. We also manufacture and sell flare systems for oil and natural gas plant and production facilities.

Use of Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make estimates and assumptions that affect the amounts reported in these 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. It is at least reasonably possible these estimates could be revised in the near term and the revisions could be material.

Cash Equivalents

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.

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% for large custom contracts. We extend credit based on management's assessment of the customer's financial condition, receivable aging, customer disputes and general business and economic conditions. The allowance for doubtful accounts was $507,000 and $436,000 at December 31, 2014 and 2013, respectively. Management believes that the allowance is adequate; however, actual write-offs may exceed the recorded allowance.

Revenue Recognition

Revenue from the sales of custom and fabricated compressors, and flare systems is recognized when title passes to the customer, the customer assumes risks and rewards of ownership, collectability is reasonably assured and delivery

occurs as directed by our customer. Exchange and rebuilt compressor revenue is recognized when both the replacement compressor has been delivered and the rebuild assessment has been completed. Revenue from compressor service and retrofitting services is recognized upon providing services to the customer. Maintenance agreement revenue is recognized as services are rendered. Rental revenue is recognized over the terms of the respective rental agreements. Deferred income represents payments received before a product is shipped. Revenue from the sale of rental units is included in sales revenue when equipment is shipped or title is transferred to the customer.

Major Customers and Concentration of Credit Risk

Sales and rental income to Devon Energy Production, Inc. ("Devon") and EOG Resources, Inc. ("EOG") in 2014 amounted to 18% and 15% of revenue, respectively. Sales and rental income to EOG and Devon in 2013 amounted to 18% and 15% of revenue, respectively. Sales and rental income to EOG and Devon in 2012 amounted to 32% and 12% of revenue. No other single customer accounted for more than 10% of our revenues in 2014, 2013 or 2012. EOG, Promatcon and Oxy amounted to 20%, 18% and 14% of our accounts receivable as of December 31, 2014. EOG and Devon amounted to 18% and 14% of our accounts receivable as of December 31, 2013, respectively. No other customers amounted to more than 10% of our accounts receivable as of December 31, 2014 and 2013.

Inventory

Inventory is valued at the lower of cost or market. The cost of inventories is determined by the weighted average method. A reserve is recorded against inventory balances for estimated obsolescence. This reserve is based on specific identification and historical experience and totaled $225,000 and $128,000 at December 31, 2014 and 2013, respectively. There were no new completed compressor units at December 31, 2014 or at December 31, 2013 available for sale or for use in our rental fleet. At December 31, 2014 and 2013, inventory consisted of the following (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Raw materials | $25,984 | $20,524 |
| Work in process | 6,640 | 6,308 |
| Total | $32,624 | $26,832 |

Property and Equipment

Property and equipment is recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from three to forty years. Rental equipment has an estimated useful life of fifteen years.

Gains and losses resulting from sales and dispositions of property and equipment are included in current operations. Maintenance and repairs are charged to operations as incurred.

Goodwill

Goodwill represents the cost in excess of fair value of the identifiable net assets acquired. Goodwill is tested for impairment annually or whenever events indicate impairment may have occurred. The annual goodwill impairment test is performed in the fourth quarter of each year. We experienced no impairment of goodwill at December 31, 2014 and 2013.

Intangibles

At December 31, 2014, NGSG had intangible assets, which relate to developed technology and a trade name. The carrying amount net of accumulated amortization at December 31, 2014 and 2013 was $1.9 million and $2.0 million respectively. Developed technology is amortized on a straight-line basis with a useful life of 20 years, with a weighted average remaining life of approximately ten years as of December 31, 2014. Amortization expense recognized in each of the years ending December 31, 2014, 2013, and 2012 was $125,000, $130,000 and $125,000 respectively. Estimated amortization expense for the years 2015-2024 is $125,000 per year. NGSG has an intangible asset with a gross carrying value of $654,000 at December 31, 2014 related to the trade name of SCS which was acquired in our acquisition of Screw Compression Systems in January 2005. This asset is not being amortized as it has been deemed to have an indefinite life.

