

2017

ANNUAL REPORT
NATURAL GAS SERVICES GROUP, INC.



LETTER TO SHAREHOLDERS



Stephen C. Taylor
*Chairman of the Board, President & Chief
Executive Officer*

The industry downturn that started at the end of 2014 continued to impact the business throughout 2017, although the Company did start to see improvements in some aspects of the oilfield compression business in the closing months of the year. While we started the year optimistic that a recovery was on the horizon, crude oil prices were more volatile than expected as prices tumbled to the low \$40s in June before recovering in the second-half of 2017. However, the effects of lower than expected prices throughout the spring and early summer tempered the optimism and activity seen in the early months of the year.

In spite of these headwinds, NGS completed 2017 on solid financial footing and continued to generate net income throughout the year; a significant achievement and testament to the hard work and dedication of the entire NGS team, especially when compared to the performance of many of our peers.

In 2017, lower oil and natural gas prices contributed to a challenging environment for both pricing and utilization. We are, however, more optimistic about the direction for oil prices into 2019. Early indications in 2018 indicate that the oversupply of equipment is slowly subsiding and we remain hopeful that pricing discipline will steadily return during the remainder of the year. Fortunately, crude oil pricing (as opposed to natural gas pricing, which is moribund) has become more important to the Company in recent years, primarily due to the greater need for gas compression in the associated gas lift production of shale oil, a technique used for enhanced oil production.

The Company's rental revenue was impacted the most during 2017, declining 19%. However, sales revenue continued to be very strong increasing 48% for the year. Combined, our Company-wide revenue declined only 6% in 2017, resulting in a reported net income per fully diluted share of \$1.51, which includes an \$18.4 million tax benefit from the 2017 Tax Act. Excluding this benefit our adjusted net income per fully diluted share was \$.11 cents. Yet, the Company continued to generate significant cash in 2017 with the cash balance growing to approximately \$69 million on December 31, 2017, an increase from \$64 million at the end of 2016, despite significantly higher capital expenditures in 2017.

During the year, the Company received the largest single order in our history, for several "large horsepower" gas compressor packages, with a majority of the order consisting of rental compression units. NGS secured this order as a result of its reputation for designing and fabricating quality gas compression packages combined with a healthy balance sheet and industry-leading liquidity.

While the size of the order was important, the ability to use such an order to jump-start the Company's entrance into the large horsepower business was just as significant. NGS introduced its first medium 400 horsepower package in 2015, and the following year expanded the Company's offerings to include 600 horsepower units. With this key 2017 order, the Company now has large horsepower packages in the 1,300 horsepower range, materially expanding the range of the Company's compression offerings.

Although our more accelerated entry into the higher horsepower market was opportunistic, NGS evaluated this market for a number of years before beginning to establish a market presence in 2015. The fundamentals of the larger horsepower market and the Company's ability to design and fabricate this equipment using existing facilities creates compelling economic benefits for NGS. While the Company will continue to vigorously compete in the wellhead compression market, our future will focus on the growth of our medium and large horsepower systems.

Between 2014 and 2016 NGS reduced total capital expenditures by approximately \$49 million annually, or 93%. However, in 2017 the Company resumed spending on gas compression equipment, investing just over \$11 million of new capital (total capitalized and work-in-process equipment). A portion of the capital was spent on the smaller Vapor Recovery Unit ("VRU") equipment, a market geared towards tank-battery methane capture which continues to be active while the majority was dedicated to the large horsepower equipment market. Such spending is likely to continue into 2018.

We recently began construction on a new headquarters building for NGS, a move justified given our need for expanded office space combined with the very tight commercial real estate market in Midland, a market where lease rates rival Dallas and Houston. The building – with many of the latest sustainable building technologies – will be large enough to house our corporate operations while leaving nearly 70% of the building for third-party tenants. This additional revenue source should enable NGS to cover its rent expense, insulate the Company from future rent inflation and provide the Company with an accretive return on the investment.

From a shareholder return perspective, the Total Shareholder Return ("TSR") for NGS has been typically higher than our direct competitors and the general oilfield services industry. Among our defined peer companies, the Company's TSR has been at the 100th percentile for the past 5 year period, 88th percentile for the past three year period and 69th percentile for 2017.

I want to thank our shareholders, employees and board members for their continued interest, work and support on behalf of NGS this past year. Although market downturns are unpredictable in their breadth and depth, I am confident that NGS will emerge in an enviable position in our currently challenged but recovering energy industry.

About The Cover

Illustration showing three Natural Gas Services Group 1,320 horsepower gas compression packages operating in the Permian Basin.

Sincerely,
Stephen Taylor
President and Chief Executive Officer

NATURAL GAS SERVICES GROUP, INC.
508 West Wall Street, Suite 550
Midland, Texas 79701

**Important Notice Regarding the Availability of Proxy Materials for the
Shareholder Meeting to be Held on Thursday, June 21, 2018**

**The proxy statement and annual report to shareholders are available at
www.proxyvote.com.**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
To be held on Thursday, June 21, 2018**

NOTICE IS HEREBY GIVEN that the Annual Meeting of Shareholders of Natural Gas Services Group, Inc., a Colorado corporation (the “Company”), will be held at the Petroleum Club of Midland, 501 West Wall Street, Midland, Texas 79701 on Thursday, June 21, 2018 at 8:30 a.m., Central Time, for the purpose of considering and voting upon proposals:

1. To elect two Directors to serve until the Annual Meeting of Shareholders to be held in 2021, or until their successors are elected and qualified;
2. To consider an advisory vote on executive compensation of our named executive officers;
3. To ratify the appointment of BDO USA, LLP as the Company’s independent registered public accounting firm for 2018; and
4. To transact such other business as may properly be presented at the meeting, or at any adjournment(s) of the meeting.

Only shareholders of record at the close of business on April 25, 2018 are entitled to notice of and to vote at the meeting and at any adjournment(s) of the meeting. On that day, 13,085,607 shares of our common stock were outstanding and entitled to vote. A complete list of our shareholders entitled to vote at the meeting will be available for examination at our offices in Midland, Texas during ordinary business hours for a period of ten (10) days prior to the annual meeting.

Our Board of Directors recommends that you vote **FOR** the (i) election of the two director nominees named in this proxy statement, (ii) approval, on an advisory basis, of the compensation programs of our named executive officers, (iii) the ratification of the appointment of BDO USA, LLP as our independent registered public accounting firm for 2018.

We cordially invite you to attend the meeting. To ensure your representation at the meeting, please vote promptly even if you plan to attend the meeting. Voting now will not prevent you from voting in person at the meeting if you are a shareholder of record and wish to do so.

BY ORDER OF THE BOARD OF DIRECTORS

/s/ Stephen C. Taylor

Stephen C. Taylor

Chairman of the Board, President and Chief Executive Officer

April 30, 2018

NATURAL GAS SERVICES GROUP, INC.

**508 West Wall Street, Suite 550
Midland, Texas 79701**

**PROXY STATEMENT
FOR THE
ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD ON THURSDAY, JUNE 21, 2018**

GENERAL INFORMATION

We are providing this proxy statement to you as part of a solicitation by the Board of Directors of Natural Gas Services Group, Inc. for use at our 2018 Annual Meeting of Shareholders and at any adjournment or postponement that may take place. We will hold the meeting at the Petroleum Club of Midland, 501 West Wall Street, Midland, Texas 79701 on Thursday, June 21, 2018 at 8:30 a.m., Central Time.

We are taking advantage of Securities and Exchange Commission, or SEC, rules that allow us to deliver our proxy materials to our shareholders on the Internet. Under these rules, we are sending most of our shareholders a two-page notice regarding the Internet availability of proxy materials instead of a full set of proxy materials. If you receive this two-page notice, you will not receive printed copies of the proxy materials unless you specifically request them. Instead, this notice tells you how to access and review on the Internet all of the important information contained in the proxy materials. This notice also tells you how to submit your proxy card on the Internet and how to request to receive a printed copy of our proxy materials.

We expect to mail, or provide notice and electronic delivery of, this proxy statement and accompanying proxy card to shareholders beginning on or about May 9, 2018.

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QUESTIONS AND ANSWERS ABOUT THE PROXY MATERIALS AND THE MEETING

Q: Why am I receiving these materials?

A: Our Board is providing these proxy materials to you in connection with our 2018 Annual Meeting of Shareholders, which will take place on Thursday, June 21, 2018. As a shareholder on the Record Date for the meeting, you are invited to attend the meeting. We also encourage you to vote on the matters described in this proxy statement.

Q: What information is contained in these materials?

A: This proxy statement includes information about the nominees for director and the other matters to be voted on at the meeting. The proxy statement also includes information about the voting process and requirements, the compensation of directors and some of our executive officers, and certain other required information.

Q: What can I vote on at the meeting?

A: There are three matters to be voted on at the meeting:

1. To elect two Directors to serve until the Annual Meeting of Shareholders to be held in 2021, or until their successors are elected and qualified;
2. To consider an advisory vote on the compensation programs of our named executive officers;
3. To ratify the appointment of BDO USA, LLP as the Company's independent registered public accounting firm for 2018; and
4. To transact such other business as may properly be presented at the meeting, or at any adjournment(s) of the meeting.

Q: How does the Board recommend that I vote on each of the matters?

A: Our Board recommends that you vote **FOR** the director nominees, and **FOR** the ratification of the appointment of BDO USA, LLP as our independent registered public accounting firm for 2018. With respect to Proposal 2, the Board of Directors recommends that you vote **FOR** approval, on an advisory basis, of the compensation programs of our named executive officers as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosure contained in the proxy statement set forth under the caption "Executive Compensation" of this proxy statement.

Q: Why did I receive a two-page notice in the mail regarding the Internet availability of proxy materials this year instead of a full set of proxy materials?

A: We are taking advantage of SEC rules that allow us to deliver proxy materials to our shareholders on the Internet. Under these rules, we are sending most of our shareholders a two-page notice regarding the Internet availability of proxy materials instead of a full set of proxy materials. If you receive this two-page notice, you will not receive printed copies of the proxy materials unless you specifically request them. Instead, this notice tells you how to access and review on the Internet all of the important information contained in the proxy materials. This notice also tells you how to submit your proxy card on the Internet and how to request to receive a printed copy of our proxy materials. Shareholders may also request to receive proxy materials in printed form by mail or electronically by email on an ongoing basis.

Q: Can I receive next year's proxy materials by email?

A: Yes. All shareholders who have active email accounts and Internet access may sign up for email delivery of shareholder materials. To sign up, go to www.proxyvote.com and click on "Electronic Enrollment." If you have multiple registered or beneficial accounts, you need to enroll for each account. If you elect to receive proxy materials by email, we will not mail you any proxy-related materials next year. Your enrollment in the email program will remain in effect as long as your account remains active or until you cancel it.

Q: Who is entitled to vote at our annual meeting of shareholders?

A: Holders of our outstanding common stock on April 25, 2018, are entitled to one vote per share on each of the items being voted on at the meeting. We refer to this date as the Record Date. On the Record Date, we had 13,085,607 shares of common stock outstanding. We have no other classes of stock outstanding.

Q: What shares can I vote?

A: You can vote all shares you owned on the Record Date. These shares include (1) shares held directly in your name as the shareholder of record and (2) shares held for you as the beneficial owner through a stockbroker, bank or other nominee.

Q: What is the difference between holding shares as a shareholder of record and as a beneficial owner?

A: Most of our shareholders hold their shares through a stockbroker, bank or other nominee rather than directly in their own name. There are some important distinctions between shares held of record and those owned beneficially.

Shareholder of Record

If your shares are registered in your name with our transfer agent, Computershare, you are the shareholder of record for those shares and are receiving proxy-related materials directly from us. As the shareholder of record, you have the right to grant your voting proxy directly to us or to vote in person at the meeting.

Beneficial Owner

If your shares are held in a stock brokerage account, by a bank or other nominee (commonly referred to as being held in “street name”) you are the beneficial owner of those shares. Your broker, bank or nominee is the shareholder of record and therefore has forwarded proxy-related materials to you as beneficial owner. As the beneficial owner, you have the right to direct your broker, bank or other nominee how to vote your shares and are also invited to attend the meeting. However, since you are not the shareholder of record, you may not vote your shares in person at the meeting unless you obtain a signed proxy from your broker, bank or nominee giving you the right to vote the shares.

Q: How do I vote if I am a shareholder of record (as described in the question and answer above)?

A: You can vote on the Internet or by telephone by following the instructions you received in the mail or by email. If you received a full printed set of our proxy materials in the mail, you can also vote by mail by signing and returning the proxy card provided with those materials. Finally, you can vote in person at the meeting.

Q: How do I vote if I am a beneficial owner (as described in the question and answer above)?

A: You can vote on the Internet or by telephone by following the instructions you received in the mail or by email. If you received a full printed set of our proxy materials in the mail, you can also vote by mail. You can vote in person at the meeting *only if you obtain a signed proxy from your broker, bank or nominee giving you this right.*

Q: Can I change my vote or revoke my proxy?

A: Yes. You can change your vote or revoke your proxy at any time before the final vote at the meeting. You can do this by casting a later proxy through any of the available methods described in the questions and answers above. If you are a shareholder of record, you can also revoke your proxy by delivering a written notice of your revocation to our Corporate Secretary at our principal executive office at 508 West Wall Street, Suite 550, Midland, Texas 79701. If you are a beneficial owner, you can revoke your proxy by following the instructions sent to you by your broker, bank or other nominee.

Q: What does it mean if I get more than one set of proxy-related materials?

A: It means you hold shares registered in more than one account. Follow the instructions in each set of proxy-related materials to ensure that all of your shares are voted.

Q: What is the quorum requirement for the meeting?

A: For a “quorum” to exist at the meeting, shareholders holding a majority of the votes entitled to be cast by the shareholders entitled to vote must be present in person or represented by proxy at the meeting. There must be a quorum for any action to be taken at the meeting (other than adjournment or postponement of the meeting). If you submit a properly completed proxy, even if you abstain from voting, then your shares will be counted for purposes of determining the presence of a quorum.

If a broker indicates on a proxy that it lacks discretionary authority as to certain shares to vote on a particular matter, commonly referred to as “broker non-votes,” those shares will still be counted for purposes of determining the presence of a quorum at the meeting. Please see the next question and answer for further information about “broker non-votes.”

Q: What are broker non-votes and how are broker non-votes and abstentions counted?

A: If you are a beneficial owner and hold your shares in street name and do not provide your broker or other nominee with voting instructions, the broker, bank, or other nominee will determine if it has the discretionary authority to vote on the particular matter. The New York Stock Exchange permits brokers to vote their customers' shares on routine matters when the brokers have not received voting instructions from the customers. The ratification of independent public accountants is an example of a routine matter on which brokers may vote. Brokers may not vote their customers' shares on non-routine matters unless they have received instructions from the customers. Non-voted shares on non-routine matters are referred to as broker non-votes. The ratification of the appointment of BDO USA, LLP as our independent public accountants for 2018 (Proposal 3) is a matter considered "routine" under applicable rules. The election of directors (Proposal 1) and the advisory vote to approve the named executive officers compensation programs (Proposal 2) are matters considered "non-routine" under applicable rules. For purposes of the election of directors and all of the proposals set forth in this proxy statement, abstentions and broker non-votes, if any, will not be counted as votes cast and will have no effect on the result of the vote, although they will be considered present for the purpose of determining the presence of a quorum.

Q: What is the voting requirement to approve each of the matters?

Proposals	Board Recommendation	Votes Required	Effect of Abstentions	Effect of Broker Non-Votes
Election of Directors	FOR each nominee	Majority of votes cast	None	None
Advisory Vote to Approve Executive Compensation ("Say on Pay" Vote)	FOR	Majority of votes cast	None	None
Ratification of Independent Registered Public Accounting Firm	FOR	Majority of votes cast	None	No Broker Non-Votes (Routine Matter)

We also will consider any other business that properly comes before the annual meeting.

Q: How can I vote on each of the matters and how will the votes be counted?

A: In the election of directors, you may vote “For All,” “Withhold All,” or “For All Except” and select the nominee who you withhold your vote from. For the (i) advisory vote on compensation of our named executive officers and the (ii) ratification of the appointment of BDO USA, LLP as our independent auditors, you may vote “FOR,” “AGAINST,” or “ABSTAIN” with respect to these two proposals. Under Colorado law (under which the Company is incorporated), abstentions are counted as shares present and entitled to vote at the Annual Meeting, and therefore counted as present for the purpose of determining whether a quorum is present, but they are not counted as shares cast and will therefore have no effect on the outcome of the vote.

If you sign and return your proxy card or voting instruction form without giving specific voting instructions, your shares will be voted as recommended by our Board. If you are a beneficial holder and do not return a voting instruction form, your broker may only vote on the ratification of the appointment of BDO USA, LLP (Proposal 3).

Q: Who will count the votes?

A: Broadridge, an international investor relations company, is assisting us with the voting of proxies for our meeting. Prior to the meeting, Broadridge will provide us with a tabulation of the votes cast prior to the meeting. We believe that Broadridge will use procedures that are consistent with Colorado law concerning the voting of shares, the determination of the presence of a quorum and the determination of the outcome of each matter submitted for a vote. In addition, we will appoint a voting inspector at the meeting to count and tabulate any votes cast at the meeting.

Q: Who may attend the meeting?

A: All shareholders as of the Record Date may attend. Please bring to the meeting:

- proof of ownership such as: a copy of your proxy or voting instruction card; the two-page notice regarding the internet availability of proxy materials you received in the mail; or a copy of a brokerage or bank statement showing your share ownership as of the Record Date; and
- proof of *identification* such as a valid driver's license or passport.

Q: How will voting on any other business be conducted?

A: We do not expect any matters to be presented for a vote at the meeting other than the three matters described in this proxy statement. If you grant a proxy, either of the officers named as proxy holders, Stephen C. Taylor and G. Larry Lawrence, or their nominees or substitutes, will have the discretion to vote your shares on any additional matters that are properly presented for a vote at the meeting and at any adjournment or postponement that may take place. If, for any unforeseen reason, our nominee is not available as a candidate for director, the persons named as the proxy holder will vote your proxy for another candidate or other candidates nominated by our Board.

Q: May I propose actions for consideration at next year's meeting of shareholders?

A: Yes. For your proposal to be considered for inclusion in our proxy statement for next year's meeting, we must receive your written proposal no later than December 28, 2018. If we change the date of next year's meeting by more than 30 days from the date of this year's meeting, then the deadline is a reasonable time before we begin to print and send our proxy materials. You should also be aware that your proposal must comply with SEC regulations regarding shareholder proposals.

Similarly, for you to raise a proposal (including a director nomination) from the floor at next year's meeting, we must receive a written notice of the proposal no later than March 13, 2019. If we change the date of next year's meeting by more than 30 days from the date of this year's meeting, then we must receive your written proposal at least 150 days before the date of next year's meeting for the proposal to be timely.

Q: Who is paying for this proxy solicitation?

A: We will pay the cost of soliciting the proxies. In addition, our officers, directors and employees may solicit proxies or votes in person, by telephone or by email. These people will not be paid any additional compensation for these activities. We will send copies of proxy-related materials or additional solicitation materials to brokers, fiduciaries and custodians who will forward these materials to the beneficial owners of our shares. On request, we will reimburse brokers and other persons representing beneficial owners of shares for their reasonable expenses in forwarding these materials to beneficial owners.

HOUSEHOLDING OF PROXY MATERIALS

In an effort to reduce printing costs and postage fees, we have adopted a practice called “householding.” Under this practice, shareholders who have the same address and last name and do not participate in email delivery of proxy-related materials will receive only one set of our proxy statement, annual report or notice of internet availability of proxy-related materials unless one or more of these people notifies us that he or she wishes to continue to receive individual copies.

If you share an address with another shareholder and receive only one set of proxy-related materials and would like to request a separate copy for this year’s annual meeting or for any future meetings, please: (1) call our Investor Relations contact at (432) 262-2700; (2) send an email message to alicia.dada@ngsgi.com; or (3) mail your request to Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701, Attn: Investor Relations. Similarly, you may also contact us through any of these methods if you receive multiple copies of the materials and would prefer to receive a single copy in the future.

PROPOSAL 1 - ELECTION OF DIRECTORS

Our Board of Directors is divided into three classes (commonly known as a “staggered” Board), each class to be as nearly equal in number as possible. At each annual meeting of shareholders, members of one of the classes, on a rotating basis, are elected for a three-year term. The authorized number of Directors is currently set at nine. We currently have five directors serving on our Board. Our Board of Directors may fill the vacancies if a qualified candidate is vetted. The following table sets forth, by class, the members of our Board of Directors as of the date of this proxy statement:

Terms Expiring at the 2018 Annual Meeting	Terms Expiring at the 2019 Annual Meeting	Terms Expiring at the 2020 Annual Meeting
David L. Bradshaw	John W. Chisholm	Charles G. Curtis
William F. Hughes, Jr.		Stephen C. Taylor

Shareholders will be electing two Directors at the meeting. The Board is recommending David L. Bradshaw and William F. Hughes, Jr. for re-election to the Board of Directors to serve a three year term expiring at the annual meeting of shareholders in 2021.

The persons named in our form of proxy will vote the shares represented by such proxy for the election of the nominees for Director named above unless other instructions are shown on the proxy card. If, at the time of the meeting, a nominee becomes unavailable for any reason, which is not expected, the persons entitled to vote the proxy will vote for such substitute nominee, if any, as they determine in their sole discretion, or we may reduce the size of the Board.

Biographical information and qualifications for each person nominated as a Director, and for each person whose term of office as a Director will continue after the 2018 Annual Meeting, is set forth below.

Nominees for Director for Terms to Expire in 2021

David L. Bradshaw

David L. Bradshaw, 63, joined our board in December of 2011. Since 2005, Mr. Bradshaw has acted as a consultant in the oil and gas exploration and production sector and has overseen his investments in this area. From August 2007 through November 2009, Mr. Bradshaw served as a Director and Audit Committee Chairman for Triangle Petroleum, a publicly traded company listed on the American Stock Exchange. From November 2007 through November 2008, Mr. Bradshaw served as a Director for Comet Ridge Limited, an Australian company listed on the Australian Securities Exchange. From 1986 to 2005, Mr. Bradshaw worked for Tipperary Corporation, a U.S. public company listed on the American Stock Exchange. During his tenure at Tipperary, the company was involved in oil and gas exploration and production, and natural gas processing and transportation. He held the positions of Chief Executive Officer from 1996 to 2005, Chairman of the Board from 1997 to 2005, Chief Financial Officer from 1990 to 1996 and Chief Operating Officer from 1993 to 1996. Mr. Bradshaw also served as Chief Executive Officer and Chairman of Tipperary Oil & Gas (Australia) Pty Ltd from 1999 to 2005, a subsidiary of Tipperary, which explored for and produced natural gas in Queensland, Australia. From 1983 to 1986, Mr. Bradshaw was an owner and officer of Bradcorp, Inc., a private exploration and production company. Prior to this, Mr. Bradshaw spent six years in public accounting serving predominantly oil and gas clients. Mr. Bradshaw graduated from Texas A&M University with a BBA in Accounting in 1976 and a MBA in 1977, and is also a Certified Public Accountant.

Mr. Bradshaw's educational and professional training and achievements as a Certified Public Accountant and MBA, along with his past experience as both a Chief Financial Officer and Chief Executive Officer of a public company involved in the natural resources industry, provides us with considerable accounting and corporate finance skills. In addition, Mr. Bradshaw's career has spanned over thirty years in the oil and gas industry and as a public accountant. His executive management positions in both private and public companies bring us significant leadership, planning and management skills and background.

William F. Hughes, Jr.

William F. Hughes Jr., 65, has served as a Director since December 2003. Mr. Hughes has over 30 years of experience in the engineering and construction industry as a Registered Civil Engineer and licensed building contractor. From 1974 to 1979, he served as an officer in the United States Air Force. From 1979 to 1986, he was a project design engineer for Cushman & Associates. From 1986 to 1996, he served as a Project Manager on a variety of public works and industrial construction

projects. Since 1983, Mr. Hughes has been co-owner of The Whole Wheatery, LLC, a natural foods store located in Lancaster, California. Mr. Hughes holds a Bachelor of Science degree in Civil Engineering from the United States Air Force Academy and a Master of Science in Engineering from the University of California at Los Angeles.

Mr. Hughes' career experience in the engineering and construction industry brings us invaluable skills which are applicable to our manufacturing processes. In addition, Mr. Hughes provides leadership skills arising from his service as an officer with the U.S. Air Force and U.S. Air Force Academy graduate.

Mr. Hughes' experience as the chairman of the compensation committee has enabled him to develop the critical expertise required by the Board as it relates to compensation matters. His ability to lead the committee, deriving assistance and varied perspectives from our compensation consultants, and objectively weigh the requirements of the Company, shareholders and executives is invaluable.

Required Vote for This Proposal

The election of each director nominee requires the affirmative vote of a majority of the votes cast at the Annual Meeting with respect to each nominee. The number of shares voted "for" a director nominee must exceed the number of votes cast "against" that nominee for the nominee to be elected as a director to serve until the next annual meeting or until his or her successor has been duly elected and qualified.

Pursuant to the resignation policy adopted by our Board of Directors and further described in our Corporate Governance Guidelines, any nominee for director who is not elected shall promptly tender his or her resignation to our Board of Directors following certification of the stockholder vote. The Corporate Governance Committee will consider the resignation offer and recommend to our Board of Directors the action to be taken with respect to the offered resignation. In determining its recommendation, the Governance Committee shall consider all factors it deems relevant. Our Board of Directors will act on the Governance Committee's recommendation within 90 days following certification of the stockholder vote and will publicly disclose its decision with respect to the director's resignation offer (and the reasons for rejecting the resignation offer if applicable).

Any director who tenders his or her resignation pursuant to the resignation policy shall not participate in the Governance Committee's recommendation or Board of Directors action regarding whether to accept the resignation offer. If each member of the Governance Committee is required to tender his or her resignation pursuant to the resignation policy in the same election then the independent directors of our Board of Directors who are not required to tender a resignation pursuant to the resignation policy shall consider the resignation offers and make a recommendation to our Board of Directors.

To the extent that one or more directors' resignations are accepted, our Board of Directors our Board of Directors in its discretion may determine either to fill such vacancy or vacancies or to reduce the size of the Board within the authorized range.