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

| | | December 31, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|---|
| | Useful Life (years) | Gross Carrying Value | Accumulated Amortization | Net Book Value | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| Developed Technology | 20 | 2,505 | 1,257 | 1,248 | 2,505 | 1,132 | 1,373 |
| Trade Name | Indefinite | 654 | — | 654 | 654 | — | 654 |
| Total | | $3,159 | $ 1,257 | $1,902 | $3,159 | $ 1,132 | $2,027 |

Our policy is to periodically review intangibles for impairment 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 at December 31, 2014 or 2013.

Warranty

We accrue amounts for estimated warranty claims based upon current and historical product warranty costs and any other related information known. The warranty reserve was $0 and $28,000 for December 31, 2014 and 2013, respectively, and is included in accrued liabilities on the balance sheet.

Financial Instruments and Concentrations of Credit Risk

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.

Per Share Data

Basic earnings per common share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per common share is computed using the weighted average number of common stock and common stock equivalent shares outstanding during the period. There were no an anti-dilutive securities in

2014, 2013, and 2012.

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Numerator: | | | |
| Net income | $14,128 | $14,390 | $12,685 |
| Denominator for basic net income per common share: | | | |
| Weighted average common shares outstanding | 12,434 | 12,324 | 12,220 |
| Denominator for diluted net income per share: | | | |
| Weighted average common shares outstanding | 12,434 | 12,324 | 12,220 |
| Dilutive effect of stock options and restricted shares | 287 | 226 | 100 |
| Diluted weighted average shares | 12,721 | 12,550 | 12,320 |
| Earnings per common share: | | | |
| Basic | $1.14 | $1.17 | $1.04 |
| Diluted | $1.11 | $1.15 | $1.03 |

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases, and operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

ASC Topic 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In order to record any financial statement benefit, we are required to determine, based on technical merits of the position, whether it is more likely than not (a likelihood of more than 50 percent) that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes. If that step is satisfied, then we must measure the tax position to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of the benefit that is greater than 50 percent likely of being realized upon ultimate settlement. We have no uncertain tax positions as of December 31, 2014 or 2013.

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. 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, 2014 and 2013 approximate their carrying values due to the short-term nature of the instruments or the use of prevailing market interest rates.

Segments and Related Information

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

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

On May 28, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), as part of a joint project with the International Accounting Standards Board (IASB) to clarify revenue-recognizing principles and develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards (IFRS). ASU No. 2014-09 finalizes Proposed ASU Nos. 1820-100, 2011-230 and 2011-250 and is expected, among other things, to remove inconsistencies and weaknesses in revenue requirements and improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. In particular, the amendments in this ASU will be added to the FASB Accounting Standards Codification (FASB ASC) as Topic 606, Revenue from Contracts with Customers, and will supersede the revenue recognition requirements in FASB ASC 605, Revenue Recognition, as well as some cost guidance in FASB ASC Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. The core principle of this ASU is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects

the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this core principle, the guidance provides that an entity should apply the following steps: (1) identify the contract(s) with a customer; (2) identify the performance obligation in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. For public entities, the amendments in ASU No. 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is prohibited. Additionally, an entity should apply the amendments either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this ASU recognized at the date of initial application. If an entity elects the latter, transition method, then it must also provide the additional disclosures in reporting periods that include the date of initial application of (1) the amount by which each financial statement line item is affected in the current reporting period, as compared to the guidance that was in effect before the change, and (2) an explanation of the reasons for significant changes. The new standard will be effective during our first quarter ending March 31, 2017. We are currently evaluating the new standard to determine which reporting option allows us to report the most meaningful information and are still evaluating the potential impact this new standard may have on our financial statements.