Continuing Directors Whose Terms Expires in 2020

John W. Chisholm

John W. Chisholm, 63, was appointed as a Director of Natural Gas Services Group in December 2006 to fill a vacancy created by expanding the size of the Board from seven to eight Directors and was first elected as a Director of Natural Gas Services Group at the annual meeting of shareholders held in June 2007. Mr. Chisholm is the founder of Wellogix, an oil and gas software company that develops software aimed at expediting the exchange of enterprise data and communication of complex engineered services. Prior to founding Wellogix, Mr. Chisholm co-founded and served as President of ProTechnics Company from 1985 until its sale to Core Laboratories in December of 1996. Mr. Chisholm served as Senior Vice President of Global Sales and Marketing of Core Laboratories until 1998, when he started Chisholm Energy Partners, an investment fund focused on mid-size energy service companies. From 2002 to 2009 Mr. Chisholm served on the Board of Directors of Flotek Industries, Inc., and became interim President in August 2009. In August 2010 Mr. Chisholm became President of the company and was appointed Chief Executive Officer in March 2012. Flotek Industries, Inc. is a public company which files reports under the Securities Exchange Act of 1934. Mr. Chisholm holds a Business Administration degree from Fort Lewis College in Colorado. He currently serves on the Editorial Advisory Board on Middle East Technology of the Oil & Gas Journal.

Mr. Chisholm brings significant natural resources experience to our Board, in connection with his background in supplying drilling and production related products and services to the oil, gas and mining industries, and his investment fund experience with mid-size energy service companies is an invaluable resource as the Company assesses its capital and liquidity needs.

In addition Mr. Chisholm's experience as a board member and executive officer of a public company provides us with a wealth of leadership and management skills.

Continuing Director Whose Term Expires in 2021

Charles G. Curtis

Charles G. Curtis, 85, has served as a Director of Natural Gas Services Group since April 2001. Since 2002, substantially all of Mr. Curtis' business activities have been devoted to managing personal investments. From 1992 until 2002, Mr. Curtis was the President and Chief Executive Officer of Curtis One, Inc., a manufacturer of aluminum and steel mobile stools and mobile ladders. From 1988 to 1992, Mr. Curtis was the President and Chief Executive Officer of Cramer, Inc., a manufacturer of office furniture. Mr. Curtis has a Bachelor of Science degree from the United States Naval Academy and a Master of Science degree in Aeronautical Engineering from the University of Southern California.

Mr. Curtis has been a long-standing member of the Board since prior to the Company's initial public offering in 2002 and as such he brings a wealth of knowledge regarding the Company's history, growth and industry. Through his manufacturing career and engineering educational background, Mr. Curtis assists the Board and the Company in connection with its compressor manufacturing business. As a past U.S. Naval Officer and U.S. Naval Academy graduate, Mr. Curtis also brings leadership skills to the Board and Company.

Stephen C. Taylor

Stephen C. Taylor, 64, has been President and Chief Executive Officer of Natural Gas Services Group since January 2005. He was elected as a Director of Natural Gas Services Group at the annual meeting of shareholders in June 2005. Effective January 1, 2006, Mr. Taylor was appointed Chairman of the Board of Directors. Immediately prior to joining Natural Gas Services Group, Mr. Taylor held the position of General Manager - US Operations for Trican Production Services, Inc. from 2002 through 2004. Mr. Taylor joined Halliburton Resource Management in 1976, becoming its Vice President - Operations in 1989. Beginning in 1993, he held multiple senior level management positions with Halliburton Energy Services until 2000 when he was elected Senior Vice President/Chief Operating Officer of Enventure Global Technology, LLC, a joint-venture deep water drilling technology company owned by Halliburton Company and Shell Oil Company. Mr. Taylor elected early retirement from Halliburton Company in 2002 to join Trican Production Services, Inc. Mr. Taylor holds a Bachelor of Science degree in Mechanical Engineering from Texas Tech University and a Master of Business Administration degree from the University of Texas at Austin.

Mr. Taylor's senior management experience in the natural resources industry provides the Board and our company with significant insight into our business. Mr. Taylor's engineering and advanced business training (MBA) uniquely suits him to provide leadership, technical expertise and financial acumen to our Board and to the operations of our company in connection with his position as our chief executive officer.

THE BOARD OF DIRECTORS AND ITS COMMITTEES

Natural Gas Services Group's Board of Directors held seven meetings in 2017. Each Director attended at least 75% of the total number of Board meetings held while such person was a Director. Each Director also attended at least 75% of all of the meetings held by all committees of the Board of Directors for which he served (during the periods that he served). The Board of Directors acts from time to time by unanimous written consent in lieu of holding a meeting.

Our non-management directors hold regularly scheduled executive sessions in which those directors meet without management participation. Generally, the Lead Director presides over these sessions; Charles G. Curtis is currently the Lead Director.

We typically schedule a Board meeting in conjunction with our annual meeting of shareholders. Although we do not have a formal policy on the matter, we expect our Directors to attend each annual meeting, absent a valid reason, such as illness or an unavoidable schedule conflict. Last year, all of the individuals then serving as Directors attended our 2017 Annual Meeting of Shareholders.

To assist it in carrying out its duties, the Board has delegated certain authority to four separately designated standing committees. These committees are described below.

Audit Committee

The primary functions of our Audit Committee include:

- assisting the Board in fulfilling its oversight responsibilities as they relate to our accounting policies, internal controls, financial reporting practices and legal and regulatory compliance;
- hiring our independent registered public accounting firm;
- monitoring the independence and performance of our independent registered public accounting firm;
- maintaining, through regularly scheduled meetings, a line of communication between the Board, our financial management and independent registered public accounting firm; and
- overseeing compliance with our policies for conducting business, including ethical business standards.

The members of the Audit Committee are David L. Bradshaw (Chairman), Charles G. Curtis, and William F. Hughes, Jr. Our common stock is listed for trading on the New York Stock Exchange, or "NYSE". Under rules of the NYSE, the Audit Committee is to be comprised of three or more Directors, each of whom must be independent. Our Board has determined that all of the members of the Audit Committee are independent, as defined under the applicable NYSE rules and listing standards. In addition, our Board of Directors has determined that David L. Bradshaw is qualified as an "audit committee financial expert" as that term is defined in the rules of the Securities and Exchange Commission. The Audit Committee met eight times during the last fiscal year. The audit committee has also received from, and discussed with, BDO the matters required to be discussed by Public Accounting Oversight Board Auditing Standard No. 1301 (AS 1301) (Communications with Audit Committees).

Any shareholder may obtain free of charge a printed copy of our Audit Committee Charter by sending a written request to Investor Relations, Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701. You can also view and print a copy of our Audit Committee Charter by clicking on the "Governance" tab at the Investor Relations page of our website at www.ngsgi.com.

Compensation Committee

The functions of our Compensation Committee include:

- assisting the Board in overseeing the management of our human resources;
- evaluating our Chief Executive Officer's performance and compensation;
- formulating and administering our overall compensation principles and plans; and
- evaluating management.

The Compensation Committee's policy is to offer the executive officers competitive compensation packages that will permit us to attract and retain individuals with superior abilities and to motivate and reward such individuals in an appropriate fashion in the long-term interests of Natural Gas Services Group and its shareholders. Currently, executive compensation is comprised of salary and cash bonuses and awards of long-term incentive opportunities in the form of restricted stock or restricted stock unit awards under the 2009 Restricted Stock/Unit Plan.

The members of the Compensation Committee are William F. Hughes, Jr. (Chairman), John W. Chisholm and David L. Bradshaw. Our Board has determined that all of the members of the Compensation Committee are independent, as defined under the applicable NYSE rules and listing standards. During the last fiscal year there were four meetings of the Compensation Committee.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee members are not officers or employees of our company, and there is not, nor was there during fiscal 2017, any compensation committee interlock (in other words, no executive of our company serves as a Director or on the compensation committee of a company that has one or more executives serving on our Board of Directors or our Compensation Committee).

Any shareholder may obtain free of charge a printed copy of our Compensation Committee Charter by sending a written request to Investor Relations, Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701. You can also view and print a copy of our Compensation Committee Charter by clicking on the "Governance" tab at the Investor Relations page of our website at www.ngsgi.com.

Governance and Personnel Development Committee

Our Governance and Personnel Development Committee primarily focuses on:

- generally overseeing the governance of the Board and its committees;
- interpreting the Governance Guidelines, the Code of Business Conduct and Ethics and other similar governance documents adopted by the Board; and
- overseeing the evaluation of the Board and its committees.

The members of the Governance and Personnel Development Committee are Charles G. Curtis (Chairman), John W. Chisholm and William F. Hughes, Jr. Our Board has determined that each of the Governance and Personnel Development Committee members is independent, as defined under the applicable NYSE rules and listing standards. During the last fiscal year there were four meetings of the Governance and Personnel Development Committee.

Any shareholder may obtain free of charge a printed copy of our Governance Committee Charter by sending a written request to Investor Relations, Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701. You can also view and print a copy of our Governance Committee Charter by clicking on the "Governance" tab at the Investor Relations page of our website at www.ngsgi.com.

Nominating Committee

The functions of our Nominating Committee include:

- identifying individuals qualified to become board members, consistent with the criteria approved by the Board;
- recommending Director nominees and individuals to fill vacant positions; and
- overseeing executive development and succession and diversity efforts.

The members of the Nominating Committee are John W. Chisholm (Chairman), David L. Bradshaw, and Charles G. Curtis. Our Board of Directors has determined that each of the Nominating Committee members is independent as defined under the applicable NYSE rules and listing standards. During the last fiscal year there were four meetings of the Nominating Committee.

Any shareholder may obtain free of charge a printed copy of our Nominating Committee Charter by sending a written request to Investor Relations, Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701. You can also view and print a copy of our Nominating Committee Charter by clicking on the “Governance” tab at the Investor Relations page of our website at www.ngsg.com. Our Nominating Committee does not have a diversity policy; however, as discussed below, the Committee’s goal is to nominate candidates who possess a range of experiences and backgrounds which will contribute to the board’s overall effectiveness in meeting its duties and forwarding the goals of our company.

Our Nominating Committee will consider a Director candidate recommended by a shareholder. A candidate must be highly qualified in terms of business experience and be both willing and expressly interested in serving on the Board. A shareholder wishing to recommend a candidate for the Committee’s consideration should forward the candidate’s name and information about the candidate’s qualifications to Natural Gas Services Group, Inc., Nominating Committee, 508 West Wall Street, Suite 550, Midland, Texas 79701, Attn.: John W. Chisholm. Submissions must include sufficient biographical information concerning the recommended individual, including age, employment history for at least the past five years indicating employer’s names and description of the employer’s business, educational background and any other biographical information that would assist the Committee in determining the qualifications of the individual. The Committee will consider recommendations received by a date not later than 120 calendar days before the date our proxy statement was released to shareholders in connection with the prior year’s annual meeting for nomination at that annual meeting. The Committee will consider nominations received after that date at the annual meeting subsequent to the next annual meeting.

The Committee evaluates nominees for Directors recommended by shareholders in the same manner in which it evaluates other nominees for Directors. Minimum qualifications include the factors discussed above.

Director Independence

The Board has determined that each of the following four members of the Board is “independent” within the meaning of applicable listing standards of the NYSE and under the standards, set forth in Exhibit A to our Governance and Personnel Development Charter, (“Governance Charter”) which are consistent with the NYSE listing standards: David L. Bradshaw, John W. Chisholm, Charles G. Curtis, and William F. Hughes, Jr. A copy of Exhibit A to our Governance Charter is available at our website, www.ngsg.com, under the heading “Investor Relations—Governance.” The Board has made an affirmative determination that each of the four directors named above satisfies these categorical standards. In making its determination, the Board examined relationships between directors or their affiliates with us and our affiliates and determined that each such relationship, if any, did not impair the director’s independence.

Board of Directors Diversity

The Company values diversity and the benefits that a diverse workforce can bring to the Company and to the Board of Directors. Diversity can promote the inclusion of different perspectives and ideas which can lead to more robust discussion regarding strategic and governance policy alternatives and, ultimately, result in better corporate governance and decision making.

The Company seeks to maintain a Board comprised of talented and dedicated directors with a diverse mix of expertise, experience, skills and backgrounds. The skills and backgrounds collectively represented on the Board should reflect the diverse nature of the business environment in which the Company operates. As new members of the Board of Directors are considered, diversity considerations should include - but not be limited to - business expertise, geography, age, gender and ethnicity.

The Company is committed to a merit-based system for Board composition within a diverse and inclusive culture which solicits multiple perspectives and views and is free of conscious or unconscious bias. When assessing Board composition or identifying suitable candidates for appointment to the Board, the Company will consider candidates on merit with due consideration to the benefits of diversity and the needs of the Board.

The Board's Leadership Structure

Under our Corporate Governance Guidelines, our Chief Executive Officer also serves as our Chairman of the Board, and that person is responsible to the Board for the overall management and functioning of the company. Stephen C. Taylor serves as both Chairman of the Board and our President and Chief Executive Officer ("CEO"). The Board believes this is the most effective Board leadership structure at the present time and believes that Mr. Taylor, in his role as Chairman/CEO, has the ability to execute on both our short-term and long-term strategies necessary for the challenging marketplace in which we compete. The independent directors believe that Mr. Taylor's detailed and in-depth knowledge of the issues, opportunities and challenges facing us and our business make him the best qualified director to develop agendas that ensure that the Board's time and attention are focused on the most critical matters. Further, as the individual with primary responsibility for managing day-to-day operations, Mr. Taylor is best positioned to chair regular Board meetings and ensure that key business issues and risks are brought to the attention of our Board and/or Audit Committee.

Each of our directors, other than Mr. Taylor, is independent, and the Board believes that the independent directors provide effective oversight of management. The Board may subsequently decide, however, to change that leadership structure which would require a revision to our Corporate Governance Guidelines. The Board believes that it has in place safeguards to ensure that we maintain the highest standards of corporate governance and continued accountability of the CEO to the Board. These safeguards include:

- All members of the Board are independent directors except for Mr. Taylor.
- Each of the Board's standing committees, including the Audit, Compensation, Governance and Nominating Committees, are comprised of and chaired solely by non-employee directors who meet the independence requirements under the NYSE listing standards and other governing laws and regulations. As noted above, these committees meet frequently.
- Review and determination of Mr. Taylor's compensation and performance remains within the purview of the Compensation Committee.
- The independent directors continue to meet in executive sessions without management present to discuss the effectiveness of the company's management, the quality of the Board meetings and any other issues and concerns.

Lead Director

To promote the independence of the Board and appropriate oversight of management and to demonstrate our commitment to strong corporate governance, the independent directors designate an independent, non-employee director to serve as our Lead Director. The Lead Director helps to facilitate free and open discussion and communication among the independent, nonemployee directors. The responsibilities of the Lead Director are set forth in our Corporate Governance Guidelines, which is available under "Investor Relations - Governance Documents" on our website at www.ngsgi.com. Charles G. Curtis was appointed Lead Director in April 2016.

Role in Risk Oversight

Our Board of Directors oversees the management of risks inherent in the operation of our business and the implementation of our strategic plan. Our executive management is responsible for the day-to-day management of risks we face. The Board is periodically advised by management on the status of various factors that could impact our business and operating results, including oil and gas industry issues, operational issues (such as compressor manufacturing issues, backlog for compressor equipment etc.), legal and regulatory risks. The full Board is also responsible for reviewing our strategy, business plan, and capital expenditure budget.

Our Board committees assist the Board in fulfilling its oversight responsibilities in certain areas of risk. Our Audit Committee serves an important role in providing risk oversight, as further detailed in its charter. One of the Audit Committee's primary duties and responsibilities is to monitor the integrity of our financial statements, financial reporting processes, systems

of internal controls regarding finance, and disclosure controls and procedures. The Compensation Committee assists the Board with risk management relating to our compensation policies and programs, and the Governance and Nominating Committee assists with risk management relating to Board organization, membership and structure, succession planning for our directors and executive officers, and corporate governance.

CODE OF ETHICS

Our Board of Directors has adopted a Code of Business Conduct and Ethics, or “Code”, which is posted on our website at www.ngsgi.com. You may also obtain a copy of our Code by requesting a copy in writing at 508 West Wall Street, Suite 550, Midland, Texas 79701 or by calling us at (432) 262-2700.

Our Code provides general statements of our expectations regarding ethical standards that we expect our Directors, officers and employees, including our Chief Executive Officer and principal financial officer, to adhere to while acting on our behalf. Among other things, the Code provides that:

- we will comply with all laws, rules and regulations;
- our Directors, officers and employees are to avoid conflicts of interest and are prohibited from competing with us or personally exploiting our corporate opportunities;
- our Directors, officers and employees are to protect our assets and maintain our confidentiality;
- we are committed to promoting values of integrity and fair dealing; and that
- we are committed to accurately maintaining our accounting records under generally accepted accounting principles and timely filing our periodic reports.

Our Code also contains procedures for our employees to report, anonymously or otherwise, violations of the Code.

SHAREHOLDER ENGAGEMENT

The Company's Board of Directors and executive management believes that building long-term relationships with all Company stakeholders is vital to our strategy for corporate governance. Our shareholders, who invest in our company and elect the board of directors, are entitled to important information about the company's business, policies and practices so they can make informed decisions and knowledgeably participate in the governance process.

The Company's executive management has directly engaged shareholders throughout the year in many diverse ways including quarterly conference calls, investor and industry conferences and individual meetings initiated by both the Company and shareholders. It is our policy to actively engage our shareholders in dialogue about our financial and operational trends, the structure of our business, and certain governance issues, including executive compensation.

As a result of past shareholder engagement, the Company has made several enhancements to its governance practices including the appointment of a lead director, the adoption of a "majority standard" for the election of directors and minimum equity ownership for officers and directors. In addition, the Compensation Committee considers the annual shareholders' advisory vote, as well as other stockholder input, when reviewing executive compensation programs, principles and policies.

As a result of critiques of our executive compensation plan, including what the Company believes are errors of fact and interpretation by certain proxy advisory services, and results from past shareholder votes on the Company's executive compensation structure, we have actively engaged many of our shareholders in ongoing dialogue regarding the structure of our executive compensation plan.

Specifically, since our last proxy statement and annual meeting, we have held meetings with a plethora of the Company's shareholders about our compensation structure including executive base compensation as well as the Company's incentive compensation programs. These discussions have included information and data regarding the compensation programs of our peers as well as updated information on our Company, its compensation practices and new data including pay ratios and other publicly available information.

The tenor of those discussions and shareholder suggestions resulting from such dialogue have been shared with and considered by our Board of Directors and the Compensation Committee of the Board as they consider and adopt changes to the Company's executive compensation program. The Board appreciates the input of our shareholders and put considerable weight on suggestions proffered by these key stakeholders. The executive compensation plan of the Company is detailed in this Proxy.

Overall, the Company engages our shareholders on a regular basis. In addition to periodic reports filed with the U.S. Securities and Exchange Commission, the Company holds quarterly conference calls to discuss interim financial and operational results with its stakeholders, participates in several industry conferences which are available to Company stakeholders in person or via various public online platforms and meets with shareholders in person throughout the year. The Company believes that its consistent and continuous shareholder engagement strategy has created an environment in which shareholders are comfortable in providing candid feedback and critique of the Company's operations, governance and executive compensation policies.

During 2017, the Company estimates it met with over 100 unique shareholders and prospective shareholders (including all of the Company's twenty largest shareholders, exclusive of index and quantitative funds) at various meetings across North America. These engagements provide detailed information about the Company's financial and operational performance as well as key information of certain corporate governance matters, including executive compensation. Such information is publicly disseminated in the form of periodic filings with the U.S. Securities and Exchange Commission, press releases and information on the Company's website, including in the investor relations section.

EXECUTIVE OFFICERS

Biographical information for the executive officers of Natural Gas Services Group who are not Directors is set forth below. There are no family relationships between any Director or executive officer and any other Director or executive officer. Executive officers serve at the discretion of the Board of Directors and until their successors have been duly elected and qualified, unless sooner removed by the Board of Directors. Officers are elected by the Board of Directors annually at its first meeting following the annual meeting of shareholders.

G. Larry Lawrence, 67, became our Chief Financial Officer, Principal Accounting Officer and Corporate Secretary on July 1, 2011. Previously, Mr. Lawrence was our Controller since September 2010. From June 2006 to August 2010, Mr. Lawrence was self-employed as a management consultant doing business as Crescent Consulting. Overlapping this time, from September 2006 to August 2009, he also served as the CFO of Lynx Operating Company. Lynx is a private company engaged in oil and gas production and gas processing activities. From May 2004 through April 2006, Mr. Lawrence served as Controller of Pure Resources, an exploration and production company and wholly owned subsidiary of Unocal Corporation which was acquired by Chevron Corporation. From June 2000 through May 2004, Mr. Lawrence was a practice manager of the Parson Group, LLC, a financial management consulting firm whose services included Sarbanes Oxley engagements with oil and natural gas industry clients. From 1973 through May 2000, Mr. Lawrence was employed by Atlantic Richfield Company where he most recently (from 1993 through 2000) served as Controller of ARCO Permian. Since May 2006, Mr. Lawrence serves as a director of Legacy Reserves, LP. Mr. Lawrence has a Bachelor of Arts in Accounting, with honors, from Dillard University.

James R. Hazlett, 62, has served as Vice President-Technical Services since June 2005. He also served as Vice President of Sales of Screw Compression Systems, Inc. from 1997 until June 2007 when Screw Compression Systems, Inc. was merged into Natural Gas Services Group. After the merger in June 2007, Mr. Hazlett continues to remain employed by Natural Gas Services Group as Vice President-Technical Services. From 1982 to 1996, Mr. Hazlett served in management roles for Ingersoll Rand/Dresser Rand working with compression of all types in several different departments from sales and service to engineering. From 1978 to 1982, Mr. Hazlett was employed by the down-hole tool division of Hughes Tool designing and installing gas lift and plunger systems. Mr. Hazlett holds a Bachelor of Science degree from the College of Engineering at Texas A&M University and has 40 years of industry experience.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Compensation Discussion and Analysis

This compensation discussion and analysis provides information regarding our executive compensation program in 2017 for the following executive officers of the Company (collectively, the "named executive officers").

Stephen C. Taylor, our Chairman, President, and Chief Executive Officer;
G. Larry Lawrence, our Chief Financial Officer; and
James R. Hazlett, our Vice President-Technical Services.

Introduction and Overview

The Compensation Committee or, the "Committee," of the Board of Directors is responsible for determining the types and amounts of compensation we pay to our executives. The Committee operates under a written charter that you can view on our website at www.ngsgi.com. The Board of Directors has determined that each member of the Committee meets the independence and financial literacy requirements of the NYSE. The Board determines, in its business judgment, whether a particular Director satisfies the requirements for membership on the Committee set forth in the Committee's charter. None of the members of the Committee are current or former employees of Natural Gas Services Group or any of its subsidiaries.

The Committee is responsible for formulating and administering our overall compensation principles and plans. This includes establishing the compensation paid to our CEO, meeting and consulting with our CEO to establish the compensation paid to our other executive officers, counseling our CEO as to different compensation approaches, administering our stock equity plans, monitoring adherence to our compensation philosophy and conducting an annual, and sometimes more frequent, review of our compensation programs and philosophy regarding executive compensation.

The Committee periodically meets in executive session without members of management or management Directors present and reports to the Board of Directors on its actions and recommendations.

Compensation Philosophy and Objectives

Our compensation philosophy is to provide an executive compensation program that:

- rewards performance and skills necessary to advance our objectives and further the interests of our shareholders;
- is fair and reasonable and appropriately applied to each executive officer;
- is competitive with compensation programs offered by our competitors; and
- serves as an adequate retention tool in a competitive market.

The overall objectives of our compensation philosophy are to:

- provide a competitive level of current annual income that attracts and retains qualified executives at a reasonable cost to us;
- retain and motivate executives to accomplish our company goals;
- provide long-term incentive compensation opportunities at levels appropriate for the respective responsibilities and performance of each executive;
- align compensation and benefits with our business strategies and goals;
- encourage the application of a decision making process that takes into account both short-term and long-term risks and the oftentimes volatile nature of our industry; and
- align the financial interests of our executives with those of our shareholders through the grant of equity based rewards.

Our Committee supports these objectives by emphasizing compensation arrangements that we believe are reasonable and will attract and retain qualified executives and reward them for their efforts to further our long-term growth and success. At the same time, we remain cognizant of and aim to balance our executive compensation arrangements with the interests and concerns of our shareholders.

The following summary highlights our commitment to executive compensation practices that align the interests of our executives and shareholders:

WHAT WE DO

- ✓ **Fully independent compensation committee** - permits the establishment of competitive compensation practices and the measurement of actual performance in a conflict-of-interest free environment

- ✓ **Broad-based retirement programs** - all of our retirement plans are broad-based and are provided to all full-time employees in addition to our executive officers

- ✓ **Independent compensation consultant** - the Committee annually engages an independent compensation consultant to assist with its compensation reviews

- ✓ **Annual review** - the Committee conducts an annual review and approval of the Company's compensation strategy, including a review of our compensation peer group used for comparative purposes and a review of our compensation related risk profile to ensure that such risks are not reasonably likely to have a material adverse effect on the Company

- ✓ **Risk mitigation** - we have certain controls in place (signature authority, compensation structure, etc.) and an analysis is conducted on a quarterly basis

- ✓ **Double-trigger employment** - our change-in-control payments and benefits with our Chief Executive Officer are based on a "double-trigger" provision

- ✓ **Stock ownership guidelines** - stringent ownership policies for directors, CEO and other officers

- ✓ **Clawback policy** - applicable to our NEO's ("named executive officers") and other executive officers

- ✓ **Three Year Vesting on Equity Awards** - equity awards to our NEOs are subject to a three-year vesting requirement

- ✓ **Performance Compensations** - our cash bonuses are primarily tied to annual financial performance metrics and a portion of our CEO's long-term equity award is tied to our total shareholder return compared to our peer group

WHAT WE DON'T DO

- ✗ **No gross-ups** - executive officers are not eligible to receive any tax reimbursement payments or "gross-ups" in connection with any severance or change-in-control payments or benefits

- ✗ **Limited perquisites** - with the exception of certain expense reimbursements as detailed in the Summary Compensation Table that follows this compensation report, we do not provide any perquisites

- ✗ **Prohibition of hedging and pledging shares** - we do not permit hedging or pledging our shares as collateral for a loan nor do we permit our executives or non-employee directors to engage in any derivatives trading with respect to our common stock

- ✗ **No stock option exchanges or repricing** - we do not allow for stock option exchanges or the repricing of outstanding stock options without shareholder approval

- ✗ **No related party transactions** - we do not have any related party transactions

We have chosen to implement a relatively streamlined compensation framework for our executives. We feel that our compensation philosophies and practices are appropriate for a public company of our size. This streamlined framework allows the Company and Compensation Committee to maintain a high degree of transparency, as well as relative certainty for our executives and our shareholders and prospective investors, while minimizing the impact of complex benefit programs that are both costly and potential confusing. Our compensation programs are focused on a simple goal: a fair, reasonable and straightforward compensation program that rewards our leadership team for achievements beneficial to the Company and its shareholders.