2. 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 two years 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, 2014 are as follows :

| Years Ending December 31, (in thousands) | |
|---|---|
| 2015 | $9,835 |
| 2016 | 1,306 |
| Thereafter | — |
| Total | $11,141 |

3. Property and Equipment

Property and equipment consists of the following at December 31, 2014 and 2013 (in thousands):

| | Useful Lives (Years) | 2014 | 2013 |
|---|---|---|---|
| Land and building | 30 | $5,636 | $5,636 |
| Leasehold improvements | 39 | 793 | 770 |
| Office equipment and furniture | 5 | 1,376 | 1,434 |
| Software | 5 | 573 | 573 |
| Machinery and equipment | 7 | 2,847 | 2,635 |
| Vehicles | 3 | 6,967 | 6,073 |
| Total | | 18,192 | 17,121 |
| Less accumulated depreciation | | (10,830) | (9,692) |
| Total | | $7,362 | $7,429 |

Depreciation expense for property and equipment and the compressors described in Note 2 was $21.4 million, $18.0 million and $15.6 million for the years ended December 31, 2014, 2013 and 2012, respectively.

4. Credit Facility

We have a senior secured revolving credit agreement with JP Morgan Chase Bank, N.A (the "Amended Credit Agreement") aggregate commitment $30 million, subject to collateral availability. We also have a right to request from the lender, on an uncommitted basis, an increase of up to $20 million on the aggregate commitment (which could potentially increase the commitment amount to $50 million).

Borrowing Base. At any time before the maturity of the Amended Credit Agreement, we may draw, repay and re-borrow amounts available under the borrowing base up to the maximum aggregate availability discussed above. Generally, the borrowing base equals the sum of (a) 80% of our eligible accounts receivable plus (b) 50% of the book value of our eligible general inventory (not to exceed 50% of the commitment amount at the time) plus (c) 75% of the book value of our eligible equipment inventory. JPMorgan Chase Bank (the “Lender”) may adjust the borrowing base components if material deviations in the collateral are discovered in future audits of the collateral. We had $29.6 million borrowing base availability at December 31, 2014 under the terms of our Amended Credit Agreement.

Interest and Fees. Under the terms of the Amended Credit Agreement, we have the option of selecting the applicable variable rate for each revolving loan, or portion thereof, of either (a) LIBOR multiplied by the Statutory Reserve Rate

(as defined in the Amended Credit Agreement), with respect to this rate, for Eurocurrency funding, plus the Applicable Margin (“LIBOR-based”), or (b) CB Floating Rate, which is the Lender's Prime Rate less the Applicable Margin; provided, however, that no more than three LIBOR-based borrowings under the agreement may be outstanding at any one time. For purposes of the LIBOR-based interest rate, the Applicable Margin is 1.50%. For purposes of the CB Floating Rate, the Applicable Margin is 1.25%.

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

Maturity . The maturity date of the Amended Credit Agreement is December 31, 2017, at which time all amounts borrowed under the agreement will be due and outstanding letters of credit must be cash collateralized. The agreement may be terminated early upon our request or the occurrence of an event of default.

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

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

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

As of December 31, 2014, we were in compliance with all covenants in our Amended Credit Agreement. A default under our Credit Agreement could trigger the acceleration of our bank debt so that it is immediately due and payable. Such default would likely limit our ability to access other credit. At December 31, 2014 our balance on the line of credit was $417,000. Our weighted average interest rate for the year ended December 31, 2014 was 1.40%.

5. Other Long-term Liabilities

At December 31, 2012, we had a long-term liability of $275,000 to Midland Development Corporation. The liability was fully satisfied during the quarter ended March 31, 2013. As a result of our performance under the agreement, a payment to Midland Development Corporation of $52,000 was made to settle the liability, resulting in a gain of $223,000, which is included in the other income line, in our statement of income for the year ended December 31, 2013.

In addition, we entered into a purchase agreement with a vendor on July 30, 2008 pursuant to which we agreed to purchase up to $4.8 million of our paint and coating requirements exclusively from the vendor. In connection with the execution of the agreement, the vendor paid us a $300,000 fee which is considered to be a discount toward future

purchases from the vendor. The $300,000 payment we received is recorded as a long-term liability and will decrease as the purchase commitment is fulfilled. The long-term liability remaining for the purchase commitment was $155,000 and $197,000 as of December 31, 2014 and 2013, respectively.