Advisory Vote on Compensation; Shareholder Engagement

At our 2017 Annual Meeting, approximately 68% of the votes cast on the annual advisory “say on pay” proposal were cast in support of the compensation of our named executive officers. This was significantly higher than the vote in 2015 where less than 50% of the votes cast were in support of the proposal and 3% higher than the vote in 2016. We believe the increase in support over the past two years has been due to the significant compensation and governance changes we made as described in this and our past Proxy Statements. However, last year's results were still disappointing, as we believe a sizeable portion of the disapproval votes were the result of the influence of misguided recommendations of certain proxy advisory firms. As noted in Supplemental Proxy Materials submitted by the Company subsequent to the filing of the 2017 Proxy Statement, we believe the reports of certain proxy advisory firms contained factual errors and erroneous assumptions that resulted in misguided conclusions and recommendations.

Although the Advisory Vote on Executive Compensation is not binding on the Company, the Board of Directors assigns significant weight to the outcome of the vote and responds accordingly. In the past three years, the Company’s Board of Directors and executive management considered the results of the vote and recommendations of the proxy advisory firms as it engaged in meaningful review of its corporate governance and executive compensation matters with advisors and other stakeholders. Those discussions included over 200 unique meetings with key institutional shareholders and prospective shareholders during the past three years. The vast majority of input on our compensation programs and executive pay from these shareholders has been positive. As noted above, we believe the preponderance of votes against the Company’s executive compensation program are the product of “automatic” voting procedures by some institutional shareholders based solely upon the recommendations of certain proxy advisory firms which, we note herein, are based on factual inaccuracies and misinterpretations.

The Compensation Committee and Board of Directors believe that our executive compensation program and corporate governance policies are optimal for the Company, continue to align company leadership with the best interests of shareholders and have facilitated and supported executive that have delivered industry-leading results. At the same time, the Compensation Committee also recognizes the ever-evolving compensation and governance landscape.

Below is a summary of the actions we took in response to many of these issues during the last three years:

Compensation and Governance Concerns	Responses to the Concerns
Insufficient Risk Mitigators (i.e., lack of clawback policy and stock ownership guidelines)	We have adopted both a Clawback Policy covering our executive officers and Stock Ownership Guidelines covering our executive officers and members of our Board of Directors.
Equity Award for CEO not directly performance driven and one year vesting of Restricted Stock Grants	A portion of the equity award for our CEO is now objectively calculated based on total shareholder return compared to our peer group and equity awards to our executive officers vest in one-third increments over three years. In addition, our Compensation Committee is also in the process of obtaining and reviewing reports and data relating to the manner in which share awards are determined and vest in keeping with the evolving trends for this type of compensation. Once finalized, we envision implementing these changes with respect to awards granted in 2019.
Equity Award for CEO based on one-year TSR	For 2017, the TSR (total shareholder return) performance-driven portion of our CEO's equity award was based on our three-year TSR results compared to the companies in our peer group.
Excessive Cash Severance	We do not feel that the cash severance benefits for our Chief Executive Officer are excessive. Any change of control severance requires a 'double-trigger' to be payable and the triggers are limited to the standard "good reason" events (see page 49). We believe the severance benefits are within the norms of companies in our industry that exhibit a similar performance profile that we do, i.e., industry leading total shareholder returns in each of the past one, three and five year periods. Please see the charts on page 25 and the 2017 performance achievements below. The cash severance due to our CEO in connection with "good reason" events (this typically would be an involuntary occurrence) equates to approximately three years of total compensation based upon a year of good performance, which the Company has generally demonstrated.
Lack of Lead Independent Director	We have amended our Corporate Governance Guidelines to include a lead independent director. Charles G. Curtis, our longest tenured independent director, has been appointed as our lead director.

Fiscal Year 2017 Performance

In 2017, our financial performance demonstrated positive results and stable financial condition that provided excellent shareholder value in a very challenging time for a service company in the oil and gas industry. Some of our financial and operational highlights include:

Financial Highlights

- Maintained a strong and conservative balance sheet which has allowed the Company to weather the oil and gas price downturn while still reporting net income and accumulating cash, while numerous energy service providers have gone into bankruptcy or restructured with significant dilutive effect to shareholders.
- Taking advantage of the Company's strong financial position to purchase land and begin construction on its own office building in order to avoid costly and escalating leases in the Midland, Texas area while potentially increasing the value of its investment if commercial real estate prices rise.
- Increased cash and cash equivalents (balance sheet) from \$64.1 million in 2016 and \$69.2 million in 2017, while simultaneously increasing capital expenses.
- Maintained debt at a continuing, very low level (less than \$500k).
- Maintained a positive Current (Quick) Ratio (Current Assets/Current Liabilities, a measure of liquidity) of 14.5 in 2017, an important metric for shareholders in an environment when liquidity tends to decrease (often severely).
- Increased capital expenditures from \$3.4 million in 2016 to \$13.5 million in 2017, in response to increased opportunities and a strategic move into higher-horsepower equipment.
- Continued to self-fund growth capital expenditures in excess of \$208 million since 2010.
- Operating cash flow as a percentage of revenue was 26% in 2017. This means that of every dollar in revenue we turned 26 cents in 2017 of it into real spendable cash.
- Free cash flow (cash remaining after funding the Company's capital expenditures) remained healthy at \$4.0 million in 2017 and as a percentage of revenue was 5.9%.
- Achieved Adjusted EBITDA as a percentage of revenue of 34% in 2017. Adjusted EBITDA reflects net income or loss before interest, taxes, depreciation and amortization and loss on retirement of rental equipment.
- Maintained adjusted gross margins in our core rental business above 60% in 2017, notwithstanding the difficult and depressed industry cycle. Adjusted Gross Margin is defined as total revenue less cost of sales (excluding depreciation and amortization expense).
- Our SG&A expenses as a percent of total revenue remained relatively steady notwithstanding the significant drop in revenue due to the challenging industry cycle.
- For the year 2017, our stock price decreased by 18.5%, while the median decrease for identified public peers was 29.5%, the OSX index decreased 18.6%.

Operational Highlights

- During the downturn, the Company was able to retain skilled and experienced employees due to its strong financial position which should benefit the Company as the Midland, Texas employment market becomes even more competitive.
- In 2017, we continued to build and set our new 400/600 horsepower gas compressors and 50 to 100 horsepower Vapor Recovery units. Utilization for the equipment continues to be high.
- At the end of 2017, we entered the 1300, horsepower rental market, with a significant commitment of almost 22,500 horsepower from a major customer.
- Developed with a major customer a unique method of digitally controlling process gas temperatures on our gas compression skids. This resulted in exceptional uptime during the critical winter period.

Elements of Our Compensation Program

Element	Characteristics	Primary Objective
Base Salary	Cash	Attract and retain highly talented individuals
Short-Term Incentives	Cash-based performance awards	Reward for corporate and individual performance
Long-Term Incentives	Restricted awards with vesting period	Align the interests of our employees and shareholders by providing employees with incentive to perform technically and financially in a manner that promotes share price appreciation
Other Benefits	401(k) matching plans and employee health benefit plans	Provide benefits that promote employee health and support employees in attaining financial security

We do not presently and have not in the past used any of the following types of executive compensation:

- defined benefit pension plans;
- employee stock purchase/ownership plans; or
- supplemental executive retirement plans/benefits (other than a Non-qualified Deferred Compensation Plan to which the Company has not contributed).

Assistance Provided to the Committee

The Committee makes all compensation decisions regarding our executive officers. Stephen C. Taylor, our Chief Executive Officer, annually reviews the performance of each of our executive officers (other than the Chief Executive Officer whose performance is reviewed by the Committee) and presents recommendations to the Committee with respect to salary and cash bonus percentage adjustments and restricted stock grants for our executives (other than the Chief Executive Officer whose salary, cash bonus percentage adjustments and restricted stock grants are determined solely by the Committee). The Committee may exercise its discretion in modifying any recommendations made by our Chief Executive Officer.

The Committee also seeks the input and insight of Mr. Taylor concerning specific factors that Mr. Taylor believes to be appropriate for the Committee's consideration and which the Committee may not be aware of, such as extraordinary efforts or accomplishments of our executive officers. Mr. Taylor also advises the Committee on general topics such as the morale of our executives.

Natural Gas Services Group's accounting department assists the Committee in the compensation process by gathering and organizing data, which is then presented to the Committee by Mr. Taylor for the Committee's review.

Since 2012, our Compensation Committee has engaged an independent compensation consultant, Longnecker & Associates (the "Compensation Consultant"), to obtain objective, expert advice and assist with compensation matters concerning our Chief Executive Officer and Directors. Our Compensation Consultant advised the Compensation Committee on a variety of compensation related issues in 2017 with respect to our Chief Executive Officer, including:

- competitive pay analysis on executive compensation;
- pay levels of the Chief Executive Officer;
- our executive compensation program design, including short-term incentive plan design, long-term incentive plan design, and pay mix; and
- analysis and recommendations concerning peer group companies.

In the course of conducting its activities, our Compensation Consultants communicated with the Compensation Committee and presented its findings and recommendations for discussion. During 2017, our Compensation Consultants also met with our Chief Executive Officer to review its compensation report.

Since its engagement, our Compensation Consultants has not provided any services to the Company, or received any payments from the Company, other than in its capacity as a consultant to the Compensation Committee. The Compensation Committee has assessed whether the services provided by our Compensation Consultants raised any conflicts of interest pursuant to the SEC rules, and has concluded that no such conflicts of interest existed since its engagement and through 2017.

Competitive Pay Analysis

To evaluate the competitiveness of our Chief Executive Officer's base salary, determine total cash compensation (i.e., base salary plus target short-term cash incentive award), long-term incentive awards, and total direct compensation (i.e. base salary, target short-term cash incentive award, and long-term incentive awards), our Compensation Consultants provided the Committee with competitive pay information derived from a custom peer group (the "Custom Peer Group") and referred to a variety of published compensation surveys utilizing companies that operate within the natural gas compression and energy services industries. In connection with compiling the data, our Compensation Consultants report blended data from the Custom Peer Group and the industry-specific published compensation surveys in order to provide the Committee with relevant comparable data.

The companies comprising the Custom Peer Group in our Compensation Consultants' compensation report used in connection with 2017 included:

NGS Custom Peer Group

Company Name	Company Description
Hornbeck Offshore Services	Hornbeck Offshore Services provides offshore marine support and transportation services primarily to companies involved in the offshore exploration and production of oil and natural gas.
Archrock Partners, L.P.	Archrock Partners, L.P. provides natural gas contract compression services to customers in the United States.
Dawson Geophysical Company	Dawson Geophysical Company provides onshore seismic data acquisition and processing services in the United States.
CARBO Ceramics, Inc.	CARBO Ceramics Inc. is a technology and service company that provides engineered oilfield production enhancement, industrial performance enhancement, and environmental protection solutions.
Gulf Island Fabrication, Inc.	Gulf Island Fabrication Inc. fabricates offshore drilling platforms and other specialized structures.
CSI Compressco LP	CSI Compressco LP provides compression services and equipment for natural gas and oil production, gathering, transportation, processing, and storage.
Geospace Technologies Corporation	Geospace Technologies Corporation provides seismic data acquisition products and services to the oil and gas industry.
Key Energy Services, Inc.	Key Energy Services offers onshore energy production services, including drilling and workover rigs, tubing, frac stock and well testing, and fluid services.
RigNet, Inc.	RigNet, Inc. provides remote communications services for the oil and gas industry.
Mitcham Industries, Inc.	Mitcham Industries, Inc., through its subsidiaries, engages in the leasing, sale, and service of geophysical and other equipment to the seismic industry worldwide.
USA Compression Partners, LP	USA Compression Partners, LP provides natural gas compression services under term contracts with customers in the oil and gas industry in the U.S.
Flotek Industries, Inc.	Flotek Industries, Inc. develops and supplies drilling, completion and production technologies and related services to the energy and mining industries in the U.S. and internationally.
TETRA Technologies, Inc.	TETRA Technologies, Inc. operates as a diversified oil and gas services company through four divisions: Fluids, Production Testing, Compression and Offshore.

The Compensation Committee, with the assistance of the Compensation Consultant, reviewed the companies comprising the Custom Peer Group in order to maintain its appropriateness for the competitive pay analysis. These companies were generally selected since they are all companies in the energy and energy services industry and the majority have relatively similar market capitalization. The Compensation Committee believes the Custom Peer Group reflects our current competitors for employee talent and that it provides an appropriate peer set for the purposes of evaluating our pay practices and the Chief Executive Officer's pay levels.

The published compensation surveys consisted of the following 2017 materials:

- Economic Research Institute -- *Executive Compensation Assessor*
- Tower Watson -- *Top Management Compensation*
- Mercer, Inc. -- *US MTCS: Energy Sector*
- WorldatWork -- *Total Salary Increase Budget Survey*
- Salary.com -- *CompAnalyst*

The Compensation Committee used the competitive pay information and surveys as a “market check” to ensure, in its subjective judgment, that the Chief Executive Officer’s base salary, target total cash compensation, long-term incentive awards and total direct compensation remain competitive. The Compensation Committee does not target any individual pay component to fall within a specific range or percentile of the competitive pay information. While the competitive pay information is important to the Compensation Committee’s approval process, it is just one of several factors considered by the Compensation Committee in approving executive compensation and the Compensation Committee has discretion in determining the nature and extent of its use.

Performance Comparison to Peer Group

The table below shows the aggregate one, three and five-year Total Shareholder Return (“TSR”) for the Company as well as the median TSR for the peer group utilized by the Company.

Aggregate Total Shareholder Return

Company/Peer Group	1-year TSR	3-year TSR	5-year TSR
Natural Gas Services Group	(18.5)%	13.7%	59.6%
Median NGS Proxy Custom Peer Group	(29.5)%	(36.1)%	(52.8)%

As the foregoing table indicates, the Company has significantly outperformed its peers in both 2017 and over the past three and five years. Moreover, as the table below indicates, on an annualized basis, the Company has also outpaced its peer group over the same time period.

Annualized Total Shareholder Return

Company/Peer Group	1-year Ann. TSR	3-year Ann. TSR	5-year Ann. TSR
Natural Gas Services Group	(18.5)%	4.4%	9.8%
Median NGS Proxy Custom Peer Group	(29.5)%	(13.9)%	(14.2)%

Disagreement with Institutional Proxy Advisors on our Custom Peer Group

The Company believes that it has received lower than expected support of its executive compensation structure because of the reports of certain proxy advisory firms which advise institutional investors on voting on annual proxy matters. As noted in Supplemental Proxy Materials submitted by the Company subsequent to the filing of the 2017 Proxy Statement, we believe the reports of certain proxy advisory firms contained factual errors and erroneous assumptions that resulted in misguided conclusions and recommendations.

One example of erroneous data provided by proxy advisory firms relates to the Company’s selection of its peer group. One firm, in its 2016 and 2017 reports, disapproved of the company-selected peer group. However, a review of both the Company peer group and that of the proxy advisory firm suggests the Company’s peer group is more appropriately aligned with the Company and its business than the peer group advocated by the proxy advisory firm.

While the peer group espoused by the proxy advisory firm was apparently selected with a focus on revenue of each enterprise, the Company determined its peer group with more emphasis on market capitalization. In our view, the focus of the proxy advisory firm’s peer group on revenue without regard for market capitalization resulted in inappropriate and punitive comparisons and conclusions with regard to the Company’s compensation program. The reliance on revenue as the key peer group selection is especially specious when the key driver of compensation analytics for proxy advisory firms is Total Shareholder Return. Revenue is not a universal predictor of corporate profitability and, may have a weak relationship to overall shareholder returns, especially in a cyclical industry such as ours where margin volatility may result in a combination of higher revenues, lower profits

and a decline in TSR. As a result, the Company will continue to rely on market capitalization as a primary variable for determining peer group members.

Moreover, we believe the proxy advisory firm's peer group has additional limitations and liabilities and contained a disparate set of companies that has little relevance to the Company's business:

- Only half of the companies in the proxy advisory firm's peer group are in the business of providing equipment and services to the oil and gas business, consistent with the GICS code of the Company.
- The proxy advisory firm did not choose any oilfield compression companies for its peer group -- our primary business.
- Seven companies (50%) in the proxy advisory firm's selected peer group were exploration and production companies. These companies are our potential customers (not peers), have different financial measurement metrics and disparate shareholder expectations than peer companies engaged in oilfield service and industrial enterprises.

The proxy advisory firm's peer group contained companies that have no connection whatsoever to the Company's business, were grossly undersized relative to the Company and exhibited unique financial and structural attributes, including bankruptcy, delisting notices and closely-held ownership, that made those companies inappropriate peers for the Company.

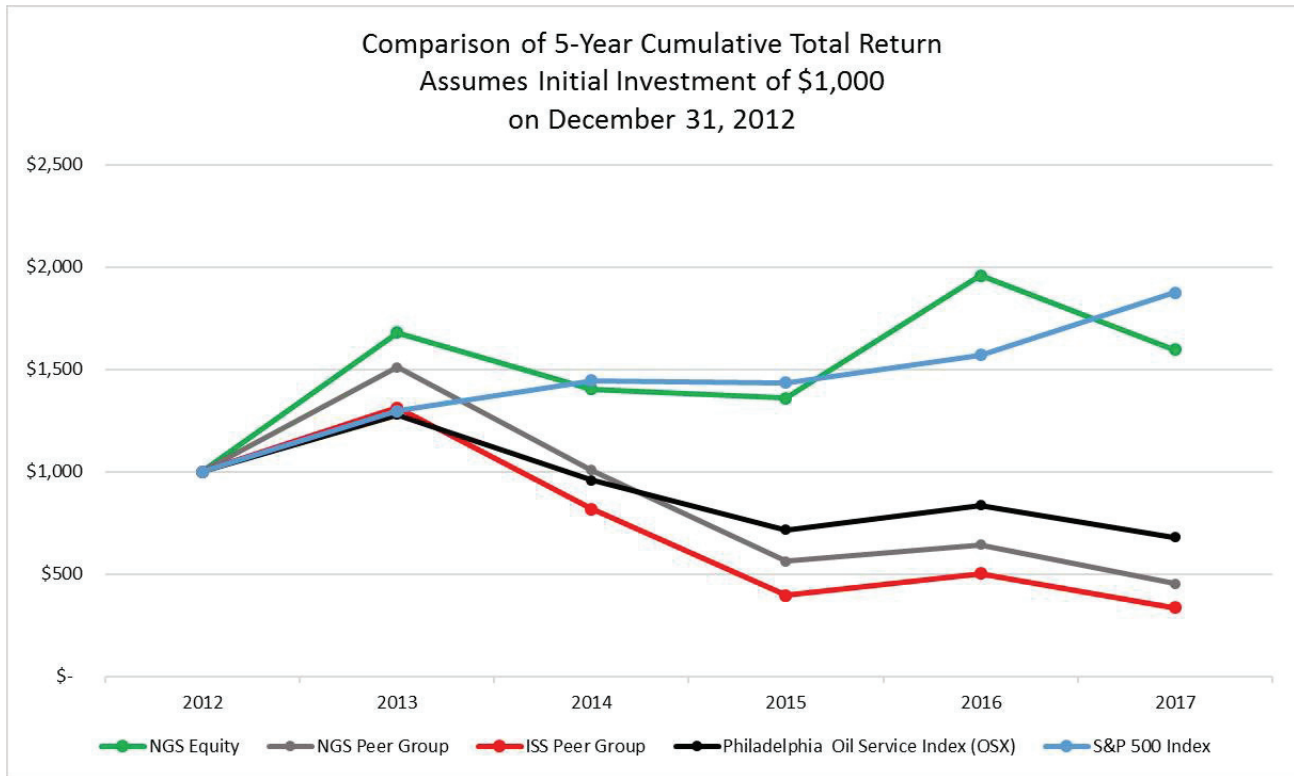
In contrast, the peer group assembled by the Company had the following attributes:

- Twelve of the thirteen companies comprising the Company's peer group are in the business of providing equipment and services to the oil and gas business, consistent with the GICS code of the Company.
- The Company included its three primary competitors - companies that provide contract compression equipment and related services - in its peer group.
- One company is a specialty chemicals company with significant presence in the oilfield equipment and services business.

We believe that the Company's peer group provides a much more relevant group of comparable companies than compared to proxy advisory firm's arbitrary peer group.

We also note that the proxy advisory firm's peer groups over the last four years have been subject to above-average churn (changes in the composition of the peer group), a concept of which the proxy advisory firm is critical when analyzing company-generated peer groups. The proxy advisory firm removed seven companies from its Company peer group between its 2014 and 2015 proxy analysis reports and removed five peers from its 2015 peer group when compared to the analytical report released in June 2016. Furthermore, the proxy advisory firm removed eight companies from its 2016 peer group compared to the most recent analytical report filed in June 2017, the highest year-to-year peer group churn the Company has seen from the proxy advisory firm.

As indicated in a review of previous proxy advisory firm peer group analysis, we posit that if issuers like NGS had similar turnover in their peer groups, the proxy advisory firm would be likely to criticize the churn as excessive and done in an attempt to create artificial comparable compensation metrics that would benefit company's executives without regard for shareholder benefits.



The chart above graphically describes the relative performance of NGS common stock over the past five years when compared to key benchmarks: the S&P 500 Index, the Philadelphia Oil Services Index, the Company’s current peer group and the most recent peer group selected by a leading proxy advisory firm.

The Compensation Committee and Board believes these data show: (1) the Company’s compensation plan has provided incentives for the leadership team to maximize both short- and long-term shareholder value; (2) regardless of the peer group used, NGS has meaningfully outperformed the identified peers; and (3) the NGS-selected peer group is more representative of the Company’s industry peers than that of the proxy advisory firm as evidenced by the similar performance of the NGS peer group and the Philadelphia Oil Services Index, the leading performance benchmark for our industry. Moreover, the Company-identified peer group provides a more appropriate “hurdle rate” for relative shareholder return than the proxy advisory firm peer group, a tenet the Company believes is key to the rigor of the Company’s analysis in contrast to that of the proxy advisory firms.

In short, over the past five years, the Company’s compensation program has resulted in management decisions and leadership that have provided NGS shareholders with consistent, industry-leading returns and has created an environment for similar opportunities into the future.

In summary, we believe greater weight should be given the Company-selected peer group, especially given the deficiencies found in this proxy advisory firm’s peer group, which include:

- The proxy advisory firm’s peer groups rely on revenue comparisons rather than market capitalization, which is more closely correlated with Total Shareholder Return;
- The proxy advisory firm’s peer groups include numerous companies in unrelated or non-comparable businesses and excludes any companies operating in the compressor business; and
- The proxy advisory firm’s peer groups are characterized by excessive year-to-year churn.

Emphasis on the integrity of the peer group is important as subsequent comparisons in the proxy advisors’ reports stem from the selection of the peer group. If the methodology for the selection of the peer group is flawed, conclusions drawn from such peer group could be incorrect.

Individual and Company Performance - Base Salary and Equity Awards

The Compensation Committee also evaluates compensation, particularly base salary levels and equity awards (restricted stock awards), through an analysis of each executive officer's individual performance and the overall performance of the Company, our goal being to strengthen the link between what we pay our executives and the performance of the Company. Factors the Committee considers in our analysis include:

- The individual performance, leadership, business knowledge and level of responsibility of our officers;
- The particular skill-set and longevity of service of the officer;
- The effectiveness of the officer in implementing our overall strategy; and
- The general financial performance and health of the Company.

Specific Company Financial Metrics - Cash Bonuses

With respect to compensation we pay in the form of cash bonuses, the Committee sets performance levels for three specific Company financial metrics. The Committee relies on whether these levels are achieved and the individual performance of our executive officers to determine whether cash bonuses are awarded and the amounts of such bonuses. The three financial metrics the Committee considers are:

- Total revenues;
- Adjusted EBITDA; and
- Adjusted net income before taxes.

Adjusted EBITDA is calculated from our audited financial statements by adding to net income, or loss, (1) amortization and depreciation expense, (2) interest expense, (3) provision for income tax expense and (4) loss on retirement of rental equipment.

Adjusted net income reflects net income before the income tax effects of the 2017 Tax Act.

We believe that our core executive compensation mix of base salary, cash bonuses and equity awards, while fairly limited, presently provides enough diversity for us to link executive compensation to our short-term and long-term objectives. For instance, annual income, while equity awards are more closely linked to the long-term objectives of earnings per share and increased market value of our common stock.

Base Salary

We provide our executive officers and other employees with base salary to compensate them for services rendered during the fiscal year. Each year the Committee receives base salary recommendations from our Chief Executive Officer for all of our executive officers (other than our Chief Executive Officer whose base salary is evaluated by the Committee on an annual basis).

In January 2017, the Compensation Committee reviewed the 2016 performance of our Chief Executive Officer, Stephen C. Taylor, along with the competitive pay information provided in the Compensation Consultant's report, in setting Mr. Taylor's base salary for 2017. In 2017 Mr. Taylor's base salary was in the 52nd percentile of the Company's peer group according to data compiled by the Company's Compensation Consultants. In connection with that review, the Committee modestly increased the base salary of Mr. Taylor from \$560,000 in 2016 to \$576,800, for 2017, an increase of approximately 3%. The increase was made in recognition of Mr. Taylor's leadership and contributions to the Company's strong 2016 financial and operational results, which included:

- Increasing cash and cash equivalents (balance sheet) from \$35.5 million in 2015 to \$64.1 million in 2016.
- Maintaining debt at a continuing, very low level (less than \$500k).
- Maintaining the Current (Quick) Ratio (Current Assets/Current Liabilities, a measure of liquidity) in a range from 15-16 in the 2015 to 2016 period. This is an important metric for shareholders in an environment when liquidity tends to decrease (often severely).