6. Income Taxes

The provision for income taxes for the years ended December 31, 2014, 2013 and 2012, consists of the following (in thousands):

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Current provision: | | | |
| Federal | $995 | $69 | $332 |
| State | 195 | 330 | 222 |
| Total current provision | 1,190 | 399 | 554 |
| Deferred provision: | | | |
| Federal | 6,840 | 7,723 | 6,972 |
| Total deferred provision | 6,840 | 7,723 | 6,972 |
| Total provision | $8,030 | $8,122 | $7,526 |

The income tax effects of temporary differences that give rise to significant portions of deferred income tax assets and (liabilities) as of December 31, 2014 and 2013, are as follows (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Deferred income tax assets: | | |
| Stock Compensation | $1,249 | $916 |
| Other | 80 | 45 |
| Total deferred income tax assets | $1,329 | $961 |
| | | |
| Deferred income tax liabilities: | | |
| Property and equipment | $(58,610) | (51,377) |
| Goodwill and other intangible assets | (1,023) | (1,048) |
| Total deferred income tax liabilities | (59,633) | (52,425) |
| Net deferred income tax liabilities | $(58,304) | $(51,464) |

The effective tax rate for the years ended December 31, 2014, 2013 and 2012, differs from the statutory rate as follows:

| | 2014 | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| Statutory rate | 34.0 | % | 34.0 | % | 34.0 | % |
| State and local taxes | 1.5 | % | 1.7 | % | 0.7 | % |
| Other | 0.7 | % | 0.4 | % | 2.5 | % |
| Effective rate | 36.2 | % | 36.1 | % | 37.2 | % |

Our policy regarding income tax interest and penalties is to expense those items as general and administrative expense. During the years ended December 31, 2014, 2013 and 2012, there were no significant income tax interest or penalty items in the statement of income.

We had a federal net operating loss carry forward of $3.2 million as of December 31, 2012, which was utilized in the year ended December 31, 2013. 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 2009.

7. 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, 2014 and 2013, there were no issued or outstanding preferred shares.

8. Stock-Based Compensation

Restricted Stock

On June 16, 2009, at our annual meeting of shareholders, our shareholders adopted the 2009 Restricted Stock/Unit Plan. On June 3, 2014, at our annual meeting of shareholders, our shareholders approved a proposed amendment to the 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. On March 20, 2014, the Compensation Committee awarded 15,000 shares of restricted common stock to each of G. Larry Lawrence, our CFO, and James Hazlett our Vice President of Technical Services, subject to the approval at our June 2014 annual meeting of shareholders of a proposal to increase the number of shares reserved for issuance under our 2009 restricted Stock\Unit Plan. As the proposal was approved by shareholders at the 2014 annual meeting, we issued the restricted shares to Messrs. Hazlett and Lawrence which vest one year from the grant date. We also awarded and issued 13,152 shares of restricted common stock to our Board of Directors as partial payment for 2014 Directors' fees. The restricted stock issued to our Directors vests over one year, in quarterly installments, beginning March 31, 2015. 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 2013 performance, Mr. Taylor, was awarded 49,420 restricted shares on January 23, 2014, which vest one year from the date of grant. Compensation expense related to the restricted shares was approximately $2,818,000, $1,485,000 and $978,000 for the years ended December 31, 2014, 2013, and 2012, respectively. As of December 31, 2014, there was a total of approximately $608,000 of unrecognized compensation expense related to the nonvested portion of these restricted shares. This expense is expected to be recognized within one year. As of December 31, 2014, 423,717 shares were still available for issuance under the 2009 Restricted Stock/Unit Plan.