- Decreased capital expenditures from \$12.5 million in 2015 to \$4.3 million in 2016. A 66% reduction in capital expenditures in 2016 demonstrates the immediate response the Company made to the deteriorating environment.
- Continued self-funded growth capital expenditures totaling in excess of \$196 million since 2010.
- Operating cash flow as a percentage of revenue was 46% in 2016 an increase from 2015's 43%. This means that of every dollar in revenue we turned 46 cents in 2016 of it into real spendable cash.
- Free cash flow as a percentage of revenue was up to 39.7% in 2016 compared to 30.3% in 2015 and (19.4%) in 2014 and compared to the S&P500 at 9%.
- Free cash flow (cash remaining after funding the Company's capital expenditures) remained healthy at \$28.5 million in 2016.
- Maintained Adjusted EBITDA at 43-44% of revenue in both years (2016/2015).
- Increased gross margins in our core rental business from 60% average in 2014 to 62% in 2015 to 64% in 2016 notwithstanding the difficult and depressed industry cycle.
- Our SG&A expenses as a percent of total revenue remained relatively steady notwithstanding the significant drop in revenue due to the challenging industry cycle.
- For the year 2016 NGS common public stock price increased by 44.2%, while the median increase for identified public peers increased 14%, the OSX index increased 16.5%, price of West Texas Intermediate crude oil increased 44.8%, while the average US land rig count decreased 48.0%.

With respect to our other two named executive officers other than our CEO, James Hazlett, our Vice President of Technical Services, base salary for 2017 was \$212,180 compared to \$206,000 for 2016. The base salary of G. Larry Lawrence, our Vice President and Chief Financial Officer, for 2017, was \$198,380 compared to \$192,600 for 2016. We continue, as we have in the past, to rely on their contributions to the above noted performance items and the following factors in evaluating and determining the amount of compensation we pay these executives:

- our general knowledge of executive compensation levels in the natural gas compression industry and similarly sized energy service companies;
- each executive's individual performance and the overall performance of the Company; and
- specific Company financial metrics and the application of specific weights to such metrics.

The applicability of these factors varies depending on the type of compensation being evaluated and determined. For instance, we do not rely on weighted company financial metrics to evaluate and determine base salary levels, but such factor is the primary means through which we evaluate and determine the amount of the cash bonuses we award to our executives. Below is a more detailed discussion of how these factors apply to the different types of compensation we utilize.

Short-Term Incentives - Annual Incentive Bonus Plan

In 2006, the Committee adopted an Annual Incentive Bonus Plan or, the "IBP," that provides guidelines for the calculation of annual non-equity incentive based compensation in the form of cash bonuses to our executives, subject to Committee oversight and modification. The bonuses awarded under the IBP are short-term awards in recognition of the overall performance and efforts made by our executives during a particular year. Each year, the Committee approves the group of executives eligible to participate in the IBP and establishes target award opportunities for such executives. For 2017, the Committee maintained Mr. Taylor's target award opportunity at 100% of his base salary. Target award opportunity was 50% of average base salary for Messrs. Lawrence and Hazlett.

In 2017, 90% of an executive officer's IBP award was based on achievement of company financial objectives relating to:

- Total revenues;
- Adjusted EBITDA; and
- Adjusted net income before taxes.

Each of these three components accounts for 30% of the total company financial objective portion of the IBP. The remaining 10% of an executive officer's IBP award is based upon individual performance as evaluated by our CEO (except with respect to our CEO whose individual performance is evaluated by the Committee).

Over the past five years, the Company has awarded executives full incentives in three years in which the Company met or exceeded its targets objectives. In the other two years, performance incentives were awarded at lower levels as the target payout metrics set by the Board were not fully met, an indication of the rigor the Board has used in setting performance targets and assessing managerial performance. In 2017 our executives did not receive any of their target payout because they did not attain the aggressive annual performance measures set by the Board, even though the Company demonstrated positive results and maintained the stable financial and operational highlights as discussed in our Fiscal year 2017 performances on page 21.

Each year, the Committee sets three performance levels for each component of the company financial objective portion of the IBP. The payment of awards under the IBP is based upon whether these performance levels are achieved for the year. Payout on each of the three financial objectives is as follows:

75% of the bonus amount attributable to a financial component will be paid if we achieve the "threshold" amount;

100% of the bonus amount attributable to a financial component will be paid if we achieve the "target" amount;
and

125% of the bonus amount attributable to a financial component will be paid if we achieve the "stretch" amount.

The following table sets forth the bonus financial criteria and the performance levels set by the Committee and the resulting bonus payout percentages in 2017:

2017 Annual Incentive Bonus Plan

2017 Executive Bonus Criteria ⁽¹⁾	Revenue	Adjusted Net Inc. before Taxes ⁽²⁾	Adjusted EBITDA ⁽³⁾
Threshold achievement pays 75% of bonus	\$ 74,975,142	\$ 8,341,410	\$ 30,014,410
Target achievement pays 100% of bonus	\$ 76,518,520	\$ 8,910,937	\$ 30,917,937
Stretch achievement pays 125% of bonus	\$ 78,241,007	\$ 9,785,148	\$ 32,142,148

- (1) The three financial criteria were based on operating performance without giving effect to an inventory write-off taken in 2017.
- (2) Adjusted net income reflects net income before the income tax effects of the 2017 Tax Act.
- (3) Adjusted EBITDA is defined as the Company's earnings before interest, income taxes, depreciation and amortization and, loss on retirement of rental equipment and is an indicator of operating performance.

The following table sets forth the maximum bonus eligibility set by the Committee for 2017 for each of our named executive officers, and based upon the payout percentages noted in the table above, the bonus payout amount earned by each named executive for 2017 under our Annual Incentive Bonus Plan:

Criteria	Actual 2017 Performance ⁽¹⁾	Target Metric	Eligible Bonus Payment Percentage	Bonus Component	Payable Bonus
Revenue	\$ 67,693,388	\$76,518,520	—%	30%	—%
Adjusted Net Inc before Taxes ⁽²⁾	\$ 1,876,499	\$ 8,910,937	—%	30%	—%
Adjusted EBITDA ⁽³⁾	\$ 23,192,616	\$ 30,971,937	—%	30%	—%
Personal Performance			100%	10%	10%
Total					10%

- (1) The three financial criteria and 2017 performance were based on operating performance without giving effect to an inventory write off taken in 2017.
- (2) Adjusted net income reflects net income before the income tax effects of the 2017 Tax Act.
- (3) Adjusted EBITDA is defined as the Company's earnings before interest, income taxes, depreciation and amortization and, loss on retirement of rental equipment and is an indicator of operating performance.

The following table sets forth the maximum bonus eligibility set by the Committee for 2017 for each of our named executive officers, and based upon the payout percentages noted in the table above, the bonus payout amount earned by each named executive for 2017 under our Annual Incentive Bonus Plan:

Name	Title	Base Salary	Max Bonus Eligibility	Bonus Base	Bonus Payout %	Bonus Payouts
Stephen C. Taylor	President & CEO	\$ 576,800	100%	\$ 576,800	10%	\$ 57,680
G. Larry Lawrence	VP and CFO	\$ 198,380	50%	\$ 99,190	10%	\$ 9,919
James R. Hazlett	VP- Technical Services	\$ 212,180	50%	\$ 106,090	10%	\$ 10,609

As noted in the tables above, actual financial performance for 2017 failed to meet any of the “threshold” performance levels, thereby entitling no bonus payout for any of the three financial metrics.

With respect to the personal performance criteria, the Committee awarded Messrs. Taylor, Lawrence and Hazlett the maximum amount payable under this component, or 10% of the maximum bonus amount that could have been earned in 2017. In addition to the Committee's non-quantitative evaluation of each executive's performance, with respect to all of the named executives, the Committee made this award in recognition of the Company's achievements during a difficult industry-wide slump which were summarized at the beginning of this compensation, discussion and analysis section.

With respect to Mr. Taylor's personal performance criteria, the Committee based its full award on his success in positioning the Company in counter-cyclical mode that enabled the Company to remain debt-free and build its cash balances during a period of unprecedented market deterioration, continuing to post positive GAAP earnings in an environment where the vast majority of the Company's peers and the energy services industry posted significant losses and his ability to reduce capital expenditures by approximately 95% between 2014 and 2016 in a most challenging operating environment, taking advantage of the Company's emphasis on large-horsepower equipment. Additionally, Mr. Taylor recognized the need to move the Company into the large-horsepower rental gas compression market segment; which the Company entered in 2017.

With respect to Mr. Lawrence's personal performance criteria, the Committee based its full award on his success in oversight of the Information Technology department with particular emphasis on the Company's exposure to cyber-threats, managing the migration of the Company's e-mail infrastructure from a local solution to a cloud-based system, managing the cost aspect of the construction of the new headquarters building and maintaining general and administrative expenses at an efficient

level.

With respect to Mr. Hazlett's personal performance criteria, the Committee based its full award on his leading the design and manufacturing efforts for our new larger 1300 horsepower compressor packages, developing a unique and efficient computer-controlled gas cooling system for our fleet rental units and efficiently managing the low level of activity in our compressor fabrication facilities.

Also see "Other Compensation" on page 34 for additional information regarding cash bonus payments.

Long-Term Incentives - Restricted Stock/Unit Awards

The Compensation Committee continually reviews equity compensation trends of public companies and solicits feedback from its stakeholders and proxy advisors to determine the most appropriate executive compensation program for the Company's executives, as well as its stakeholders. When reviewing the Company's long-term incentive plan, the Compensation Committee considered a variety of factors when determining the appropriateness of the plan, which include:

- Address proxy advisory firms' concerns related to the performance measurement period;
- Address the proxy advisor firms' criticism of a perceived lack of rigor related to the TSR target goal;
- Address the issue of balance between time-based and performance-based long-term compensation;
- Acknowledge the Company's belief that balancing short-term performance - demonstrating the agility of the leadership team - with long-term performance - demonstrating the ability of the leadership team to create durable value - is important in compensation awards, especially in cyclical industries;
- Acknowledge the importance of the Compensation Committee's judgment and board discretion in designing compensation programs that retain and motivate critical leadership that have provided positive returns to shareholders across cycles; and
- Address concerns over the salary multiplier from the previous long-term incentive plan.

Based upon this review, the Compensation Committee determined it was appropriate to adjust the long-term incentive award for 2017 to provide a balance between a quantitative, performance-based award and a qualitative, discretionary award based on performance measures evaluated annually by the Compensation Committee and Board of Directors, a practice consistent with the Company's peers and, more generally, other oilfield services companies.

The performance-based award was based off the Company's relative prior three-year total shareholder return ("TSR") compared to the company-defined peer group. The Compensation Committee established the following award parameters based on the company's relative TSR performance.

The award is determined by the Company's ranking on the peer-based table below:

Total Shareholder Return: Long-Term Incentive Award Table

Relative TSR Performance Rank	Payout vs. Target	Award Payout
1	200%	Maximum
2	190%	
3	172%	
4	154%	
5	136%	
6	118%	
7	100%	Target
8	75%	
9	50%	
10	25%	Threshold
11	—%	
12	—%	
13	—%	
14	—%	

The qualitative, discretionary award was set to a maximum of 200% of the base pay of the named executive officer and will vest in equal parts over a three-year period. Performance measures taken into account include those provided in the *2017 Financial and Operational Highlights* section of this Proxy as well as other personal achievements of the respective executive officers.

The Compensation Committee considers restricted stock and restricted stock units to be a type of long-term incentive compensation that motivates our executive officers to work toward our long-term growth and allows them to participate in the growth and profitability of the Company. We believe that restricted stock aligns the interests of our executive officers with our shareholders in that our executive officers will benefit to the extent that the value of our common stock increases. With the exception of Mr. Taylor, our Chief Executive Officer, the number of shares of restricted stock granted to an executive officer is based on a discretionary determination of an officer's individual performance and his current contributions and potential for future contributions to the overall performance of the Company.

In early 2018, the Compensation Committee reviewed the Company's 2017 TSR performance against its peers and determined that the Company's prior three-year performance was second out of the Company identified 14-member peer group (including Natural Gas Services Group). Such performance, as noted in the accompanying table, entitled Mr. Taylor to a TSR performance-based award of 190% of his current base salary of \$594,100.

In addition, the Compensation Committee, after a review of all relevant Company and personal performance factors, agreed to provide Mr. Taylor an additional discretionary award equal to 160% of his current base salary (out of a maximum possible award of 200% of his current base salary).

As a result of these grants and as noted in the table below, on March 15, 2018, Mr. Taylor was awarded 84,700 shares of restricted common stock under our 2009 Restricted Stock/Unit Plan, as amended, based on the closing price of \$24.55 per share as of March 15, 2018, subject to a three-year schedule whereby the award will vest in one-third tranches beginning on the first anniversary of the grant date. In addition, two other executive officers were awarded discretionary grants as noted in the accompanying table.

Name	Dollar Value of the Award	Number of Restricted Shares
Stephen C. Taylor, CEO and President	\$ 2,079,385	84,700
G. Larry Lawrence, Chief Financial Officer	\$ 491,000	20,000
James R. Hazlett, Vice President - Technical Services	\$ 491,000	20,000

All of the restricted stock awards reported in the table above are subject to a three-year vesting period, although such vesting is subject to acceleration and will immediately vest in the case of (i) death, or disability of the recipient employee or (ii) certain circumstances in connection with a change of control in the Company. Further information concerning these awards is set forth in column (i) of the "Summary Compensation Table" on page 38 and column (i) of the "Grants of Plan-Based Awards for Fiscal 2017" on page 39.

The Compensation Committee continuously evaluates the Company's executive compensation plan to ensure that the each of the components of that plan is designed, when considered both individually and holistically, with the goal of attracting and retaining executive leadership capable of delivering industry leading results for shareholders. This review, with the assistance of Board-retained executive compensation experts, includes reviewing peer-group compensation programs, broader industry compensation trends, innovations in executive compensation design as well as seeking input from our shareholders and other stakeholders.

The Compensation Committee notes that there has been significant evolution in executive compensation plan design in the past several years including changes in standard performance measures and measurement periods. The Company's Compensation Committee will continue to consider changes to industry executive compensation practices as it contemplates future changes to the Company's executive compensation program.

Other Compensation

In addition to the cash payments described in this Compensation, Discussion and Analysis section, we made additional bonus cash payments to our executive officers as follows: Taylor -- \$86,250; Hazlett -- \$42,436; Lawrence -- \$39,676. We made these additional cash payments in recognition of our executive management (i) maintaining outstanding liquidity, cash flow and minimal long-term debt during a difficult economic times for the oil and gas industry in general, and for oil and gas service companies in particular; (ii) swiftly taking advantage of market opportunities by moving into the large horsepower compression market; (iii) guiding and managing the process of the ongoing construction of the Company's new office headquarters to protect against growth constraints and exorbitant rental rates; (iv) retaining skilled employees during the difficult industry-wide downturn; (v) providing superior budgeting, marketing and operational expertise with a small and streamlined staff of executive officers.

We maintain a 401(k) retirement plan in which all of our executives and employees are eligible to participate. We match executive and employee contributions to our 401(k) plan, on an equal percentage basis, with cash contributions. The Company matching portion is equal to one-half of the employee's annual contribution up to a maximum of 3% of the employee's salary. Our matching amounts for our executive officers are included in column (i) of the "Summary Compensation Table" on page 38.

We also maintain an unfunded, nonqualified deferred compensation plan (the "Deferred Compensation Plan"). Our executive officers and directors are eligible to participate at their election. The Deferred Compensation Plan provides the ability to defer receipt of income, including shares, to a later date, which may be an attractive tax planning opportunity. We generally do not contribute to the Deferred Compensation Plan on behalf of the participants; therefore, our cost to maintain the Deferred Compensation Plan is limited to administration expenses, which are minimal.

Total Direct Compensation

Among its peer group companies, the total shareholder return from NGS was in the 69th percentile in 2017, 88th percentile over the past three years and the 100th percentile (top of peer group) over the past five years. Our Chief Executive Officer's base compensation was in the 50th to 55th percentile among his peers in 2017 and his total compensation was in the 50th to 60th percentile. With base salary being in the median range, the Committee thinks it appropriate that his short-term and long-term incentives be designed and awarded to reflect the value delivered to the Company's shareholders. Significantly, the total compensation paid to our Chief Executive Officer over the one-year or the three-year or the five-year periods ranked lower in compensation paid than the performance achieved on a percentile basis. This demonstrates the Committee's stewardship when aligning executive pay with shareholder benefit.

Employment Agreements

We employed Mr. Taylor in January 2005. On October 23, 2013, we entered into a new written employment agreement with Stephen C. Taylor, our President and Chief Executive Officer. We do not have written employment agreements with any of our other executive officers. On April 24, 2015, we entered into an amendment with Mr. Taylor to his Employment Agreement pursuant to which the "modified single trigger" change of control provision was changed to a "double trigger" change of control. Under the "modified single trigger provision", Mr. Taylor could voluntarily terminate the Employment Agreement for any reason immediately upon a change in control and collect severance benefits. Under the new "double trigger" change of control provision, a change of control must occur followed by the Company or its successor terminating Mr. Taylor's employment other than for cause, death, or disability, or by Mr. Taylor terminating his employment for Good Reason. See "*Compensation Agreements with Management*" beginning on page 48 of this Proxy Statement for detailed information concerning Mr. Taylor's employment agreement, as amended.

Allocation of Amounts and Types of Compensation

Other than the restricted stock awards we grant to our executives from time to time and the determinations made by the Committee as to specific target award opportunities under our IBP, the allocation of different amounts and types of compensation has not been a consideration for us. The Committee has not adopted a specific policy or target for the allocation between amounts or types of compensation. We believe that the use of stock awards in our compensation package will align the interests of our management and employees with our shareholders. Notwithstanding moderately increasing the use of stock-based compensation, we intend to maintain and continue our practice of having a simplified, but effective and competitive, compensation package.

Change of Control and Severance Arrangements

Our 1998 Stock Option Plan, as amended, and our 2009 Restricted Stock/Unit Plan contains change of control provisions. In addition, Mr. Taylor's employment agreement contains change of control and severance provisions. Information regarding these provisions is provided under the caption "Potential Payments Upon Termination or Change of Control" on page 44.

Perquisites

We provide limited perquisites to our executives. The primary perquisites allow our executives a choice of receiving an automobile allowance or personal use of a company-provided automobile. Although we provide Mr. Taylor with Midland Petroleum Club membership, since his use of the club is limited solely for business entertainment, we have not considered it to be a perquisite and have not valued it as such for inclusion in column (i) of the Summary Compensation Table on page 38.

Our executives also participate in the same medical, dental and life insurance plans as other employees. However, we pay a greater percentage of the premiums for health insurance for our executives than we do for our other employees.

Tax Deductibility of Executive Compensation

Section 162(m) of the Internal Revenue Code denies a deduction to any publicly held corporation for compensation paid to each of our named executive officers in a taxable year to the extent that compensation exceeds \$1,000,000 for a covered employee.

Effective for taxable years beginning prior to January 1, 2018, an exception to this deduction limit applied to "performance-based compensation", such as equity awards that satisfies certain criteria. Under the federal tax reform legislation signed into law on December 22, 2017, the performance-based pay exception to Section 162(m) was eliminated, but a transition rule may allow the exception to continue to apply to certain performance-based compensation payable under written binding contracts that were in effect on November 2, 2017.

The Compensation Committee intends to consider the potential impact of Section 162(m) on compensation decisions, but the Committee may continue to structure our executive compensation program to accomplish business objectives that it believes are in our best interests and those of our stockholders, even though doing so may reduce the amount of our tax deduction for such compensation.

Say-on-Pay

At our 2017 Annual Meeting of Shareholders held in June 2017, we submitted a proposal to our shareholders regarding our executive compensation practices. The proposal was an advisory vote on the 2016 compensation awarded to our named executive officers (commonly known as a “say-on-pay” vote). Our shareholders approved our 2016 compensation with approximately 68% of the votes cast on the proposal voting in favor of our 2016 executive compensation practices. This represented an increase of approximately 3% from the say-on-pay vote in 2016.

While the increasing results for the past two years have been encouraging, we are still disappointed since we believe many of the disapproval votes have been the result of the influence of recommendations of certain proxy advisory firms, both of which advise institutional investors on voting on annual proxy matters. We believe the reports of certain proxy advisory firms contained factual errors and erroneous assumptions that resulted in misguided conclusions and recommendations. In June 2017 we sent a letter to these proxy advisory firms which detailed our concerns and issues with these reports. We also sent our shareholders a copy of these letters and filed our correspondence with the Securities and Exchange Commission on June 12, 2017. You can access this filing free of charge on the Investor Relations section of our website (www.ngsgi.com). A paper copy is also available, without charge upon written request, at Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701.

Notwithstanding, we have taken numerous remedial measures over the past three years, including:

- adopting a clawback policy that covers all executive officers;
- adopting executive and director stock ownership guidelines;
- extending the vesting terms on restricted stock awards made to our executive officers to three years;
- calculating a portion of our CEO’s long-term equity award to meeting set objective total shareholder returns compared to our Custom Peer Group;
- adopting a majority votes cast requirement with respect to the election of directors; and
- amending our Corporate Governance Guidelines to include a lead independent director. Charles Curtis, our longest tenured independent director, has been appointed as our lead director.

Corporate Governance Policies

To ensure our compensation programs are aligned with the long-term interest of our shareholders, we have adopted several governance policies that we expect our executive officers to comply with, including meaningful stock ownership guidelines, a pledging and hedging policy and a recapture or “clawback” policy that provides for the recoupment of any performance-based payouts made based on financial results that are not in compliance with any financial reporting requirement that requires restatement of the Company’s financial statements.

Compensation Clawback Policy

The Company has adopted a compensation recoupment, or “clawback” policy intended to be consistent with the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). This policy provides that, in the event we are required to restate our financial statements as a result of “material noncompliance” with financial reporting requirements under the securities laws, we will recover from our current and former executive officers any incentive-based compensation (including equity awards) that is (i) based on material erroneous data, (ii) received during the three-year period preceding the date on which the Company becomes required to prepare an accounting restatement, and (iii) in excess of what would have been paid if calculated under the restatement. In addition, the Dodd-Frank Act requires the SEC to issue regulations requiring issuers to seek recovery from executive officers in certain circumstances involving financial restatements. The SEC has issued proposed regulations implementing this portion of the Dodd-Frank Act. Once the SEC finalizes its regulations regarding the required form of a clawback policy under the Dodd-Frank Act, we expect to amend our clawback policy accordingly.

Pledging and Hedging Policy

The Company considers it improper and inappropriate for any director, executive officer or associate to engage in short-term or speculative transactions involving our Common Stock. We therefore prohibit directors, executive officers and other associates from engaging in pledging, short sales or other short position transactions in our Common Stock. We also strongly discourage directors, executive officers and other associates from engaging in certain forms of hedging or monetization transactions.

Director and Executive Officer Stock Ownership Guidelines

The Company has stock ownership requirements for its directors and executive officers. The purpose of the ownership requirements is to further our goal of increasing stockholder value and to further align the interests of our directors and key executives with the interests of our shareholders. Satisfaction of the policy requires that individuals attain and retain holdings of our common stock with a market value equal to the following multiple of the individual's compensation, defined as either a director's cash retainer fee or an officer's base salary. Shares that count toward the minimum share ownership include: shares owned outright or beneficially owned; vested restricted stock; vested restricted stock units in our Deferred Compensation Plan; and shares issued from the exercise of vested options.

The table below indicates the stock ownership guidelines for our executive officers and Board members:

Stock Ownership Guideline

Executive Officer/Director	(as a multiple of base salary/annual cash retainer)
CEO	3 times Base Salary
All other executive officers	2 times Base Salary
Non-employee Directors	1 times Base Annual Cash Retainer

Each person's stock ownership requirement will be adjusted annually each January 1 to reflect any changes in his or her retainer or base salary. Generally, individuals have a five-year period to attain their stock ownership requirements. At any time at which the individual's stock ownership requirement has not been met, including during the initial five-year period to attain compliance, the individual will be required to retain at least 50% of "Net Shares" received upon vesting of restricted stock, restricted stock units and performance units. "Net Shares" are defined to include shares of common stock that are owned by the individual after shares are sold, swapped or traded to pay applicable withholding taxes. Subsequent to achieving the initial stock ownership requirement, all directors and executives are required to continuously maintain stock ownership at their specified levels.

If an individual does not meet the applicable ownership requirements, then he or she is subject to certain restrictions upon the vesting of equity awards, and may only dispose of shares for particular reasons set forth in the policy. The policy provides a hardship exemption, for which an individual must submit a request to the corporate governance committee. Presently, all of our directors and our executive officers have attained or exceeded their ownership requirements.

Compensation Committee Report

The Committee has reviewed and discussed the Compensation Discussion and Analysis with management. Based on its review and discussions, the Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in our proxy statement for the 2018 Annual Meeting of Shareholders.

Members of the Compensation Committee

William F. Hughes, Jr. (Chairman)
John W. Chisholm
David L. Bradshaw

The table below sets forth the compensation earned by, and paid to our CEO, Stephen C. Taylor, and our other named executive officers for services rendered to us for the fiscal years ended December 31, 2017, 2016 and 2015.

Summary Compensation Table

Name and Principal Position	Year	Salary ⁽¹⁾	Bonus ⁽²⁾	Stock Awards ⁽³⁾	Option Awards ⁽⁴⁾	Non-Equity Incentive Plan Compensation ⁽⁵⁾	Change in Pension Value and Nonqualified Deferred Compensation Earnings ⁽⁶⁾	All Other Compensation ⁽⁷⁾	Total
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Stephen C. Taylor, Chairman, President & CEO	2017	\$ 574,215	\$ 4,090	\$ 2,079,385	\$ —	\$ 144,200	\$ —	\$ 15,246	\$ 2,817,136
	2016	559,349	8,285	2,018,794	—	392,000	—	15,053	2,993,481
	2015	561,036	6,646	1,679,999	—	665,252	—	14,264	2,927,197
G. Larry Lawrence, Chief Financial Officer	2017	198,158	1,407	491,000	—	49,595	—	16,450	756,610
	2016	192,600	2,849	501,000	—	67,410	—	16,284	780,143
	2015	193,754	2,289	407,800	—	114,538	—	16,722	735,103
James R. Hazlett, Vice President, Technical Services	2017	211,942	1,505	491,000	—	53,045	—	36,880	794,372
	2016	206,000	3,048	501,000	—	72,100	—	34,737	816,885
	2015	207,539	2,448	407,800	—	122,500	—	31,619	771,906

- (1) The amounts in column (c) includes amounts deferred under our Deferred Compensation Plan and 401(k) Plan.
- (2) The amounts reflected in column (d) reflect payments under the company's profit sharing program administered to all employees.
- (3) The amounts in column (e) reflect the grant date fair value of stock granted under our 2009 Restricted Stock/Unit Plan.
- (4) The amounts in column (f) reflect the dollar amounts recognized for financial statement reporting purposes for the fiscal years ended December 31, 2017, 2016 and 2015, in accordance with FASB ASC Topic 718, associated with stock option grants under our Stock Option Plan. Assumptions used to calculate these amounts are included in footnote 10 of our audited consolidated financial statements for the fiscal year ended December 31, 2017; footnote 10 of our audited financial statement for fiscal year ended December 31, 2016; and footnote 9 of our audited financial statement for fiscal year ended December 31, 2015.
- (5) The amounts in column (g) reflect the cash bonus awards to the named executive officers under our Annual Incentive Bonus Plan, including amounts deferred under our Deferred Compensation Plan. This is discussed in further detail on page 29 under the caption "Short-Term Incentives - Annual Incentive Bonus Plan."
- (6) The Deferred Compensation Plan (h) does not pay above-market or preferential earnings.

- (7) The amounts shown in column (i) include matching contributions made by Natural Gas Services Group to each named executive officer under our 401(k) plan and the aggregate incremental cost to Natural Gas Services Group of perquisites provided to our named executive officers as follows:

Name	Year	Automobile Allowance	Personal Use of Company Provided Automobiles	Additional Incremental Portion of Health Insurance Premiums Paid for Officers Only	401(k) Plan	Total
Stephen C. Taylor	2017	\$ —	\$ 1,800	\$ 7,944	\$ 5,502	\$ 15,246
	2016	—	1,800	7,686	5,567	15,053
	2015	—	1,800	6,912	5,552	14,264
G. Larry Lawrence	2017	10,200	—	—	6,250	16,450
	2016	10,200	—	—	6,084	16,284
	2015	10,592	—	—	6,130	16,722
James R. Hazlett	2017	10,200	—	20,016	6,664	36,880
	2016	10,200	—	19,362	5,175	34,737
	2015	10,592	—	17,400	3,627	31,619
Total	2017	20,400	1,800	27,960	18,416	68,576
	2016	20,400	1,800	27,048	16,826	66,074
	2015	21,184	1,800	24,312	15,309	62,605

Grants of Plan Based Awards

The table below sets forth the estimated future payouts under non-equity incentive plan awards and restricted stock awards granted and the grant date fair value of such awards.

Grants of Plan-Based Awards for Fiscal 2017

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards ⁽¹⁾			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#) ⁽²⁾	All Other Option Awards: Number of Securities Underlying Option (#)	Exercise or Base Price of Option Awards (\$/Sh)	Grant Date Fair Value of Stock and Option Awards (\$)
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (#)	Target	Maximum (\$)				
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)
Stephen C. Taylor	3/15/2018	—	—	—	—	—	—	84,700	—	\$ 24.55	\$ 2,079,385
G. Larry Lawrence	3/15/2018	—	—	—	—	—	—	20,000	—	24.55	491,000
James R. Hazlett	3/15/2018	—	—	—	—	—	—	20,000	—	24.55	491,000

- (1) No awards were made under the non-equity Annual Incentive Bonus Plan for 2017 except for the personal performance portion of the Plan. More information regarding the Plan and the calculation of awards is provided below and under the caption “Short-Term Incentives - Annual Incentive Bonus Plan” on page 29.
- (2) The information shown in this column reflects awards of restricted stock or units earned in 2017 (but issued in early 2018) our named executive officers pursuant to our 2009 Restricted Stock/Unit Plan, as amended and restated.

Annual Incentive Bonus Plan

Our Annual Incentive Bonus Plan provides for annual non-equity incentive based compensation in the form of cash bonuses to our executive officers. Our Compensation Committee administers and determines from year to year the executives that are eligible to participate in the Plan. The Committee establishes target award opportunities for the executives eligible to participate in the plan. These target award opportunities are expressed as a percentage of an executive's base salary. An executive's target award opportunity is the maximum cash bonus an executive is eligible to receive in any one year under the Plan.

The Committee establishes annual target levels for Natural Gas Services Group's total revenues, Adjusted EBITDA and adjusted net income before taxes and assigns a weight of 30% to each of these components. The executive's individual performance is assigned a weight of 10%. If during the year, Natural Gas Services Group achieves all of the target levels established by the Committee for total revenues, Adjusted EBITDA and net income before taxes, and it is determined by the Committee that an executive is entitled to the full 10% weight assigned to individual performance, the executive is entitled to receive the maximum cash bonus amount for the executive for that year. If any one of the target levels is not met or it is determined that an executive is not entitled to the full 10% weight assigned to individual performance, the cash bonus award for the executive is reduced accordingly. More information regarding the Plan and the calculation of awards is provided under the caption "Short-Term Incentives - Annual Incentive Bonus Plan" on page 29.

1998 Stock Option Plan

Our 1998 Stock Option Plan, as amended and restated, provides for the issuance of stock options to purchase up to 1,000,000 shares of our common stock. The purpose of this plan is to attract and retain the best available personnel for positions of substantial responsibility and to provide long-term incentives to employees and consultants and to promote the long-term growth and success of our business. The plan is administered by the Compensation Committee of the Board of Directors. At its discretion, the Compensation Committee determines the persons to whom stock options may be granted and the terms upon which options will be granted. In addition, the Compensation Committee may interpret the plan and may adopt, amend and rescind rules and regulations for its administration. Option awards are generally granted with an exercise price equal to the closing price of our common stock at the date of grant and generally vest based on three years of continuous service and have ten-year contractual terms.

As of December 31, 2017, stock options to purchase a total of 327,270 shares of our common stock were outstanding under the 1998 Stock Option Plan, as amended and restated, and a total of 313,169 shares of common stock were available at December 31, 2017 for future grants of stock options under the plan. Since the beginning of 2018, we have issued no shares of common stock, but had 500 shares returned to the pool due to forfeitures. This left 313,669 shares available under the 1998 Stock Option Plan as of the date of this proxy statement.

2009 Restricted Stock/Unit Plan

The purpose of our 2009 Restricted Stock/Unit Plan (the "2009 Plan") is to retain our employees and directors having experience and ability, to attract new employees and directors whose services are considered valuable, to encourage the sense of proprietorship, and to stimulate the active interest of such persons in our development and financial success. We believe that grants of restricted stock and restricted stock units are an increasingly important means to retain and compensate employees and directors.

General Description

Shares Reserved for Issuance under the 2009 Plan. A total of 800,000 shares of our common stock are reserved for issuance under the 2009 Plan. The number of shares of our common stock available under the 2009 Plan will be subject to adjustment in the event of a stock split, stock or other extraordinary dividend, or other similar change in our common stock or capital structure.

Administration. The Plan is administered by the plan administrator, defined as one or more committees the Company designates consisting of independent directors. The draft of the Plan appoints our Compensation Committee as the administrator (the "Committee").

Generally, the Committee has the authority, in its discretion, (a) to select officers, directors and employees to whom awards may be granted from time to time, (b) to determine whether and to what extent, awards are granted, (c) to determine the number of shares of our common stock, or the amount of other consideration to be covered by each award, (d) to approve award agreements for use under the Plan, (e) to determine the terms and conditions of any award (including the vesting schedule applicable

to the award), (f) to amend the terms of any outstanding award granted under the Plan, (g) to construe and interpret the terms of the Plan and awards granted, and (h) to take such other action not inconsistent with the terms of the Plan, as the Committee deems appropriate.

Types of Awards; Eligibility. Awards of restricted stock and restricted stock units (RSUs) may be granted under the Plan. Awards of restricted stock are shares of our common stock that are awarded subject to such restrictions on transfer as the Committee may establish. Awards of RSUs are units valued by reference to shares of common stock that entitle a participant to receive, upon the settlement of the unit, one share of our common stock for each unit. Awards may be granted to our officers, directors and employees and our related entities, if any. Each award granted under the Plan shall be designated in an award agreement.

Terms and Vesting of Awards. As noted above, the Committee determines the terms and conditions of each award granted to a participant, including the restrictions applicable to shares underlying awards of restricted stock and the dates these restrictions lapse and the award vests, as well as the vesting and settlement terms applicable to RSUs. When an award vests, we deliver to the participant a certificate for the number of shares without any legend or restrictions (except as necessary to comply with applicable state and federal securities laws).

In addition to time-based vesting requirements, the Committee is also authorized to establish quantitative and qualitative performance goals in order for awards to vest. For instance, quantitative performance standards, including, but not limited to, financial measurements such as (a) increase in share price, (b) earnings per share, (c) total shareholder return, (d) operating margin, (e) gross margin, (f) return on equity, (g) return on assets, (h) net operating income, (i) pre-tax profit, (j) cash flow, (k) revenue, (l) expenses, and (m) EBITDA, or other performance goal requirements may be adopted by the Committee and set forth in the particular restricted stock or RSU agreement which must be met in order for shares to vest.

Termination of Service. Unless otherwise set forth in an individual award agreement, the Plan and forms of award agreements generally provide that in the event a participant's continuous service with us terminates as a result of death or disability (an "Acceleration Event"), unvested shares or RSUs at the time of termination due to an Acceleration Event will immediately become vested. However, the Committee may revise this default provision on an individual basis, as it deems advisable. In the case of a termination of service other than by an Acceleration Event, any unvested restricted shares or RSUs will immediately become null and void, except that with respect to Restricted Stock awards, the Board of Directors may vest any or all unvested shares in its discretion in the case of any termination of service.

In addition, subject to revision by the Committee, the default provisions of the Plan provide that a Change of Control triggers accelerated vesting of all shares or units. Under the 2009 Plan, a Change in Control Event is generally defined as:

- a complete liquidation or dissolution;
- acquisition of 50% or more of our stock by any individual or entity including by tender offer or a reverse merger;
- a merger or consolidation in which we are not the surviving entity; or
- during any period not longer than 12 consecutive months, members of the Board who at the beginning of such period cease to constitute at least a majority of the Board, unless the election, or the nomination for election of each new Board member, was approved by a vote of at least 3/4 of the Board members then still in office who were Board members at the beginning of such period.

Restricted Stock. Under an award of restricted stock, we issue shares of our common stock in the participant's name; however, the participant's rights in the stock are restricted until the shares vest. If the vesting requirements are not met prior to the end of the vesting period, the shares are forfeited. In connection with an award of restricted stock, since actual shares are issued and outstanding, the participant is legally entitled to vote the shares and receive any dividends declared and paid on our common stock prior to the satisfaction of the vesting requirements. However, as discussed above, Participants who hold unvested restricted stock may not sell, assign or transfer such shares until they have vested.

Restricted Stock Units. Like a restricted stock award, a restricted stock unit is a grant valued in terms of our common stock. Unlike a restricted stock award, none of our common stock is issued at the time the RSU award is granted. Instead, the award is a mere promise to deliver shares of our common stock upon satisfaction of the vesting requirements. Upon satisfaction of the vesting requirements of the award, we then issue and deliver the number of shares subject to the award. If the vesting requirements are not satisfied prior to the end of the vesting period, the units expire and no shares are issued. Since shares of our common stock are not issued in connection with RSUs until such time as the vesting conditions have been satisfied, participants

in the Plan who receive awards of RSUs will not have any voting rights and will not be entitled to dividends until such time as the units vest and shares of our common stock are issued.

Amendment, Suspension or Termination of the Plan. We may at any time amend, suspend or terminate the Plan. The Plan will be for a term of ten (10) years unless sooner terminated. Awards may be granted under the Plan upon it becoming effective, but awards granted prior to obtaining shareholder approval will be rescinded if the shareholders do not approve the Plan. We may amend the Plan subject to compliance with applicable provisions of federal securities laws, state corporate and securities laws, the Internal Revenue Code, and the rules of the NYSE (or such other stock exchange as our common stock may be traded upon at the time).

Change in Capitalization. Subject to any required action by our shareholders, the number of shares of common stock covered by outstanding awards, the number of shares of common stock that have been authorized for issuance under the 2009 Plan, the exercise or purchase price of each outstanding award, the maximum number of shares of common stock that may be granted subject to awards to any participant in a calendar year, and the like, shall be proportionally adjusted by the Committee in the event of: (i) any increase or decrease in the number of issued shares of common stock resulting from a stock split, stock dividend, combination or reclassification or similar event affecting our common stock; (ii) any other increase or decrease in the number of issued shares of common stock effected without receipt of consideration by us; or (iii) any other transaction with respect to common stock including a corporate merger, consolidation, acquisition of property or stock, separation (including a spin-off or other distribution of stock or property), reorganization, liquidation (whether partial or complete), distribution of cash or other assets to shareholders other than a normal cash dividend, or any similar transaction; provided, however, that conversion of any of our convertible securities shall not be deemed to have been “effected without receipt of consideration.” Except as the Committee determines, no issuance by us of shares of any class, or securities convertible into shares of any class, shall affect, and no adjustment by reason hereof shall be made with respect to, the number of shares of common stock subject to an award.

As of April 15, 2018, we had issued 878,712 shares and units of restricted stock under the 2009 Plan of which 123,514 have been returned to the pool from tax withholding and 651,375 have vested and become unrestricted.

Outstanding Equity Awards at Fiscal Year-End

The following table shows certain information about stock options outstanding as of December 31, 2017 and held by our Chief Executive Officer, Stephen C. Taylor, and each other named executive officer.

Outstanding Equity Awards at 2017 Fiscal Year-End

Name	Option Awards					Stock Awards				
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares of Stock That Have Not Vested (#)	Market Value of Shares of Stock that Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Unearned Shares or Other Rights that Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares or Other Rights that Have Not Vested (\$)	
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	
Stephen C. Taylor	25,000	—	—	\$ 17.51	9/10/2018	—	—	—	—	
	30,000	—	—	\$ 9.95	1/28/2019	—	—	—	—	
	23,852	—	—	\$ 7.84	3/17/2019	—	—	—	—	
	30,000	—	—	\$ 19.90	1/18/2020	—	—	—	—	
	—	—	—	—	—	37,957	\$ 839,988	—	—	
	—	—	—	—	—	70,464	\$ 2,018,794	—	—	
G. Larry Lawrence	5,000	—	—	\$ 17.81	1/24/2021	—	—	—	—	
	—	—	—	—	—	10,000	\$ 203,900	—	—	
	—	—	—	—	—	20,000	501,000	—	—	
James R. Hazlett	5,000	—	—	\$ 17.51	9/10/2018	—	—	—	—	
	10,000	—	—	\$ 17.74	12/9/2019	—	—	—	—	
	10,000	—	—	\$ 17.81	1/24/2021	—	—	—	—	
	—	—	—	—	—	10,000	\$ 203,900	—	—	
	—	—	—	—	—	20,000	501,000	—	—	

Option Exercises and Stock Vested in 2017

In the table below, we show certain information about (i) the number of shares of common stock acquired upon exercise of stock options by each of the named executive officers in 2017 and the value realized on exercise of the stock options and (ii) stock awards.

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting	Value Realized on Vesting
(a)	(b)	(c)	(d)	(e)
Stephen C. Taylor	40,000	\$355,201	37,958	\$ 1,189,983
G. Larry Lawrence	—	—	10,000	275,000
James R. Hazlett	—	—	10,000	275,000

Nonqualified Deferred Compensation

We adopted a Deferred Compensation Plan in December 2015, which permits eligible employees, including our NEOs, and our directors to annually elect to defer a portion of their salary, commissions, cash bonus, director fees and/or stock awards they would otherwise have received when earned. Under this plan, participants can defer up to 90% of their salary, commissions, cash bonus, director fees and stock awards. Amounts deferred under the Deferred Compensation Plan are deemed invested in the investment funds selected by the participant with similar options as available under the Company's 401(k) Plan. We have option to, but we do not currently contribute to the Deferred Compensation Plan on behalf of its participants, or match the deferrals made by participants.

At the time of deferral, a participant must indicate whether he or she wishes to receive the amount deferred while in-service or upon separation of service. In either case, the payment will be in either a lump sum or in substantially equal annual installments. In-service installments cannot exceed five years, while installments elected to start upon separation of service cannot exceed ten years. If separation is due to a disability or a change in control deferrals will be paid similar to deferrals paid upon separation of service, with deferrals related to death being paid in a lump sum to the participant's beneficiary. If a participant experiences an unforeseeable emergency during the deferral period, the participant may petition to receive a partial or full payout from the Deferred Compensation Plan. All distributions are made in cash, except for deferred stock awards which are settled in Company stock.

The following table sets forth the deferred compensation earned by and paid to our Chief Executive Officer, Stephen C. Taylor, and other named executive officers in 2017.

Deferred Compensation Table

Name	Beginning Aggregate Balance	Executive Contributions in Last FY (\$) ⁽¹⁾	Registrant Contributions in Last FY (\$)	Aggregate Earnings in Last FY (\$)	Aggregate Withdrawals/ Distributions (\$)	Aggregate Balance at Last Fiscal Year End (\$)
Stephen C. Taylor	\$ 153,106	\$ 496,354	\$ —	\$ 72,103	\$ —	\$ 721,563
G. Larry Lawrence	10,073	16,649	—	2,606	—	29,328
James R. Hazlett	22,385	39,219	—	9,253	—	70,857

(1) All contributions were from salary and bonus deferrals in 2017.

Potential Payments Upon Termination or Change of Control

Our 1998 Stock Option Plan and 2009 Restricted Stock/Unit Plan contains "change of control" provisions. These provisions are designed to provide some assurance that we will be able to rely upon each executive's services and advice as to the best interests of Natural Gas Services Group and our shareholders without concern that the executive might be distracted by the personal uncertainties and risks created by any proposed or threatened change of control and to promote continuity of our executive team.

Under our stock option plan, the Committee may adjust the stock options held by our executives upon the occurrence of a change of control. With this authority, the Committee may in its discretion elect to accelerate the vesting of any stock options that were not fully vested and allow for the exercise of such options as to all shares of stock subject thereto.

Likewise, under our 2009 Restricted Stock/Unit Plan, a change in control will accelerate the vesting of all awards under the plan unless the Committee has provided otherwise in a particular award under the plan. In addition, upon death, disability or retirement, any vesting or other restrictions on the restricted stock awards will accelerate or lapse such that all shares underlying a restricted stock award will become unencumbered.

As noted in the tables above and summarized below, our named executive officers have stock options and restricted stock awards which are subject to certain vesting requirements.

At December 31, 2017, our named executive officers had the following number of unvested restricted stock awards which were subject to forfeiture as of that date:

- Stephen C. Taylor -- 108,421 shares

- G. Larry Lawrence -- 30,000 shares
- James R. Hazlett -- 30,000 shares

Each of these restricted stock awards could have become vested and issued without restrictions on December 31, 2017 assuming a change of control were to have occurred on that date. In addition, the restricted stock awards would have been issued without restrictions on December 31, 2017, assuming the named executive officer had died, became disabled or retired. The closing price of our common stock on December 31, 2017, was \$26.20 per share. Accordingly, on December 31, 2017, had there been a change in control event or had the named executive officer died, became disabled or retired, the vesting terms of the restricted stock awards would have lapsed and the shares would have become unrestricted. As a result, there was a potential for Messrs. Taylor, Hazlett and Lawrence to realize immediate value upon the lapse of restrictions on restricted stock awards as follows: Mr. Taylor --\$2,840,630; Mr. Hazlett --\$786,000; and Mr. Lawrence --\$786,000.

As described under "Compensation Agreements with Management" on page 48, we entered into a written employment agreement with Stephen C. Taylor, President, Chief Executive Officer and Chairman of the Board in October 2013. Under the employment agreement, Mr. Taylor is eligible for certain benefits in connection with a change in control. These provisions were included in Mr. Taylor's initial employment agreement with us and were continued in his current agreement as part of our negotiations with Mr. Taylor as to the terms of his employment and as an inducement for him to continue his employ with our company. The change of control and severance provisions were designed to promote stability and continuity with respect to Mr. Taylor's employment as our Chief Executive Officer and President.

Chief Executive Officer Potential Payments Table

The following table summarizes the benefits in effect as of December 31, 2017 that Mr. Taylor would receive assuming that a qualifying termination (i.e., a termination described in footnote 2 below) in connection with a change in control death or disability or a termination by the Company without cause, or a voluntary termination by Mr. Taylor with and without good reason, occurred on December 31, 2017. Those payments that are available generally to salaried employees that do not discriminate in scope, terms or operation in favor of executive officers are also not included in this table.

Named Executive Officer Stephen C. Taylor	Qualifying Termination in Connection with a Change in Control, Voluntary Resignation with Good Reason, or Termination by Company without Cause ⁽¹⁾ (\$)	Death or Disability ⁽²⁾ (\$)	Termination by Company with Cause, Voluntary Termination without Good Reason (\$)	Retirement ⁽²⁾ (\$)
Acceleration of Unvested Restricted Stock Units (3)	\$ 2,840,630	\$ 2,840,630	\$ —	\$ 2,840,630
Severance	3,893,400	—	—	—
Medical, Dental, and Vision Benefits	40,428	—	—	—
Life Insurance Premiums	756	—	—	—
TOTAL	\$ 6,775,214	\$ 2,840,630	\$ —	\$ 2,840,630

- (1) See "Compensation Agreements with Management" beginning on page 48 for definitions and discussion of Mr. Taylor's severance package in connection with termination due to change of control, voluntary resignation with good reason or termination by the Company without cause.
- (2) In the event of Mr. Taylor's employment terminates on account of death or disability 100% of unvested Restricted Stock awards will immediately vest.
- (3) The value attributable to the acceleration of unvested Restricted Stock awards is based upon the number of awards multiplied by the closing price of our common stock (\$26.20) on December 31, 2017.

Pay Ratio

As required by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the ratio of the compensation of our Chairman and Chief Executive Officer compared to the compensation of our median employee in 2017 is set forth below. SEC rules require the Company to disclose annually (i) the median of the annual total compensation of all employees of the Company (excluding the Company's principal executive officer, Stephen C. Taylor); (ii) the annual total compensation of the Mr. Taylor; and (iii) the ratio of Mr. Taylor's annual total compensation to the median annual total compensation of all employees (excluding Mr. Taylor).

Based on the methodology and material assumptions described below, the Company has estimated these amounts to be as follows:

Median annual total compensation of all employees (excluding Mr. Taylor)	\$	65,930
Annual total compensation of Mr. Taylor	\$	2,817,136
Ratio of Mr. Taylor's annual total compensation to median annual total compensation of all other employees		43:1

To determine the median employee, the Company compiled a list of all employees (excluding Mr. Taylor) as of December 31, 2017, sorted the list of employees by their total compensation as reported for federal income tax purposes from the Company's payroll records for the 12-month period ended December 31, 2017 and selected the employee with the median total compensation amount. The Company annualized the total compensation of any full-time or part-time employees on the list who were not employed for the full year and did not include the value of non-taxable Company-provided benefits such as retirement plan contributions and medical and life insurance benefits. As of December 31, 2017, the Company had 235 employees.

The annual total compensation of Mr. Taylor is the total amount of his compensation presented in the Summary Compensation Table on page 38. The Company determined the annual total compensation of the median employee shown above using the same rules applicable to the completion of the Summary Compensation Table for Mr. Taylor and the other named executive officers.

For comparison purposes, the median Pay Ratio of the ten (10) companies in the Company's peer group that had reported such data (out of a total peer group of 14 and outlined on page 24) as of April 25, 2018 is 42.5:1, the mean is 47.5:1 with a range of 13.0:1 to 98.1:1.

In February, 2018 Equilar, an executive compensation data consultancy, conducted a survey of companies expecting to disclose CEO Pay Ratio data prior to the traditional annual proxy reporting period. Of the 356 companies responding to the survey, 30 were determined to be in the energy sector. Of those 30 companies, the median self-reported CEO pay ratio was approximately 72:1.

As of April 23, 2018, Equilar has compiled data from 1,440 companies that have disclosed CEO pay ratio data in proxy filings. The median CEO pay ratio of those companies, as compiled and calculated by Equilar, is 70:1.

The CEO pay ratios calculated herein are based on reasonable estimates in accordance with SEC rules and methods for disclosure. Given the varying methodologies, assumptions, exclusions and estimates other public companies may use to determine their CEO pay ratio, the pay ratio reported by other companies may not be comparable to the pay ratio reported above.

Compensation of Directors

We use a combination of cash and equity-based incentive compensation to attract and retain qualified candidates to serve on our Board of Directors. In setting compensation for our Directors, we consider the substantial amount of time that Directors expend in fulfilling their duties to us and our shareholders, as well as the skill-sets required to fulfill these duties.

The following table discloses the cash, equity awards and other compensation earned, paid or awarded, as the case may be, to each of our non-employee Directors during the fiscal years ended December 31, 2017, 2016 and 2015:

Name (a)	Year	Fees Earned Or Paid (\$) ⁽¹⁾ (b)	Stock Awards (\$) ⁽²⁾ (c)	Option Awards (\$) (d)	Non-Equity Incentive Plan Compensation (\$) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (f)	All Other Compensation (\$) (g)	Total (\$) (h)
Charles G. Curtis	2017	\$ 50,000	\$ 100,000	\$ —	\$ —	\$ —	\$ —	\$ 150,000
	2016	50,000	119,975	—	—	—	—	169,975
	2015	50,000	102,975	—	—	—	—	152,975
David L. Bradshaw	2017	60,000	100,000	—	—	—	—	160,000
	2016	60,000	119,975	—	—	—	—	179,975
	2015	60,000	102,975	—	—	—	—	162,975
John Chisholm	2017	50,000	100,000	—	—	—	—	150,000
	2016	50,000	119,975	—	—	—	—	169,975
	2015	50,000	102,975	—	—	—	—	152,975
William F. Hughes, Jr.	2017	60,000	100,000	—	—	—	—	160,000
	2016	60,000	119,975	—	—	—	—	179,975
	2015	60,000	102,975	—	—	—	—	162,975

- (1) Our non-employee Directors are paid a quarterly cash fee. The cash fee payable to our non-employee Directors for 2017, 2016 and 2015 was \$11,250 per quarter. In addition, (i) the Chairman of the Audit Committee, David L. Bradshaw and the Chairman of the Compensation Committee, William F. Hughes Jr., were entitled to an additional quarterly cash fee in the amount of \$3,750 and (ii) the Chairman of the Nominating Committee John W. Chisholm, and the Chairman of the Governance and Personnel Development Committee, Charles G. Curtis, were entitled to an additional quarterly cash fee in the amount of \$1,250.
- (2) On March 23, 2017, each of our non-employee Directors were granted 3,992 restricted shares/units of common stock at an issue price of \$25.05 per share; on April 6, 2016, each of our non-employee Directors were granted 5,884 restricted shares of common stock at an issue price of \$20.39 per share; and on March 19, 2015, each of our non-employee Directors were granted 5,492 restricted shares of common stock at an issue price of \$18.75 per share.