A summary of all restricted stock activity as of December 31, 2014 and changes during the year then ended is presented below.

| | Number of Shares | Weighted Average Grant Date Fair Value | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding, December 31, 2013 | 103,618 | $18.94 | 9.07 | $2,857 |
| Granted | 92,572 | 29.18 | — | 2,701 |
| Vested | (96,952) | 19.21 | — | 2,935 |
| Canceled/Forfeited | — | — | — | — |
| Outstanding, December 31, 2014 | 99,238 | $28.22 | 9.00 | $2,286 |

Stock Option Plan

Our 1998 Stock Option Plan (the "Plan"), which is stockholder approved, permits the grant of stock options to its employees for up to 550,000 shares of common stock. On June 16, 2009, at our annual meeting of shareholders, our shareholders approved a proposed amendment to the Plan to add additional 200,000 shares of common stock to the Plan, thereby authorizing the issuance of up to 750,000 shares of common stock under the Plan. We believe that such awards better 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 Plan). The last date that grants can be made under the Plan is March 1, 2016. As of December 31, 2014, 186,419 shares were still available for issue under the 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 years ended December 31, are as follows: | 2014 | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| Risk free rate | 1.96 | % | 1.02 | % | 0.98 | % |
| Expected life | 6 years | | 6 years | | 5 years | |
| Expected volatility | 58.44 | % | 60.39 | % | 62.37 | % |
| Expected dividend yield | — | | — | | — | |

A summary of all option activity as of December 31, 2014 and changes during the year then ended is presented below.

| | Number of Stock Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding, December 31, 2013 | 378,852 | $15.61 | 5.23 | $4,533 |
| Granted | 60,000 | 30.06 | | |
| Exercised | (3,500) | 17.13 | | 48 |
| Canceled/Forfeited | (3,083) | 22.13 | | 24 |
| Expired | — | — | | |
| Outstanding, December 31, 2014 | 432,269 | $17.55 | 10.10 | $2,786 |
| Exercisable, December 31, 2014 | 340,435 | $15.34 | 8.99 | $2,622 |

We granted three options to purchase a total of 60,000 shares to non-executive employees in March, July and October 2014 at an exercise price of $30.41, $33.36 and $23.30, respectively with a three year vesting period.

The weighted average grant date fair value of options granted during the years 2014, 2013, and 2012 was $16.56, $10.30, and $8.22 respectively. 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, 2014, 2013, and 2012 was approximately $48,000, $458,000, and $151,000 respectively. Cash received from stock options exercised during the years ended December 31, 2014, 2013, and 2012 was $59,000, $829,000, and $180,000, respectively.

The following table summarizes information about our stock options outstanding at December 31, 2014:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Shares | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| $0.01-9.43 | 71,352 | 1.97 | $8.72 | 71,352 | $8.72 |
| $9.44-15.60 | 70,000 | 4.06 | $12.51 | 64,166 | $12.30 |
| $15.61-18.75 | 146,917 | 5.60 | $17.81 | 119,917 | $17.60 |
| $18.76-33.36 | 144,000 | 6.03 | $24.12 | 85,000 | $20.00 |
| | 432,269 | 4.89 | $17.55 | 340,435 | $15.34 |

The summary of the status of our unvested stock options as of December 31, 2014 and changes during the year then ended is presented below.

| Unvested stock options: | Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Unvested at December 31, 2013 | 63,082 | $9.87 |
| Granted | 60,000 | $16.56 |
| Vested | (28,915) | $9.80 |
| Cancelled/Forfeited | (2,333) | $12.87 |
| Unvested at December 31, 2014 | 91,834 | $14.19 |

We recognized stock compensation expense from stock options vesting of $426,000, $198,000, and $440,000 for the years ended December 31, 2014, 2013 and 2012, respectively. As of December 31, 2014, there was approximately $808,000 of total unamortized compensation cost related to unvested stock options. We expect to recognize such cost over a weighted-average period of 3.0 years.

9. Commitments and Contingencies

401(k) Plan

We offer a 401(k) Plan to all employees that have reached the age of eighteen and have completed six months of service. The participants may contribute up to 100% of their salary subject to IRS limitations. Employer contributions are subject to Board discretion and are subject to a vesting schedule of 20% each year after the first year and 100% after six years. We contributed $296,000, $294,000, and $283,000 to the 401(k) Plan in 2014, 2013 and 2012, respectively.