Cash Compensation Paid to Independent Directors

We pay our non-employee Directors a quarterly cash fee for their attendance at each meeting of our Board of Directors. The cash fee payable to our non-employee Directors for 2017, 2016 and 2015 was \$11,250 per quarter. In addition, the Chairmen of the Audit and Compensation Committees were entitled to an additional quarterly cash fee in the amount of \$3,750, while the Chairmen of the Nominating and Governance and Personnel Development Committees were entitled to an additional quarterly cash fee of \$1,250.

Equity Based Compensation Paid to Independent Directors

Our compensation policy for independent directors is to grant an annual award of restricted shares based upon a review of equity award values paid by other public companies in the Company's peer group and the Company's market and financial performance in comparison to such peer group companies. For 2017, based upon the Company's performance compared to its peer group, the Compensation Committee recommended and the Board approved an equity award value of approximately \$100,000 in restricted stock. In connection therewith, each of our four independent directors was granted for 2017 the amount of 3,992 shares /units of restricted stock pursuant to the Plan, based upon the closing price of \$25.05 per share as of March 23, 2017, the date of the grant. The restricted shares/units are subject to vesting whereby no shares will vest during the first year, and then upon the first anniversary date of the award, one-fourth of the shares will vest every three months so that all restricted shares/units will have vested on the second anniversary date of the grant of the award. Notwithstanding the vesting schedule, all of the restricted

shares/units are subject to acceleration and will immediately vest in the case of (i) death or disability of the recipient employee, or (ii) a change of control in the Company, as set forth in the Restricted Stock/Unit Plan.

Directors who are our employees do not receive any compensation for their services as Directors.

Other

All Directors are reimbursed for their expenses incurred in connection with attending meetings. We provide liability insurance for our Directors and officers. The cost of this coverage for 2017 was \$87,250. We do not offer non-employee Directors travel accident insurance, life insurance or a pension or retirement plan.

Compensation Agreements with Management

On October 23, 2013, we and Stephen C. Taylor entered into a new employment agreement (the "Employment Agreement"), pursuant to which Mr. Taylor continues his employment as our President and Chief Executive Officer. The new Employment Agreement became effective on the same date and Mr. Taylor's previous employment agreement with us, which was set to expire on October 25, 2013, was terminated in connection therewith.

On April 24, 2015, we entered into an amendment with Mr. Taylor to his Employment Agreement pursuant to which the "modified single trigger" change of control provision was changed to a "double trigger" change of control. Under the "modified single trigger provision", Mr. Taylor could voluntarily terminate the Employment Agreement and for any reason and collect severance benefits. Under the new "double trigger" change of control provision, a change of control must occur followed by the Company or its successor terminating Mr. Taylor's employment other than for cause, death, or disability, or by Mr. Taylor terminating his employment for Good Reason. We discuss the definitions of "Change of Control" and "Good Reason" below, along with Mr. Taylor's severance benefits in connection with these events.

The term of the Employment Agreement is for three years but the agreement contains an "evergreen" feature whereby the agreement is automatically extended on a monthly basis on the last day of each month so that the term of the agreement will always be three years unless written notice of nonrenewal is given by the Company. If a notice of nonrenewal is given, the term of employment then ends three years from the date of that written notice of nonrenewal unless terminated earlier as described below. The Employment Agreement provides for Mr. Taylor to receive a base salary, potential cash bonus, equity compensation, and certain other benefits, which are summarized below.

Base Salary. Mr. Taylor is entitled to Base Salary which is reviewed annually at the beginning of the year by, and may be increased at the discretion of, the Compensation Committee of the Board of Directors of the Company (the "Compensation Committee").

Bonus. Mr. Taylor will continue to be eligible for an annual cash bonus under the Company's current Annual Incentive Bonus Plan. Mr. Taylor's annual bonus opportunity payable upon achievement of "target" levels shall be at least ninety percent (90%) of Base Salary for 2013 and at least one hundred percent (100%) thereafter. The performance metrics, weighting and thresholds for each annual bonus opportunity will be determined by the Company's Board of Directors or Compensation Committee in good faith following consultation with Mr. Taylor.

Annual Equity Compensation. Mr. Taylor is eligible for annual grants of equity-based incentive awards under the Company's equity compensation plans. While the agreement provides an annual equity award grant to Mr. Taylor with an aggregate minimum value equal to 175% of his Base Salary, subject to one-year vesting terms, Mr. Taylor has waived the 175% and one-year vesting requirement for the past three years in order to enable the Compensation Committee to make discretionary and performance based awards with a three-year vesting term (subject to customary acceleration) in keeping with current public company pay practices.

Benefits. The Company will provide Mr. Taylor such retirement, and other benefits as are customarily provided to similarly situated executives of the Company, including paid vacation, coverage under the Company's medical, life, disability and other insurance plans, and reimbursement for all reasonable business expenses in accordance with the Company's expense reimbursement policy.

Termination. The Company or Mr. Taylor may terminate the agreement prior to the expiration of its Term at any time upon written notice.

Severance upon Early Termination. Mr. Taylor will be entitled to the following severance benefits during the first ten years of his employment:

(A) If (i) the Company terminates Mr. Taylor's agreement without Cause (ii) Mr. Taylor terminates the agreement for Good Reason or due to a Change of Control event (as defined below) followed by the Company or its successor terminating Mr. Taylor's agreement without cause or Mr. Taylor terminating the agreement for Good Reason or (iii) Mr. Taylor's employment is terminated due to death or disability, then he will receive (a) a lump sum payment equal to 300% of Base Salary and Annual Bonus; (b) vesting of all unvested equity awards or other long-term incentive compensation; (c) continuation of health insurance benefits and payment of any life insurance premiums for a period of 36 months after termination; and (d) receipt of any other vested benefits which had not yet been paid prior to the date of termination.

(B) If Mr. Taylor's employment is terminated for Cause or he voluntarily resigns, then he will be entitled to any unpaid compensation earned through the date of termination and receipt of any other vested benefits which had not yet been paid prior to the date of termination.

(C) If Mr. Taylor retires in compliance with the Company's retirement policy, then he will be entitled to (i) any unpaid compensation earned through the date of retirement; (ii) vesting of all unvested equity awards or other long-term incentive compensation; and (iii) receipt of any other vested benefits which had not yet been paid prior to the date of termination.

After the tenth anniversary date of Mr. Taylor's employment agreement, in the event the Company delivers to Mr. Taylor a Notice of Nonrenewal and:

(A) his employment is automatically terminated upon the expiration of the remaining three year term, Mr. Taylor shall be entitled to (i) any unpaid compensation earned through the date of retirement; (ii) vesting of all unvested equity awards or other long-term incentive compensation; and (iii) receipt of any other vested benefits which had not yet been paid prior to the date of; or

(B) his employment is terminated prior to the expiration of the remaining three year term, unless said termination is due to Cause, voluntary resignation or retirement, then Mr. Taylor shall be entitled to (i) lump sum payment of his Base Salary at the time of termination for the remainder of the three year term of the agreement; (ii) a lump sum cash payment equal to 100% of the Annual Bonus for each full year (if any) remaining in the three year term, plus a pro-rata portion of such Annual Bonus for any partial remaining year in the three year term; (iii) vesting of all unvested equity awards or other long-term incentive compensation; (iv) continuation of health insurance benefits and payment of any life insurance premiums for the remainder of the three year term of the agreement; and (v) receipt of any other vested benefits which had not yet been paid prior to the date of termination.

Under the Employment Agreement, a "Change of Control" event includes (i) the acquisition by a person, entity or group of related persons or entities of more than 30% of the total voting power in the Company (excluding sales to underwriters in a public offering); (ii) consummation of the sale of 50% or more of the Company's assets; (iii) consummation of a merger or consolidation of the Company with or into an entity unless the voting securities of the Company immediately prior to the merger or consolidation continue to represent more the 70% of the voting power of the surviving entity after the merger or consolidation; and (iv) replacement of at least a majority of the incumbent members of the Company's Board of Directors, excluding directors whose election to the Board was approved by at least a majority of the then incumbent directors, subject to further limited exceptions as set forth in the "Change of Control" definition in Employment Agreement.

Under the Employment Agreement, a "Good Reason" event includes (i) a material diminution of Mr. Taylor's duties, control, authority or status or position or a requirement that the Executive report to a corporate officer or employee instead of reporting directly to the board of directors; (ii) a material reduction in Mr. Taylor's compensation; (iii) a material breach by the Company of the Employment Agreement; or (iv) a relocation of more than 50 miles of Mr. Taylor's principal office with the Company or its successor. And in connection with a termination due to Change of Control, the following provisions also constitute "Good Reason" events: (i) a material diminution of Mr. Taylor's duties, control, authority or status or position or a requirement that Mr. Taylor report to a corporate officer or employee instead of reporting directly to the Company's or successor's board of directors depending on its composition after the change in control; (ii) the failure of the Company or successor to continue in effect any plan in which Mr. Taylor participates immediately prior to the Change in Control which is material to the Executive's total compensation, unless an equitable arrangement has been made with respect to any such plan on a basis not less favorable, both in terms of the amount or timing of payment of benefits provided; and (iii) a material breach by the Company or its successor

of the Employment Agreement or any other material agreement between Mr. Taylor and the Company or its successor.

Non-Competition and Non-Solicitation. In connection with the payment of the severance benefits described above, for a period of two years following Mr. Taylor's separation from the Company, he may not compete with the Company in any geographic area within a 100 mile radius of a Company owned or leased facility which is Company staffed and actively engaging in business on behalf of the Company.

We do not have any written employment agreements with our other named executive officers.

Limitation on Directors' and Officers' Liability

Our Articles of Incorporation provide our Directors and Officers with certain limitations on liability to us or any of our shareholders for damages for breach of fiduciary duty as a Director or officer involving certain acts or omissions of any such Director or Officer.

This limitation on liability may have the effect of reducing the likelihood of derivative litigation against Directors and Officers and may discourage or deter shareholders or management from bringing a lawsuit against Directors and Officers for breach of their duty of care even though such an action, if successful, might otherwise have benefited our shareholders and us.

Our Articles of Incorporation and bylaws provide certain indemnification privileges to our Directors, employees, agents and officers against liabilities incurred in legal proceedings. Also, our Directors, employees, agents or officers who are successful, on the merits or otherwise, in defense of any proceeding to which he or she was a party, are entitled to receive indemnification against expenses, including attorneys' fees, incurred in connection with the proceeding.

We are not aware of any pending litigation or proceeding involving any of our Directors, Officers, employees or agents as to which indemnification is being or may be sought, and we are not aware of any other pending or threatened litigation that may result in claims for indemnification by any of our Directors, officers, employees or agents.

Even though we maintain Directors' and Officers' liability insurance, the indemnification provisions contained in our Articles of Incorporation and bylaws remain in place.

Procedures for Reviewing Certain Transactions

On March 7, 2007, we adopted a written policy for the review, approval or ratification of related party transactions. All of our officers, Directors and employees are subject to the policy. Under this policy, the Audit Committee will review all related party transactions for potential conflict of interest situations. Generally, our policy defines a "related party transaction" as a transaction in which we are a participant and in which a related party has an interest. A "related party" is:

- any of our Directors, Officers or employees or a nominee to become a Director;
- an owner of more than 5% of our outstanding common stock;
- certain family members of any of the above persons; and
- any entity in which any of the above persons is employed or is a partner or principal or in which such person has a 5% or greater ownership interest.

Approval Procedures

Before entering into a related party transaction, the related party or our department responsible for the potential transaction must notify the CEO or the Audit Committee of the facts and circumstances of the proposed transaction. If the amount involved is equal to or less than \$100,000, the proposed transaction will be submitted to the CEO. If the amount involved exceeds \$100,000, the proposed transaction will be submitted to the Audit Committee. Matters to be submitted will include:

- the related party's relationship to us and interest in the transaction;
- the material terms of the proposed transaction;
- the benefits to us of the proposed transaction;

- the availability of other sources of comparable properties or services; and
- whether the proposed transaction is on terms comparable to terms available to an unrelated third party or to employees generally.

The CEO or the Audit Committee, as applicable, will then consider all of the relevant facts and circumstances available, including the matters described above and, if applicable, the impact on a director's independence. Neither the CEO nor any member of the Audit Committee is permitted to participate in any review, consideration or approval of any related party transaction if such person or any of his or her immediate family members is the related party. After review, the CEO or the Audit Committee, as applicable, may approve, modify or disapprove the proposed transaction. Only those related party transactions that are in, or are not inconsistent with, our best interests and that of our shareholders will be approved.

Ratification Procedures

If one of our officers or Directors becomes aware of a related party transaction that has not been previously approved or ratified by the CEO or the Audit Committee then, if the transaction is pending or ongoing, the transaction must be submitted, based on the amount involved, to either the CEO or the Audit Committee and the CEO or the Audit Committee will consider the matters described above. Based on the conclusions reached, the CEO or the Audit Committee, as applicable, will evaluate all options, including ratification, amendment or termination of the related party transaction. If the transaction is completed, the CEO or the Audit Committee will evaluate the transaction, taking into account the same factors as described above, to determine if rescission of the transaction or any disciplinary action is appropriate, and will request that we evaluate our controls and procedures to determine the reason the transaction was not submitted to the CEO or the Audit Committee for prior approval and whether any changes to the procedures are recommended.

We did not have any related party transactions in 2017 with our Officers or Directors.

PRINCIPAL SHAREHOLDERS AND SECURITY OWNERSHIP OF MANAGEMENT

For purposes of the following tables, "beneficial ownership" is determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934, pursuant to which a person or group of persons is deemed to have "beneficial ownership" of any shares of Common Stock that such person has the right to acquire within 60 days.

The following table indicates the beneficial ownership of our Common Stock as of April 25, 2018 by: (1) each of our current directors and nominees for election; (2) our chief executive officer, principal accounting officer and our other named executive officers (as defined in Item 402(a) (3) of Regulation S-K) (together as a group, the "*Named Executive Officers*"); and (3) all of our current directors, nominees and executive officers as a group, based on our records and data supplied by each of the current directors, nominees and executive officers.

Name of Beneficial Owner and Position	Amount and Nature of Beneficial Ownership ⁽¹⁾	Percent of Class
Directors & Nominees Who Are Not Named Executive Officers		
John W. Chisholm Current Director	18,464 ⁽²⁾	*
Charles G. Curtis Current Director & Director Nominee	85,085 ⁽³⁾	*
William F. Hughes, Jr. Current Director	150,267 ⁽⁴⁾	1.15%
David L. Bradshaw Current Director	19,572	*
Named Executive Officers		
Stephen C. Taylor Chief Executive Officer, Current Director & Director Nominee	446,653 ⁽⁵⁾	3.41%
James R. Hazlett Vice President – Technical Services	83,034 ⁽⁶⁾	*
G. Larry Lawrence Chief Financial Officer	62,150 ⁽⁷⁾	*
All Directors (and nominees) and executive officers as a group (7 persons)	865,225 ⁽⁸⁾	6.61%

* Less than one percent.

(1) The number of shares listed includes all shares of common stock owned or indirectly owned by, which vest or may be acquired within 60 days of April 25, 2018 upon exercise of options held by the shareholder (or group), or which vest within 60 days of April 25, 2018, under outstanding restricted stock units. Beneficial ownership is calculated in accordance with the rules of the Securities and Exchange Commission. Unless otherwise indicated, all shares of common stock are held directly with sole voting and investment powers. As of April 25, 2018, none of the shares of common stock owned by our officers and Directors had been pledged as collateral to secure repayment of loans.

(2) Includes 7,500 shares of common stock that may be acquired upon exercise of stock options granted under our 1998 Stock Option Plan, as amended and restated.

(3) Includes 5,000 shares of common stock that may be acquired upon exercise of stock options granted under our 1998 Stock Option Plan, as amended and restated.

(4) Includes (i) 110,500 shares of common stock indirectly owned by Mr. Hughes through the William and Cheryl Hughes Family Trust and (ii) 898 shares of common stock held indirectly by a "rabbi trust," the receipt of which has been deferred by Mr. Hughes

to the Company's Non-qualified Deferred Compensation Plan. Mr. and Mrs. Hughes are co-trustees of the William and Cheryl Hughes Family Trust and have shared voting and investment powers with respect to the shares held by the trust. Mr. and Mrs. Hughes are beneficiaries of the trust along with their two children. Does not include 5,461 shares of common stock which may be issued upon the vesting of restricted stock units.

(5) Includes 108,852 shares of common stock that may be acquired upon exercise of stock options granted to Mr. Taylor under our 1998 Stock Option Plan, as amended and restated. Also includes 21,139 shares of common stock held indirectly by a "rabbi trust," the receipt of which has been deferred by Mr. Taylor pursuant to the Company's Non-qualified Deferred Compensation Plan. Does not include 70,230 shares of common stock which may be issued upon the vesting of restricted stock units.

(6) Includes 20,000 shares of common stock that may be acquired upon exercise of stock options granted under our 1998 Stock Option Plan, as amended and restated. Also includes 5,000 shares of common stock held indirectly by a "rabbi trust," the receipt of which has been deferred by Mr. Hazlett pursuant to the Company's Non-qualified Deferred Compensation Plan. Does not include 14,000 shares of common stock which may be issued upon the vesting of restricted stock units.

(7) Includes 5,000 shares of common stock that may be acquired upon exercise of stock options granted under our 1998 Stock Option Plan, as amended and restated. Also includes 5,000 shares of common stock held indirectly by a "rabbi trust," the receipt of which has been deferred by Mr. Lawrence pursuant to the Company's Non-qualified Deferred Compensation Plan. Does not include 14,000 shares of common stock which may be issued upon the vesting of restricted stock units.

(8) Includes 146,352 shares of common stock that may be acquired upon exercise of stock options. Does not include 103,691 shares of common stock which may be issued upon the vesting of restricted stock units.

The following table sets forth information as of April 25, 2018 regarding the beneficial owners of more than five percent of the outstanding shares of our Common Stock. To our knowledge, there are no beneficial owners of more than five percent of the outstanding shares of our Common Stock as of April 25, 2018 other than those set forth below.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
Blackrock, Inc. 40 East 52 nd Street New York, New York 10022	891,975 ⁽¹⁾	6.82%
Franklin Resources One Franklin Parkway San Mateo, California 94403	977,034 ⁽²⁾	7.47%
Dimensional Fund Advisors Palisades West, Building One, 6300 Bee Cave Road Austin, Texas 78746	1,087,793 ⁽³⁾	8.31%

(1) As reported in Amendment No. 8 to Schedule 13G filed with the Securities and Exchange Commission on January 25, 2018. According to the filing, Blackrock, Inc. has the sole voting and dispositive power over the shares reported in the table above.

(2) As reported in Schedule 13G filed with the Securities and Exchange Commission on February 5, 2018. According to the filing, Franklin Advisory Services, LLC is an indirect wholly owned subsidiary of Franklin Resources, Inc., and it holds investment and voting power over the securities; however economic ownership is held by one or more open-end investment companies or other managed accounts that are investment management clients of Franklin Advisory Services, LLC or affiliated companies.

(3) As reported in Amendment No. 6 to schedule 13G filed with the Securities and Exchange Commission in February 9, 2018. According to the filing, Dimensional Fund Advisors holds voting and/or investment power over the shares, but economic ownership is beneficially held by four investment companies.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our Directors, officers and persons who beneficially own more than 10% of our Common Stock to file certain reports of beneficial ownership with the Securities and Exchange Commission. These reports show the Directors', officers' and greater than 10% shareholders' ownership and the changes in ownership of our common stock and other equity securities. The SEC regulations also require that a copy of all such Section 16(a) forms filed must be furnished to us by the person or entity filing the report.

Based on a review of Section 16(a) filings furnished to us, all transactions in our equity securities required to be reported by Section 16(a) of the Securities Exchange Act of 1934, as amended, were reported on a timely basis, except that Stephen C. Taylor inadvertently failed to timely file a Form 4 reporting the delivery of 15,696 shares of common stock for payment of taxes in connection with the vesting of restricted stock awards. The Form 4 was filed immediately upon discovery of the failure to file.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee is responsible for overseeing the integrity of the Company's financial statements; financial reporting processes; compliance with legal and regulatory requirements; the independent registered public accounting firm qualifications and independence; and the performance of the Company's internal accounting functions and independent registered public accounting firm.

The Company's independent registered public accounting firm is responsible for performing an independent audit of the Company's financial statements in accordance with the Standards of the Public Company Accounting Oversight Board (United States) and to issue a report thereon. The Audit Committee reviews with management the financial statements and management's assessment of internal controls over financial reporting and the Company's risk exposures; reviews with the independent registered accounting firm their independent report on the condition of the company's financial statements; and reviews the activities of the independent registered public accounting firm. The Audit Committee selects our independent registered public accounting firm each year. The Audit Committee also considers the adequacy of the Company's internal controls and accounting policies. The Audit Committee performs an annual self-assessment of its performance. The chairman and members of the Audit Committee are all independent Directors of the Board of Directors within the meaning of Section 303A of the New York Stock Exchange Listed Company Manual.

The Audit Committee has reviewed and discussed our audited financial statements with our management. The Audit Committee has also received from, and discussed with, BDO the matters required to be discussed by Public Company Accounting Oversight Board Auditing Standard No. 1301 (Communications with Audit Committees). In addition, the Audit Committee has received the written disclosures and the letter from our independent registered public accounting firm required by the Public Company Accounting Oversight Board in Rule 3200T. In addition, the Audit Committee has received the written disclosures and the letter from our independent registered public accounting firm matters pertaining to their independence. Based upon the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in our Annual Report on Form 10-K for 2016 for filing with the Securities and Exchange Commission. See "*Proposal 3 - Ratification of Appointment of Independent Registered Accounting Firm*" on page 57 further information.

Respectfully submitted by the Audit Committee,

David L. Bradshaw, Chairman

Charles G. Curtis

William F. Hughes, Jr.

PROPOSAL 2 - CONSIDERATION OF AN ADVISORY VOTE ON EXECUTIVE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), gives the shareholders the right to endorse or not endorse the compensation of our named executive officers as disclosed in this Proxy Statement in accordance with the SEC’s rules. The proposal, commonly known as a “Say On Pay” proposal, gives our shareholders the opportunity to express their views on the Company’s executive compensation.

At the Company’s annual meeting of shareholders held in June 2011, our shareholders recommended that the advisory vote on the Say-on-Pay of our named executives in our proxy materials be submitted annually, notwithstanding that our Board of Directors recommended that the advisory vote be submitted every third year. In light of the recommendation of the shareholders, we decided to include the Say-on-Pay advisory vote in our proxy materials on an annual basis until the next shareholder vote on the frequency of Say-on-Pay (which is this year - please see Proposal 3 in this Proxy Statement) or our Board of Directors otherwise determines that a different frequency of Say-on-Pay vote is in the best interests of the shareholders.

We are asking our shareholders to indicate whether or not they support the compensation program as described in this proxy statement. This proposal is not intended to address any specific item of compensation, but rather the overall compensation of the named executive officers and the compensation policies, methodologies and practices described in this proxy statement. Accordingly, we ask our stockholder to vote “FOR” the following resolution at our annual meeting:

“RESOLVED, that the shareholders approve the compensation of the Company’s named executive officers, as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosure contained in the proxy statement set forth under the caption “Executive Compensation” of this proxy statement.”

The Company believes its compensation philosophy and programs are strongly linked to performance and results and appropriately aligned with the interests of shareholders. Our compensation philosophy is to provide an executive compensation program that:

- rewards performance and skills necessary to advance our objectives and further the interests of our shareholders;
- is fair and reasonable and appropriately applied to each executive officer;
- is competitive with compensation programs offered by our competitors; and
- is appropriately focused on achieving annual financial and operational goals through the Company’s cash bonus plan and on maximizing stockholder value over the long term, through grants of restricted shares and stock options.

The Board of Directors recommends that you vote FOR approval, on an advisory basis, of the compensation programs of our named executive officers as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosure contained in the proxy statement set forth under the caption “Executive Compensation” of this proxy statement.

PROPOSAL 3 – RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We are asking the shareholders to ratify the Audit Committee’s appointment of BDO USA, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2018. BDO USA, LLP is a registered public accounting firm with the Public Company Accounting Oversight Board (“PCAOB”), as required by the Sarbanes-Oxley Act of 2002 and the rules of the PCAOB. Shareholder ratification of the appointment is not required under the laws of the State of Colorado, but the Board believes it is important to allow the shareholder to vote on the proposal. In the event the shareholders fail to ratify the appointment, the Audit Committee will reconsider this appointment. Even if the appointment is ratified, the Audit Committee, in its discretion, may direct the appointment of different independent registered public accounting firm at any time during the year if the Audit Committee determines that such a change would be in our best interests and that of our shareholders.

BDO USA, LLP representatives are expected to attend the 2018 Annual Meeting in person. They will have an opportunity to make a statement if they desire to do so and will be available to respond to appropriate shareholder questions.

The Board of Directors recommends that the shareholders vote “FOR” the ratification of the appointment of BDO USA, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2018.

Principal Accountant Fees

Our principal accountant for the fiscal years ended December 31, 2015, 2016 and 2017 was BDO USA, LLP.

Audit Fees

The aggregate fees billed for professional services rendered by BDO USA, LLP for the audit of our financial statements for our fiscal years ended December 31, 2016 and 2017 and the review of the financial statements on Forms 10-Q for the fiscal quarters in such fiscal years were approximately \$282,796 and \$302,171, respectively.

Audit Related Fees

During the years ended December 31, 2016 and 2017, there were no audit related fees.

Tax Fees

We were not billed by nor was there any tax work performed by BDO USA, LLP during the years ended December 31, 2016 or 2017.

All Other Fees

No other fees were billed by BDO USA, LLP, during our fiscal years ended December 31, 2016 and 2017, other than as described above.

Audit Committee Pre-Approval Policies and Procedures

As of the date of this proxy statement, our Audit Committee has not established general pre-approval policies and as of December 31, 2017, our Audit Committee had not established pre-approval policies and procedures for the engagement of our principal accountant to render audit or non-audit services. However, in accordance with Section 10A(i) of the Exchange Act, our Audit Committee, as a whole, approves the engagement of our principal accountant prior to the accountant rendering audit or non-audit services.

Certain rules of the Securities and Exchange Commission provide that an auditor is not independent of an audit client if the services it provides to the client are not appropriately approved, subject, however, to a *de minimus* exception contained in the rules. The Audit Committee pre-approved all services provided by BDO USA, LLP in 2017 and the *de minimus* exception was not used.