Rented Facilities, Vehicles and Equipment

We lease certain of our facilities and equipment under operating leases with terms generally ranging from month-to-month to five years. Most leases contain renewal options. Remaining future minimum rental payments due under these leases are as follows:

| Years Ending December 31, (in thousands) | |
|---|---|
| 2015 | $301 |
| 2016 | 268 |
| 2017 | 243 |
| 2018 | 113 |
| 2019 | 15 |
| Total | $940 |

Rent expense under such leases was $380,000, $358,000, and $453,000 for the years ended December 31, 2014, 2013 and 2012, respectively.

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.

10. Quarterly Financial Data (in thousands, except per share data) – Unaudited

| 2014 | Q1 | Q2 | Q3 | Q4 | Total |
|---|---|---|---|---|---|
| Total revenue | $22,322 | $21,952 | $25,599 | $27,101 | $96,974 |
| Operating income | 4,362 | 5,085 | 5,840 | 6,699 | 21,986 |
| Net income | 2,856 | 3,385 | 3,883 | 4,004 | 14,128 |
| Net income per share - Basic | 0.23 | 0.27 | 0.31 | 0.32 | 1.14 |
| Net income per share - Diluted | 0.23 | 0.27 | 0.30 | 0.32 | 1.11 |

| 2013 | Q1 | Q2 | Q3 | Q4 | Total |
|---|---|---|---|---|---|
| Total revenue | $23,983 | $20,258 | $21,865 | $23,142 | $89,248 |
| Operating income | 6,138 | 5,844 | 5,088 | 4,950 | 22,020 |
| Net income | 3,994 | 3,844 | 3,394 | 3,158 | 14,390 |

| | | | | | |
|---|---|---|---|---|---|
| Net income per share - Basic | 0.33 | 0.31 | 0.28 | 0.25 | 1.17 |
| Net income per share - Diluted | 0.32 | 0.31 | 0.27 | 0.25 | 1.15 |

Amounts may not add due to rounding differences.

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INDEX TO EXHIBITS

| Exhibit No. | Description |
|---|---|
| 3.1 | Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3.1 of the 10-QSB filed and dated November 10, 2004) |
| 3.2 | Bylaws (Incorporated by reference to Exhibit 3.4 of the Registrant's Registration Statement on Form SB-2, No. 333-88314) |
| 4.1 | Non-Statutory Stock Option Agreement (Incorporated by reference to Exhibit 10.2 to Form 8-K filed with the SEC on August 30, 2005) |
| 4.2 | Form of Senior Indenture (Incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form S-3 (No. 333-161346) and filed on August 14, 2009) |
| 10.1 | Lease Agreement, dated March 26, 2008, between WNB Tower, LTD and Natural Gas Services Group, Inc. (Incorporated by reference to Exhibit 10.15 of the Registrant's Form 10-K for the fiscal year ended December 31, 2008 and filed with the Securities and Exchange Commission on March 9, 2009) |
| 10.2 | 2009 Restricted Stock/Unit Plan (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K dated September 18, 2009 and filed with the Securities and Exchange Commission on September 18, 2009.) |
| 10.3 | 1998 Stock Option Plan, as amended (Incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K dated September 18, 2009 and filed with the Securities and Exchange Commission on September 18, 2009.) |

| | |
|---|---|
| 10.4 | Lease Agreement, dated December 11, 2008, between Klement-Wes Partnership, LTD and Natural Gas Services Group, Inc. and commencing on January 1, 2009 |
| 10.5 | 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.) |
| 10.6 | Third Amendment of Credit Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated November 19, 2014 (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 January 9, 2012.) |
| 10.7 | 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.) |
| 10.8 | First Amendment of Security Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated December 31, 2011 (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 January 9, 2012.) |
| 10.9 | Promissory Note in the aggregate amount of $30,000,000 issued to JPMorgan Chase Bank, N.A., dated December 31, 2014, in connection with the revolving credit line under the Credit Agreement with JPMorgan Chase Bank, N.A. (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 November 24, 2014.) |
| 10.10 | Employment Agreement between Natural Gas Services Group, Inc. and Stephen C. Taylor dated October 23, 2013 (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 October 25, 2013) |
| *23.1 | Consent of BDO USA, 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.