SHAREHOLDER PROPOSALS

Under SEC Rule 14a-8, if a shareholder wants us to include a proposal in our proxy statement and form of proxy for presentation at our 2019 Annual Meeting of Shareholders, the proposal must be received by us at our principal executive offices at 508 West Wall Street, Suite 550, Midland, Texas 79701 by December 28, 2018, unless the date of our 2019 Annual Meeting of Shareholders is more than 30 days from the anniversary date of our 2018 Annual Meeting of Shareholders, in which case the deadline is a reasonable time before we print and mail our proxy materials for the 2019 Annual Meeting of Shareholders. The proposal should be sent to the attention of the Secretary of Natural Gas Services Group.

Rule 14a-4 of the SEC's proxy rules allows a company to use discretionary voting authority to vote on matters coming before an annual meeting of shareholders for the prior year's annual meeting of shareholders or the date specified by an overriding advance notice provision in the company's bylaws. Our bylaws do not contain such an advance notice provision. Accordingly, for our 2019 annual meeting, shareholders' written notices must be received by us before March 13, 2019 for any proposal a shareholder wishes to bring before the meeting but for which such shareholder does not seek to have a written proposal considered for inclusion in the proxy statement and form of proxy. Your notice should be addressed to President, Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701.

In order to curtail controversy as to the date on which a proposal was received by us, it is suggested that proponents submit their proposals by certified mail-return receipt requested. Such proposals must also meet the other requirements established by the SEC for shareholder proposals.

COMMUNICATIONS WITH THE BOARD OF DIRECTORS

Because of our relatively small size, to date we have not developed formal processes by which shareholders or other interested parties may communicate directly with Directors. Until formal procedures are developed and posted on our website (www.ngsgi.com), any communication to one or more members of our Board of Directors may be made by sending them in care of Investor Relations, Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701. Shareholders should clearly note on the mailing envelope that the letter is a "Shareholder-Board Communication." All such communications will be forwarded to the intended recipients.

OTHER MATTERS

Our Board of Directors does not know of any matters to be presented at the meeting other than the matters set forth herein. If any other business should come before the meeting, the person's named in the enclosed proxy card will vote such proxy according to their judgment on such matters.

New York Stock Exchange Certification. We listed our common stock on the New York Stock Exchange in October 2008. The certification of our Chief Executive Officer required by the NYSE Listing Standards, Section 303A.12(a), relating to our compliance with the NYSE Corporate Governance Listing Standards, was submitted to the NYSE on June 5, 2017, in connection with our listing on the exchange. The certifications of our Chief Executive Officer and Principal Accounting Officer required by the SEC in connection with our Annual Report on Form 10-K for the year ended December 31, 2017, were submitted to the SEC on March 9, 2018, with our Annual Report on Form 10-K.

You may obtain our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, without charge upon written request to Stephen C. Taylor, President, at Natural Gas Services Group, Inc., 508 West Wall Street, Suite 550, Midland, Texas 79701. In addition, the exhibits to the Annual Report on Form 10-K for the fiscal year ended December 31, 2017, may be obtained by any shareholder upon written request to Mr. Taylor.

In addition, 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. We do not intend for information contained in our website to be part of this proxy statement.

BY ORDER OF THE BOARD OF DIRECTORS

April 30, 2018
Midland, Texas

/s/ Stephen C. Taylor

Stephen C. Taylor
Chairman of the Board, President and Chief
Executive Officer

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FORM 10-K

— 2017 ANNUAL REPORT —



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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, 2017**

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)

<u>Colorado</u>	<u>75-2811855</u>
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
<u>508 W. Wall St. Suite 550, Midland, Texas</u>	<u>79701</u>
(Address of principal executive offices)	(Zip Code)
<u>Registrant's telephone number, including area code:</u>	<u>(432) 262-2700</u>
Securities registered pursuant to Section 12(b) of the Act:	
<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
<u>Common Stock, \$.01 par value</u>	<u>New York Stock Exchange</u>

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

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

Yes No

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

Yes No

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Yes No

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

(Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company
(Do not check if 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 No

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2017 was approximately \$321,493,471 based on the closing price of the common stock on that date on the New York Stock Exchange.

At March 2, 2018, there were 12,982,262 shares of the Registrant's common stock outstanding.

Documents Incorporated by Reference

Certain information called for in Items 10, 11, 12, 13 and 14 of Part III are incorporated by reference to the registrant's definitive proxy statement for the annual meeting of shareholders to be held on June 21, 2018.

FORM 10-K
NATURAL GAS SERVICES GROUP, INC.
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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- conditions in the oil and natural gas industry, including the supply and demand for natural gas and wide fluctuations and possible prolonged depression in the prices of oil and natural gas;
- economic challenges presently faced by our customers in the oil and natural gas business that, in turn, could adversely affect our sales, rentals and collectability of our accounts receivable;
- regulation or prohibition of new well completion techniques;
- competition among the various providers of compression services and products;
- changes in safety, health and environmental regulations;
- changes in economic or political conditions in the markets in which we operate;
- failure of our customers to continue to rent equipment after expiration of the primary rental term;
- the inherent risks associated with our operations, such as equipment defects, malfunctions and natural disasters;
- our inability to comply with covenants in our debt agreements and the decreased financial flexibility associated with our debt;
- future capital requirements and availability of financing;
- fabrication and manufacturing costs;
- general economic conditions;
- acts of terrorism; and
- fluctuations in interest rates.

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

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, with an emerging position in the large horsepower market. 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. hydrocarbon 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 production 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 to enable gas to continue to flow in the pipeline to its destination.

Our revenue decreased to \$67.7 million from \$71.7 million for the year ended December 31, 2017 compared to the year ended December 31, 2016. Net income for the year ended December 31, 2017 increased to \$19.9 million (\$1.51 per diluted share), includes a net income tax benefit of approximately \$18.4 million due to a reduction in corporate income tax rates (see Note 7 to our Consolidated Financial Statements for further information), as compared to \$6.5 million (\$0.50 per diluted share) for the year ended December 31, 2016.

At December 31, 2017, current assets were \$108.2 million, which included \$69.2 million of cash and cash equivalents. Current liabilities were \$7.5 million, and the amount outstanding on our line of credit at December 31, 2017 was \$417,000. Our stockholders' equity as of December 31, 2017 was \$257.3 million.

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

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.

The steep decline in oil prices towards the end of 2014 resulted in capital budget cuts for many energy companies in 2015 and 2016. These budget reductions translated to fewer well completions and a softening of near-term demand for compression. In the latter half of 2017, we began to see an increase in oil prices and activity, and we anticipate a continuation of these increased prices and activity in E&P companies in 2018. 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 oil in the United States increased 1.0% while natural gas decreased 1.1% for the twelve months ended November 2017 compared to the same period 2016. This follows a 0.3% and 1.6% increase in oil consumption and a 0.6% and 3.2% increase in natural gas consumption in the periods from 2015 to 2016 and 2014 to 2015, respectively. EIA expects total oil and natural gas consumption in the U.S. to increase in the U.S in 2018. While we anticipate long-term increased demand for oil and natural gas, we expect our business to continue to experience pressure on revenues in 2018 due to the delayed impact of an upturn on the compression business.

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 sustained oil price collapse that began towards the end of 2014 has made 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 in the United States and worldwide. Over the last several years gas prices have not shown the resiliency that crude oil prices have typically shown. Now crude prices are beginning to show strength. 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. Prices for oil and natural gas will also be determined by the energy strategies of the world's top producing companies.

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. Balance sheet pressure associated with low energy prices could make renting an even more likely option, as overall producing activity begins to increase.

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

- the increasing demand for 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.
- the increase in worldwide mobility of natural gas via LNG

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 natural gas and oil production. We provide rental of small to medium horsepower compression equipment, with an emerging position in the large horsepower market, 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. At December 31, 2017, 32% of our rented compressors were under a lease term while the remainder were leased on a month-to-month basis. 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, 2017, we had 2,546 natural gas compressors in our rental fleet totaling 369,961 horsepower, as compared to 2,530 natural gas compressors totaling 362,408 horsepower at December 31, 2016. As of December 31, 2017, we had 1,259 natural gas compressors totaling 184,382 horsepower rented to 87 customers, compared to 1,298 natural gas compressors totaling 186,328 horsepower rented to 79 customers at December 31, 2016. As of December 31, 2017, the utilization rate of our rental fleet was 49.5% compared to 51.3% as of December 31, 2016.

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 late 2014, our strategy has been to reduce expenses in line with the lower anticipated business activity, and fabricate compressor equipment only in direct response to market requirements. As the industry recovery has been slow, we will continue with this strategy. 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 prudently 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, with an emerging position in the large horsepower market.
- ***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, joint ventures and other opportunities that could 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 has 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 Occidental Permian, LTD. ("Oxy") and Devon Energy Production, Inc. ("Devon") for the year ended December 31, 2017 amounted to 20% and 15% of our revenue, respectively. Sales and rental income to Devon and Oxy for the year ended December 31, 2016 amounted to 21% and 19% of our revenue, respectively. Sales and rental income to Devon and Oxy for the year ended December 31, 2015 amounted to 21% and 10% of our revenue. No other single customer accounted for more than 10% of our revenues in 2017, 2016 or 2015.

Oxy amounted to 14% of our accounts receivables as of December 31, 2017. Oxy, APR Energy, LLC and BP America Inc. amounted to 15%, 15% and 14% of our accounts receivable as of December 31, 2016. No other customers amounted to more than 10% of our accounts receivable as of December 31, 2017 and 2016. 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, 2017, we had a sales backlog of approximately \$7.8 million compared to \$6.0 million as of December 31, 2016. We are scheduled to fulfill the backlog primarily in the first half of 2018. 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, 2017, we had 235 total employees, none of which are represented by a labor union. We believe we have good relations with our employees.

Liability and Other Insurance Coverage

Our equipment and services are provided to customers who are subject to hazards inherent in the oil and natural gas industry, such as 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 Clean Water Act ("CWA") and the Oil Pollution Act of 1990 and implementing regulations govern:

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

The CWA and analogous state laws impose restrictions and strict controls with respect to the discharge of pollutants, including spills and leaks of oil and other substances, into waters of the United States. The discharge of pollutants into regulated

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

Air Emissions

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

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

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

In 2012, the EPA finalized rules that establish new air emission controls for oil and natural gas production and natural gas processing operations. Specifically, the EPA’s rule package included New Source Performance Standards to address emissions of sulfur dioxide and volatile organic compounds (“VOCs”) and a separate set of emission standards to address hazardous air pollutants frequently associated with oil and natural gas production and processing activities. The rules established specific new requirements regarding emissions from compressors and controllers at natural gas processing plants, dehydrators, storage tanks and other production equipment as well as the first federal air standards for natural gas wells that are hydraulically fractured. The EPA has taken a number of steps to amend or expand on these regulations since 2012. For example, in June 2016, the EPA published New Source Performance Standards that require certain new, modified or reconstructed facilities in the oil and natural gas sector to reduce methane gas and VOC emissions. However, in a March 2017 executive order, President Trump directed the EPA to review the 2016 regulations and, if appropriate, to initiate a rulemaking to rescind or revise them consistent with the stated policy of promoting clean and safe development of the nation’s energy resources, while at the same time avoiding regulatory burdens that unnecessarily encumber energy production. On June 16, 2017, the EPA published a proposed rule to stay for two years certain requirements of the 2016 regulations, including fugitive emission requirements.

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

To the extent that new laws or other governmental actions restrict the energy industry or impose additional environmental protection requirements that result in increased costs to the oil and gas industry, we could be adversely affected. We cannot

determine to what extent our future operations and earnings may be affected by new legislation, new regulations or changes in existing regulations.

Occupational Safety and Health

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

Patents, Trademarks and Other Intellectual Property

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

Suppliers and Raw Materials

Fabrication of our rental compressors involves the purchase by us of engines, compressors, coolers and other components, and the assembly of these components on skids for delivery to customer locations. These major components of our compressors are acquired through periodic purchase orders placed with third-party suppliers on an "as needed" basis, which typically requires a three to 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 on 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.

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 and oil 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 significant. Uncertainty and turmoil in the credit markets may negatively impact the ability of our customers to finance purchases of our products and services and could result in a decrease in, or cancellation of, orders included in our backlog or adversely affect the collectability of our receivables. If the availability of credit to our customers is reduced, they may reduce their drilling and production expenditures, thereby decreasing demand for our products and services, which could have a negative impact on our financial condition. A prolonged period of depressed prices for 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 adversely affect our revenue.

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

- the level of oil and natural gas production;
- the level of oil and natural gas inventories;
- domestic and worldwide demand for oil and natural gas;
- the expected cost of developing new reserves;
- the cost of producing oil and natural gas;

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

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 prolonged reduction in drilling and production activities historically has materially eroded 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 have been required to enter into lower rate rental contracts in response to market conditions and our rentals and sales revenue have decreased as a result of such conditions. Due to the short-term nature of most of our rental contracts, changes in market conditions can quickly affect our business. As a result of the cyclicity of our industry, we anticipate results of operations will be volatile in the future.

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

From time to time, for example, legislation has been proposed in Congress to amend the federal Safe Drinking Water Act ("SDWA") to require federal permitting of hydraulic fracturing and the disclosure of chemicals used in the hydraulic fracturing process. Further, the EPA completed a study finding that hydraulic fracturing could potentially harm drinking water resources under adverse circumstances such as injection directly into groundwater or into production wells lacking mechanical integrity. Further, legislation to amend the SDWA to repeal the exemption for hydraulic fracturing (except when diesel fuels are used) from the definition of "underground injection" and require federal permitting and regulatory control of hydraulic fracturing, as well as legislative proposals to require disclosure of the chemical constituents of the fluids used in the fracturing process, have been proposed in recent sessions of Congress. Several states and local jurisdictions also have adopted or are considering adopting regulations that could restrict or prohibit hydraulic fracturing in certain circumstances, impose more stringent operating standards and/or require the disclosure of the composition of hydraulic fracturing fluids.

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

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

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

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

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

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

Risks Associated With Our Company

As of December 31, 2017, a 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 has and will have a material adverse effect upon our business, financial condition, results of operations and cash flows.

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

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

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

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

The loss of one or more of our current customers could adversely affect our results of operations.

Our business is dependent not only on securing new customers but also on maintaining current customers. We had two customers that accounted for an aggregate of approximately 35% of our revenue for the year ended December 31, 2017, and two customers that accounted for an aggregate of approximately 40% of our revenue for the year ended December 31, 2016. At December 31, 2017, one customer accounted for an aggregate of 14% 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.

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

In keeping with our streamlined approach to our business, our executive management team consists of three officers: our (i) Chief Executive Officer, (ii) Chief Financial Officer and (iii) Vice President of Technical Services. We depend on the continued employment and performance of these three key members of our executive management team. In particular, we are significantly reliant upon the leadership and guidance of Stephen C. Taylor, who has been our President, Chief Executive Officer and Board member since 2004. In addition to his management duties, Mr. Taylor has been instrumental in our communications and standing with the investment community. If any of our key executives resign or become unable to continue in his present role and is not adequately replaced, our business operations could be materially adversely affected. We do not carry any key-man insurance on any of our officers or directors.

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

Many of our customers finance their exploration and development activities through cash flow from operations, the incurrence of debt or the issuance of equity. During times when the oil or natural gas markets weaken, our customers are more likely to experience a downturn in their financial condition. Many of our customers' equity values and liquidity substantially declined during the most recent fall in oil and natural gas prices, and in some cases access to capital markets may be an unreliable source of financing for some customers. The combination of a reduction in cash flow resulting from declines in commodity prices, a reduction in borrowing bases under reserve-based credit facilities and the lack of availability of debt or equity financing may result in flat or moderate growth in our customers' spending for our products and services in 2018. For example, our customers could seek to preserve capital by canceling month-to-month contracts, canceling or delaying scheduled maintenance of their existing natural gas compression equipment or determining not to enter into any new natural gas compression service contracts or purchase new compression equipment.

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

Many of the compressors that we sell or rent are mechanically complex and often must perform in harsh conditions. We believe that our success depends upon our ability to employ and retain a sufficient number of technical personnel who have the ability to design, utilize, enhance and maintain these compressors. Our ability to 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 may require a substantial amount of capital to expand our compressor rental fleet and grow our business.

During 2018, the amount we will spend on capital expenditures related to rental compression equipment will be determined primarily by the activity of our customers. The amount and timing of any 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 cash flows from operations and borrowings under bank credit facilities. Although we believe that cash on hand, cash flows from our operations and/or bank borrowing from our line of credit will provide us with sufficient cash to fund our planned capital expenditures for 2018, we cannot assure you that these sources will be sufficient. We may require additional capital to fund any significant unanticipated capital expenditures, such as material acquisition. To the extent we would require any necessary capital, it may not be available to us when we need it or on acceptable terms. Our ability to raise additional capital will depend on the results of our operations and the status of various capital and industry markets at the time we seek such capital. Failure to generate sufficient cash flow, together with the absence of alternative sources of capital, could have a material adverse effect on our business, financial condition, results of operations or cash flow.

Of our \$30 million line of credit, we owe \$417,000 as of December 31, 2017. All outstanding principal and unpaid interest is due on December 31, 2020. 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 than our existing line. For instance, changes in the terms of a new line of credit may include, but not be limited to: a reduction in the borrowing amount, an increase in interest rate to be paid on borrowings under the line, or restrictive covenants that are more onerous than those on our existing line of credit.

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

Should we utilize our full debt capacity, growth beyond that point could be impacted. As of December 31, 2017, we had an aggregate of approximately \$417,000 of outstanding indebtedness, and accounts payable and accrued expenses of approximately \$7.3 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:

- 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, 2017, 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 2018. 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 evaluate potential acquisitions of other businesses or assets. However, there can be no assurance that we will be successful in consummating any such acquisitions. Successful acquisition of businesses or assets will depend on various factors, including, but not limited to, our ability to obtain financing and the competitive environment for acquisitions. In addition, we may not be able to successfully integrate any businesses or assets that we acquire in the future. The integration of acquired businesses is likely to be complex and time consuming and place a significant strain on management and may disrupt our business. We also may be adversely impacted by any unknown liabilities of acquired businesses, including environmental liabilities. We may encounter substantial difficulties, costs and delays involved in integrating common accounting, information and communication systems, operating procedures, internal controls and human resources practices, including incompatibility of business cultures and the loss of key employees and customers. These difficulties may reduce our ability to gain customers or retain existing customers, and may increase operating expenses, resulting in reduced revenues and income and a failure to realize the anticipated benefits of acquisitions.

Failure to effectively manage our 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.

Changes in accounting pronouncements or taxation rules or practices may adversely affect our financial results.

Changes in accounting pronouncements or taxation rules or practices can have a significant effect on our reported results. New accounting pronouncements and taxation rules can have a material impact on effective tax rates, results of operations, and our financial condition. On December 22, 2017, President Trump signed into law the statute commonly referred to as the Tax Cuts and Jobs Act (“2017 Tax Act”), which makes broad and complex changes to the U.S. tax code. As we collect and prepare necessary

data, and interpret the 2017 Tax Act and any additional guidance issued by the IRS or other standard-setting bodies, we may make adjustments to the provisional amounts in accordance with Staff Accounting Bulletin No. 118 (“SAB 118”), which provides SEC staff guidance for the application of ASC 740 in the reporting period in which the 2017 Tax Act was signed into law. This change could materially affect our financial position.

Our income taxes may change.

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

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

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

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

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 and results of operations.

The Company has witnessed the effects of the foregoing risks. Since the beginning of the steep decline in oil and gas prices in late 2014, the Company's revenues have declined approximately 30% from 2014 and its compressor utilization rate has declined from 76.0% at December 31, 2014 to 49.5% at December 31, 2017.

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

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

We are also subject to cyber security attacks and have taken steps to minimize the probability of an attack penetrating our systems. These include network security, virus protection, filtering software and intrusion protection measures. While an attack could potentially disrupt our activity, we do not house sensitive data that would affect the privacy of our customers, employees or business partners.

Risks Associated With Our Common Stock

The price of our common stock may fluctuate.

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

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 15.25% of the outstanding shares of our common stock are owned by two institutional investors, each of which owns more than 5.0% of our outstanding shares as of March 5, 2018. 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 6.0% of the outstanding shares of our common stock as of March 5, 2018, and because of the negative perception of sales by insiders, could also have a negative impact on our stock price.

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

Because of our relatively low number of outstanding shares of common stock, the trading price of our common stock will likely be subject to significant price fluctuations and limited liquidity. This may adversely affect the value of your investment. In addition, our common stock price 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 under certain circumstances.

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, 2017:

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
Midland, Texas	Owned	—	Corporate Office*
Total		<u>222,035</u>	

*In 2017, the Company purchased 3.059 acres in Midland, Texas for the location of its new corporate office. Construction for the new 45,000 sq ft building is under way, and expected to cost approximately \$12.0 million and complete in the first quarter of 2019.

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

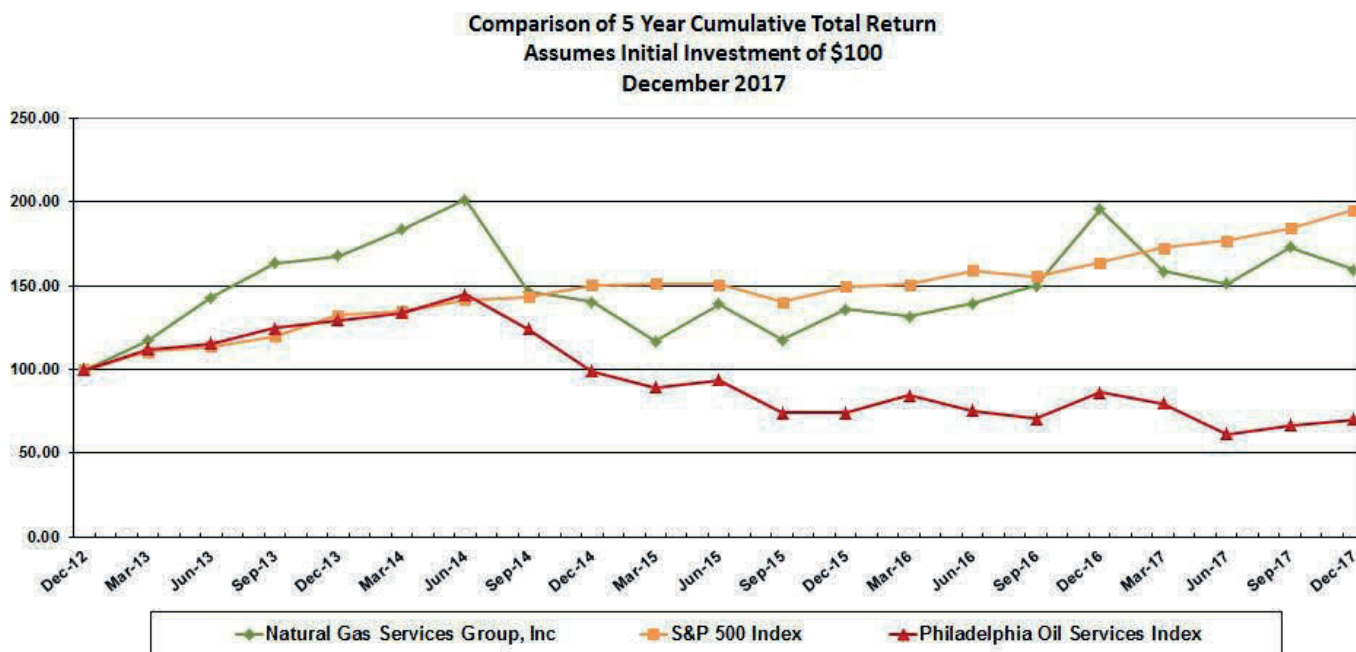
ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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 2017 and 2016.

2017	Low	High
First Quarter	\$24.50	\$32.05
Second Quarter	22.85	28.80
Third Quarter	22.80	29.25
Fourth Quarter	24.35	29.05
2016	Low	High
First Quarter	\$16.16	\$22.41
Second Quarter	20.27	24.61
Third Quarter	22.18	26.00
Fourth Quarter	21.00	33.90

As of December 31, 2017 as reflected by our transfer agent records, we had 18 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, 2018, the last reported sale price of our common stock as reported by the New York Stock Exchange was \$26.45 per share.

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



The performance graph shall not be deemed incorporated by reference by any general statement incorporating by reference 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 a cash dividend on our common stock. Although we intend to retain our earnings, if any, to finance the growth of our business, our Board of Directors will have the discretion to declare and pay dividends in the future. Payment of dividends in the future will depend upon our earnings, capital requirements, and other factors, which our Board of Directors may deem relevant. Our credit agreement also contains restrictions on our paying dividends under certain circumstances.

Equity Compensation Plans

The following table summarizes certain information regarding our equity compensation plans as of December 31, 2017:

Plan Category	(a) Number of Securities Issued or to be Issued Upon Exercise of Outstanding Options	(b) Weighted- average Issuance or Exercise Price of Outstanding Options	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders:			
Stock Option Plan	327,270 ⁽¹⁾	\$ 20.21	313,169
Restricted Stock / Unit Plan	184,389	\$ 25.32	162,770
Total	511,659		475,939

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

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, 2017.

Sale of Unregistered Securities

We made no sales of unregistered securities during the year ended December 31, 2017.

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, 2017. In the table we also present non-GAAP financial measures, Adjusted EBITDA and Adjusted Gross Margin, which we use in our business. These measures are not calculated or presented in accordance with GAAP. We explain these measures below and reconcile them to the most directly comparable financial measure calculated and presented in accordance with GAAP in "Non-GAAP Financial Measures." 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,				
	2017	2016	2015	2014	2013
	<i>(in thousands, except per share amounts)</i>				
STATEMENTS OF INCOME AND OTHER INFORMATION:					
Revenues	\$ 67,693	\$ 71,654	\$ 95,919	\$ 96,974	\$ 89,248
Costs of revenues, exclusive of depreciation and amortization shown separately below	34,743	31,872	42,655	43,147	40,943
Loss on retirement of rental equipment	—	545	4,370	—	—
Depreciation and amortization	21,302	21,796	22,758	21,507	18,144
Selling, general and administrative expenses	10,081	9,011	10,989	10,334	8,141
Operating income	1,567	8,430	15,147	21,986	22,020
Total other income, net	36	35	117	172	492
Income before income taxes	1,603	8,465	15,264	22,158	22,512
Income tax (benefit) expense	(18,248)	1,996	5,117	8,030	8,122
Net income	\$ 19,851	\$ 6,469	\$ 10,147	\$ 14,128	\$ 14,390
Net income per common share:					
Basic	\$ 1.55	\$ 0.51	\$ 0.81	\$ 1.14	\$ 1.17
Diluted	\$ 1.51	\$ 0.50	\$ 0.79	\$ 1.11	\$ 1.15
Weighted average shares of common stock outstanding:					
Basic	12,831	12,702	12,567	12,434	12,324
Diluted	13,110	12,935	12,793	12,721	12,550
Adjusted EBITDA ⁽¹⁾	\$ 22,919	\$ 30,814	\$ 42,407	\$ 43,675	\$ 40,712
Adjusted gross margin ⁽²⁾	\$ 32,950	\$ 39,782	\$ 53,264	\$ 53,827	\$ 48,305
Cash flows from:					
Operating Activities	\$ 17,452	\$ 31,785	\$ 41,566	\$ 33,742	\$ 40,039
Investing Activities	(12,791)	(3,414)	(12,270)	(52,280)	(44,119)
Financing Activities	453	191	55	276	437
Net change in cash and cash equivalents	\$ 5,114	\$ 28,562	\$ 29,351	\$ (18,262)	\$ (3,643)

	As of December 31,				
	2017	2016	2015	2014	2013
	<i>(in thousands)</i>				
BALANCE SHEET INFORMATION:					
Current assets	\$ 108,226	\$ 95,359	\$ 68,074	\$ 49,631	\$ 54,062
Total assets	298,310	293,524	285,553	282,712	256,589
Long-term debt (including current portion)	417	417	417	417	577
Stockholders' equity	257,319	232,954	223,981	210,587	192,737

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

(2) Adjusted Gross Margin is defined, reconciled to operating income and discussed immediately below under "Non-GAAP Financial Measures".

Non-GAAP Financial Measures

Our definition and use of Adjusted EBITDA

“Adjusted EBITDA” is a non-GAAP financial measure that we define as earnings (net income) from operations before interest, taxes, loss on retirement of rental equipment, 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. Adjusted EBITDA should not be considered in isolation or as a substitute for operating income, net income or loss, cash flows provided by operating, investing and financing activities, or other income or cash flow statement data prepared in accordance with GAAP. However, management believes Adjusted EBITDA is useful to an investor in evaluating our operating performance because:

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

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

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

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

Reconciliation

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

	Year Ended December 31,				
	2017	2016	2015	2014	2013
	<i>(in thousands)</i>				
Net Income	\$ 19,851	\$ 6,469	\$ 10,147	\$ 14,128	\$ 14,390
Interest expense	14	8	15	10	56
Income taxes (benefit) expense	(18,248)	1,996	5,117	8,030	8,122
Loss on retirement of rental equipment	—	545	4,370	—	—
Depreciation and amortization	21,302	21,796	22,758	21,507	18,144
Adjusted EBITDA	<u>\$ 22,919</u>	<u>\$ 30,814</u>	<u>\$ 42,407</u>	<u>\$ 43,675</u>	<u>\$ 40,712</u>

Our definition and use of Adjusted Gross Margin

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

Adjusted gross margin has certain material limitations associated with its use as compared to operating 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, adjusted gross margin should not be considered an alternative to, or more meaningful than, operating income as determined in accordance with GAAP. Our adjusted gross margin may not be comparable to a similarly titled measure of another company because other entities may not calculate adjusted gross margin in the same manner.

Reconciliation

The following table reconciles our operating income, the most directly comparable GAAP financial measure, to Adjusted Gross Margin:

	Year Ended December 31,				
	2017	2016	2015	2014	2013
	<i>(in thousands)</i>				
Operating Income	\$ 1,567	\$ 8,430	\$ 15,147	\$ 21,986	\$ 22,020
Depreciation and amortization	21,302	21,796	22,758	21,507	18,144
Selling, general, and administration expenses	10,081	9,011	10,989	10,334	8,141
Loss on retirement of rental equipment	—	545	4,370	—	—
Adjusted Gross Margin	<u>\$ 32,950</u>	<u>\$ 39,782</u>	<u>\$ 53,264</u>	<u>\$ 53,827</u>	<u>\$ 48,305</u>

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, 2017, 2016 and 2015. 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 include maintenance charges and are paid monthly in advance. As of December 31, 2017, we had 1,259 natural gas compressors totaling 184,382 horsepower rented to 87 customers, compared to 1,298 natural gas compressors totaling 186,328 horsepower rented to 79 customers at December 31, 2016. Of the 1,259 compressors rented at December 31, 2017, 853 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 non-rental customers under written maintenance contracts or on an as required basis in the absence of a service contract. Maintenance agreements typically have terms of six months to one year and require payment of a monthly fee.

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

	Year Ended December 31,		
	2017	2016	2015
	(in thousands)		
Rental	\$ 46,046	\$ 56,717	\$ 76,432
Sales	20,208	13,621	18,519
Service and maintenance	1,439	1,316	968
Total	<u>\$ 67,693</u>	<u>\$ 71,654</u>	<u>\$ 95,919</u>

Our strategy for growth is focused on our compressor rental business. Margins, exclusive of depreciation and amortization, for our rental business historically run in the 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, exclusive of depreciation and amortization, to improve over time.

The oil and natural gas equipment rental and services industry is cyclical in nature. The most critical factor in assessing the outlook for the industry is the worldwide supply and demand for 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 and oil shale and tight gas, which typically requires more compression than production from conventional natural gas reservoirs.

Demand for our products and services was relatively strong through most of 2014 due to increasing oil prices, in spite of continued low natural gas prices. Towards the end of 2014 crude oil prices collapsed and remained low through mid-2017, placing uncertainty on the growth in demand for our products and services.

For fiscal year 2018, our forecasted capital expenditures will be directly dependent upon our customers' compression requirements and are not anticipated to exceed our internally generated cash flows. Any required capital will be for additions to our compressor rental fleet and/or addition or replacement of service vehicles. We believe that cash on hand and cash flows from operations will be sufficient to satisfy our capital and liquidity requirements through 2018. If we require additional capital to fund any significant unanticipated expenditures, including any material acquisitions of other businesses, joint ventures or other opportunities, which exceed our current resources. To the extent needed, any such additional capital may not be available to us when we need it or on acceptable terms.

Notwithstanding the continued 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. 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. Revenue from the sale of rental units is included in sales revenue when equipment is shipped or title is transferred to the customer.

From time to time, upon the customer's written request, we recognize revenue when manufacturing is complete and the equipment is ready for shipment. At the customer's request, we will bill the customer upon completing all performance obligations, but before shipment. The customer will formally request we ship the equipment per their direction from our manufacturing facility at a later specified date and that we segregate the equipment from our finished goods, such that they are not available to fill other orders. Title of the equipment and risk of loss passes to the customer when the equipment is complete and ready for shipment, per the customer's agreement. At the transfer of title, all risks of ownership has passed to the customer on the manufactured items that have not yet been shipped. We have operated using bill and hold agreements with certain customers for many years, with consistent satisfactory results for both the customer and us. The credit terms on this agreement are consistent with the credit terms on all other sales. All risks of loss are shouldered by the customer, and there are no exceptions to the customer's commitment to accept and pay for these manufactured equipment. Revenues recognized at the completion of manufacturing in 2017 and 2016 were approximately \$4.6 million and \$5.6 million, respectively.

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, 2017, one customer accounted for 14% of our accounts receivable, and at December 31, 2016, three customers accounted for approximately 15%, 15% 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 receivable and our future operating results. At December 31, 2017 and 2016, our allowance for doubtful accounts balance was \$569,000 and \$597,000, respectively.

Accounting for Income Taxes

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

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "2017 Tax Act"), which makes broad and complex changes to the U.S. tax code. Certain income tax effects of the 2017 Tax Act are reflected in the Company's financial results in accordance with Staff Accounting Bulletin No. 118 ("SAB 118"), which provides SEC staff guidance regarding the application of Accounting Standards Codification Topic 740 Income Taxes ("ASC 740"). See Note 7, "Income Taxes," to our Consolidated Financial Statements included here for further information on the financial statement impact of the 2017 Tax Act.

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 for impairment on our goodwill and indefinite-lived intangibles assets during the fourth quarter of 2017. Our analysis considered multiple qualitative factors to determine whether events and circumstances indicate that we more than likely than not 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 or indefinite-lived intangibles was recorded during the year ended December 31, 2017. Future impairment tests could result in impairments of our intangible assets or goodwill.

Inventories

We value our total inventory (current and long-term) at the lower of the actual cost and net realizable value of the inventory. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and production requirements. At December 31, 2017, an adjustment to the allowance of \$273,000 or 1% of inventory was made to remove obsolete inventory and bring inventory to current estimated net realizable value. This adjustment was the result of our obsolescence and lower cost and net realizable value which is conducted each year. We ended 2017 with an inventory allowance balance of \$15,000.

Our Performance Trends and Outlook

In anticipation of a slow recovery of natural gas and oil prices our customers are expected to be cautious in capital investments. We expect the overall activity levels will increase as we move through 2018. The expected slow increase in capital commitments and the inherent delay in demand for our products may result in modestly higher activity levels for 2018. In addition, we may continue to experience price pressure from our competitors until a more stable demand for products and services is established. We believe our fabrication business will likely reflect this level of activity in our production level through 2018. We believe growth in our rental operations business will also be moderated by this slow recovery.

Results of Operations

Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016

The table below shows our revenues and percentage of total revenues for each of our product lines for the years ended December 31, 2017 and December 31, 2016.

	Revenue			
	Year Ended December 31,			
	2017		2016	
	<i>(dollars in thousands)</i>			
Rental	\$ 46,046	68.0%	\$ 56,717	79.2%
Sales	20,208	29.9%	13,621	19.0%
Service & Maintenance	1,439	2.1%	1,316	1.8%
Total	<u>\$ 67,693</u>		<u>\$ 71,654</u>	

Total revenue decreased to \$67.7 million from \$71.7 million, or 5.5%, for the year ended December 31, 2017, compared to 2016. This was the result of a 18.8% decrease in rental revenue offset by a 48.4% increase in sales revenue and a 9.3% increase in service and maintenance revenue.

Rental revenue decreased to \$46.0 million from \$56.7 million, or 18.8%, for the year ended December 31, 2017, compared to 2016. This decrease is due to reduced demand from the lower average oil and natural prices for the year ended December 31, 2017, resulting in units being returned. As of December 31, 2017, we had 2,546 natural gas compressors in our rental fleet totaling 369,961 horsepower, as compared to 2,530 natural gas compressors totaling 362,408 horsepower as of December 31, 2016. As of December 31, 2017, we had 1,259 natural gas compressors totaling 184,382 horsepower rented to 87 customers, compared to 1,298 natural gas compressors totaling 186,328 horsepower rented to 79 customers as of December 31, 2016. The rental fleet had a utilization of 49.5% as of December 31, 2017 as compared to 51.3% at December 31, 2016.

Sales revenue increased to \$20.2 million from \$13.6 million, or 48.4%, for the year ended December 31, 2017, compared to 2016. Our sales activity continues to reflect a demand from our customers' investments in non-conventional shale plays which require compression for producing natural gas. Due to lagging crude oil prices, along with economic uncertainty and continued tight credit markets, the energy industry continued to encounter reduced capital spending. While our strategy is to maintain our rental revenues so that they are a larger component of total revenue, we will continue to build and sell custom fabricated equipment. In support of this, we intend to cultivate new sales oriented customers and are actively pursuing small, medium and large reciprocating compressor fabrication projects, as well as, building rotary screw-type equipment of any size. Sales include: (1) compressor unit sales, (2) flare sales, (3) parts sales and (4) compressor rebuilds.

Operating income decreased to \$1.6 million from \$8.4 million, for the year ended December 31, 2017, compared to 2016. This decrease is attributed to a 18.8% drop in our rental revenue, due to the low oil and natural gas prices, resulting in the return of our units, as mentioned earlier.

During the fourth quarter of 2017, management performed a review of our rental compressor units and determined there were no units in our rental fleet which needed to be retired. In management's annual review performed in 2016, we determined that 63 units should be retired, with certain key components being re-utilized, representing total horsepower of 7,749. Based on this review, at December 31, 2016 we recorded a \$545,000 non-cash loss on the retirement of rental equipment to reduce the book value to approximately \$242,000, the estimated fair value of the key components being kept.

Selling, general, and administrative expenses increased to \$10.1 million for the year ended December 31, 2017, as compared to \$9.0 million for 2016. This 11.9% increase is primarily a result in an increase in stock compensation of \$1.7 million offset by a decrease in the executive incentive cash bonus of \$570,000.

Depreciation and amortization expense decreased to \$21.3 million from \$21.8 million, or 2.3%, for the year ended December 31, 2017, compared to 2016. The decrease is the result of fewer units being added to the fleet and older units becoming fully depreciated. We added only 20 units to our fleet over the past twelve months.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act ("2017 Tax Act"), which makes broad and complex changes to the U.S. tax code. Certain income tax effects of the 2017 Tax Act are reflected in our financial results in accordance with SAB 118. SAB 118 provides SEC staff guidance regarding the application of Accounting Standards Codification Topic 740 ("ASC 740") Income Taxes, and the required disclosures due to the enactment of the 2017 Tax Act. The income tax effects of the 2017 Tax Act include a \$18.4 million income tax benefit related to the re-measurement of our deferred tax assets and liabilities at the reduced rate of 21 percent. Refer to Note 7, "Income Taxes," in the Notes to the Consolidated Financial Statements for further information on the financial statement impact of the 2017 Tax Act.

Provision for income tax decreased to a benefit of \$18.2 million from \$2.0 million in expense for the year ended December 31, 2017 compared to 2016. This is a result of the \$18.4 million income tax benefit recorded in connection with the 2017 Tax Act, due to the re-measurement of our deferred tax assets and liabilities at the new federal statutory rate.

Year Ended December 31, 2016 Compared to the Year Ended December 31, 2015

The table below shows our revenue and percentage of total revenues for each of our product lines for the years ended December 31, 2016 and December 31, 2015.

	Revenue			
	Year Ended December 31,			
	2016		2015	
	<i>(dollars in thousands)</i>			
Rental	\$ 56,717	79.2%	\$ 76,432	79.7%
Sales	13,621	19.0%	18,519	19.3%
Service & Maintenance	1,316	1.8%	968	1.0%
Total	<u>\$ 71,654</u>		<u>\$ 95,919</u>	

Total revenue decreased to \$71.7 million from \$95.9 million, or 25.3%, for the year ended December 31, 2016, compared to 2015. This was the result of a 25.8% decrease in rental revenue and a 26.4% decrease in sales revenue offset, partially, by a 36.0% increase in service and maintenance revenue.

Rental revenue decreased to \$56.7 million from \$76.4 million, or 25.8%, for the year ended December 31, 2016, compared to 2015. This decrease is due to reduced demand from the significant drop in oil and natural gas prices resulting in units being returned. As of December 31, 2016, we had 2,530 natural gas compressors in our rental fleet totaling 362,408 horsepower, as compared to 2,622 natural gas compressors totaling 372,482 horsepower as of December 31, 2015. As of December 31, 2016, we had 1,298 natural gas compressors totaling 186,328 horsepower rented to 79 customers, compared to 1,818 natural gas compressors totaling 256,204 horsepower rented to 84 customers as of December 31, 2015. The rental fleet had a utilization of 51.3% as of December 31, 2016 as compared to 69.3% at year end 2015.

Sales revenue decreased to \$13.6 million from \$18.5 million, or 26.4%, for the year ended December 31, 2016, compared to 2015. Our sales activity continues to reflect a softening of demand from our customers' investments in non-conventional shale plays which require compression for producing natural gas. Due to lagging crude oil prices, along with economic uncertainty and continued tight credit markets, the energy industry continues to encounter reduced capital spending. While our strategy is to maintain our rental revenues so that they are a larger component of total revenue, we will continue to build and sell custom fabricated equipment. In support of this, we intend to cultivate new sales oriented customers and are actively pursuing small, medium and large reciprocating compressor fabrication projects, as well as, building rotary screw-type equipment of any size. Sales include: (1) compressor unit sales, (2) flare sales, (3) parts sales and (4) compressor rebuilds.

Operating income decreased to \$8.4 million from \$15.1 million, for the year ended December 31, 2016, compared to 2015. This decrease is attributed to a 25.8% drop in our rental revenue, due to the significant drop in oil and natural gas prices, resulting in the return of our units, as mentioned earlier.

During the fourth quarter of 2016 management performed a review of our rental compressor units and determined that 63 units should be retired, with certain key components being re-utilized, representing total horsepower of 7,749. Based on this review, at December 31, 2016 we recorded a \$545,000 non-cash loss on the retirement of rental equipment to reduce the book value to approximately \$242,000, the estimated fair value of the key components being kept.

Selling, general, and administrative expenses decreased to \$9.0 million for the year ended December 31, 2016, as compared to \$11.0 million for 2015. This 18.0% decrease is primarily a result in a reduction in stock compensation of \$1.0 million due to moving from a one year vesting period to a two vesting period for our 2016 restricted stock awards to our executive officers and a decrease in the executive incentive cash bonus of \$400,000.

Depreciation and amortization expense decreased to \$21.8 million from \$22.8 million, or 4.4%, for the year ended December 31, 2016, compared to 2015. The decrease in depreciation expense is driven by the 258 units we retired in 2015 that had a net book value of \$5.3 million, which was slightly offset by the full year of depreciation recognized on the 52 units added to our rental fleet in 2015 and the 18 units we added in 2016.

Provision for income tax decreased to \$2.0 million from \$5.1 million, or 61.0%. This is the result of the decrease in pre-tax income and effective tax rate, due to research and development credits taken in 2016. Our effective tax rate was 23.6% for 2016 and 33.5% for 2015.

Adjusted Gross Margin Year Ended December 31, 2017 Compared to the Year Ended December 31, 2016

The table below shows our adjusted gross margin and related percentages for each of our product lines for the years ended December 31, 2017 and December 31, 2016. Adjusted gross margin is the difference between revenue and cost of revenues, exclusive of depreciation and amortization expense.

	Adjusted Gross Margin ⁽¹⁾			
	Year Ended December 31,			
	2017		2016	
	<i>(dollars in thousands)</i>			
Rental	\$ 27,959	60.7%	\$ 36,367	64.1%
Sales	3,922	19.4%	2,497	18.3%
Service & Maintenance	1,069	74.3%	918	69.8%
Total	<u>\$ 32,950</u>	<u>48.7%</u>	<u>\$ 39,782</u>	<u>55.5%</u>

(1) For a reconciliation of adjusted 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.

The overall adjusted gross margin percentage dropped to 48.7% for the year ended December 31, 2017 compared to 55.5% for the year ended December 31, 2016, exclusive of depreciation and amortization. Our drop in gross margins is mainly due to the drop in rental revenue margins due to some pricing pressures from our customers. Rental margins decreased for the year ended December 31, 2017 compared to 2016 to 60.7% from 64.1%. Sales margin increased to 19.4% from 18.3% for the year ended 2017 compared to 2016. Third party service and maintenance margins increased to 74.3% from 69.8% for the year ended December 31, 2017 compared to 2016. Service and maintenance represents 2% of our revenue providing minimal impact on our overall adjusted gross margin.

Adjusted Gross Margin Year Ended December 31, 2016 Compared to the Year Ended December 31, 2015

The table below shows our adjusted gross margin and related percentages for each of our product lines for the years ended December 31, 2016 and December 31, 2015. Adjusted gross margin is the difference between revenue and cost of revenues, exclusive of depreciation and amortization expense.

	Adjusted Gross Margin ⁽¹⁾			
	Year Ended December 31,			
	2016		2015	
	<i>(dollars in thousands)</i>			
Rental	\$ 36,367	64.1%	\$ 47,682	62.4%
Sales	2,497	18.3%	4,886	26.4%
Service & Maintenance	918	69.8%	696	71.9%
Total	<u>\$ 39,782</u>	<u>55.5%</u>	<u>\$ 53,264</u>	<u>55.5%</u>

(1) For a reconciliation of adjusted 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.

The overall adjusted gross margin percentage remained steady at 55.5% for the twelve months ended December 31, 2016 and December 31, 2015, exclusive of depreciation and amortization. Our ability to maintain the percentage during the depressed market is a result of the relatively higher margin rentals comprising a larger share of total revenue. Rental margins increased for the year ended December 31, 2016 compared to 2015 to 64.1% from 62.4%. Sales margin decreased to 18.3% from 26.4% for the year ended 2016 compared to 2015. Third party service and maintenance margins increased to 69.8% from 71.9% for the year ended December 31, 2016 compared to 2015. Service and maintenance represents 2% of our revenue providing minimal impact on our overall adjusted gross margin.

Liquidity and Capital Resources

Our working capital positions as of December 31, 2017 and 2016 are set forth below.

	2017	2016
	<i>(in thousands)</i>	
Current Assets:		
Cash and cash equivalents	\$ 69,208	\$ 64,094
Trade accounts receivable, net	8,534	7,378
Inventory, net	26,224	21,433
Prepaid income taxes	3,443	1,482
Prepaid expenses and other	817	972
Total current assets	<u>108,226</u>	<u>95,359</u>
Current Liabilities:		
Line of credit	\$ —	\$ 417
Accounts payable	4,162	971
Accrued liabilities	3,106	2,887
Deferred income	185	2,225
Total current liabilities	<u>7,453</u>	<u>6,500</u>
Net working capital	<u>\$ 100,773</u>	<u>\$ 88,859</u>

Historically, we have funded our operations through cash flows from operations and borrowings under bank credit facilities. 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, 2017, we invested approximately \$13.5 million in equipment for our rental fleet service vehicles and land for our new corporate office. We financed this activity with cash on hand.

Cash flows

At December 31, 2017, we had cash and cash equivalents of \$69.2 million and working capital of \$100.8 million, and total debt of \$417,000 under our credit agreement, which is due in 2020. Our cash and cash equivalents increased from 2016 due to the continued hold on our capital program for non-contracted new compressor builds due to the continuing depressed oil and natural gas prices. We had positive net cash flow from operating activities of approximately \$17.5 million during 2017. This was primarily from net income of \$19.9 million and non-cash items of depreciation and amortization of \$21.3 million and \$4.0 million related to stock-based compensation, offset by a decrease in deferred income taxes of \$21.6 million and a decrease in cash flows related to working capital and other of \$6.1 million.

At December 31, 2016, we had cash and cash equivalents of \$64.1 million, working capital of \$88.9 million and total debt of \$417,000, under our line of credit which was due in 2017, and has subsequently been renewed. Our cash and cash equivalents increased from 2016 due to a the continued hold in our capital program which was the result of a decrease in compressor rentals due to the decrease in oil and natural gas prices. We had positive net cash flow from operating activities of approximately \$31.8 million during 2016. This was primarily from net income of \$6.5 million and non-cash items of depreciation and amortization of \$21.8 million, \$2.3 million related to stock-based compensation, a loss on retirement of rental fleet of \$545,000, a decrease in deferred income taxes of \$2.7 million and an increase in working capital of \$4.4 million.

Inventory increased to \$26.2 million as of the end of 2017, as compared to \$21.4 million as of the end of 2016. This increase is mainly due to purchases related to future jobs 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	2018	2019	2020	2021	Thereafter	Total
Line of credit	\$ —	\$ —	\$ 417	\$ —	\$ —	\$ 417
Interest on line of credit	17	17	17	—	—	51
Purchase obligations	300	300	300	300	266	1,466
Other long term liabilities	—	—	—	—	92	92
Facilities and office leases	484	122	9	1	—	616
Total	\$ 801	\$ 439	\$ 743	\$ 301	\$ 358	\$ 2,642

The Company also has a contractual obligation related to the construction of a new corporate office of \$12 million. Construction on the new office began in late 2017 and is expected to be completed in early 2019.

Senior Bank Borrowings

We have a senior secured revolving credit agreement the ("Amended Credit Agreement") with JP Morgan Chase Bank, N.A (the "Lender") with an aggregate commitment of \$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). On August 31, 2017, we amended and renewed the Amended Credit Agreement, which was set to expire on December 31, 2017. The Credit Agreement Amendment extends the maturity date to December 31, 2020. No other material revisions were made to the credit facility. As of December 31, 2017, 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, 2020, 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, 2017, 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 if we were to borrow a significant amount under facility.

Components of Our Principal Capital Expenditures

Capital expenditures for the three years ended December 31, 2017:

Expenditure Category	2017	2016	2015
	<i>(in thousands)</i>		
Rental equipment and property and equipment	\$ 13,489	\$ 3,321	\$ 12,459

The level of our expenditures will vary in future periods depending on energy market conditions and other related economic factors. Based upon existing economic and market conditions, we believe that our cash on hand, operating cash flow and available bank line of credit are adequate to fully fund our net capital expenditures requirements for 2018 and beyond. We also believe we have significant flexibility with respect to our financing alternatives and adjustment of our expenditure plans if circumstances warrant. We do not have any material continuing commitments related to our current operations that cannot be met with our cash on hand and our current line of credit.

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, 2017, 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, 2017, we had met \$3.3 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, 2017 was \$92,000.

Recently Issued Accounting Pronouncements

On February 25, 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for capital and operating leases with lease terms of more than 12 months. Additionally, this ASU will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The new standard will be effective during our first quarter ending March 31, 2019. We are currently determining the impacts of the new standard on our consolidated financial statements and the additional applicable disclosure requirements.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This update provides a five-step analysis on how 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. This guidance also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued an accounting standards update for a one-year deferral of the revenue recognition standard's effective date for all entities, which changed the effectiveness to interim and annual reporting periods beginning after December 15, 2017. As a result, we adopted the guidance on January 1, 2018. The guidance offered two transition methods: a full retrospective approach to be applied to each prior reporting period presented or a modified retrospective approach where the cumulative effect of initially applying the standard is recognized at the date of initial application. We have selected the modified retrospective transition method. We have determined the impact of the new standard on our consolidated financial statements. Our approach included performing a detailed review of key contracts that are representative of our various revenue streams and comparing our historical accounting policies and practices to the new standard. Based upon our analysis, we have determined there will be no material financial impact upon adoption, but we will have a change in our disclosures under the new standard and have implemented new internal controls to ensure compliance under this new standard.

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, 2017 and 2016, 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, 2017, we had one customer that accounted for a total of approximately 14% 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, 2017, 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, 2017, 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 of December 31, 2017 using the criteria set forth by the Commission of Sponsoring Organizations of the Treadway Commission (COSO) in their *Internal Control-Integrated Framework (2013)*. Based on this assessment, our management concluded that, as of December 31, 2017, 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, 2017. BDO USA, LLP, our independent registered public accounting firm, has issued an attestation report dated March 9, 2018 on the effectiveness of internal control over financial reporting on page 36.

ITEM 9B. OTHER INFORMATION

None.

Report of Independent Registered Public Accounting Firm

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

Opinion on Internal Control over Financial Reporting

We have audited Natural Gas Services Group, Inc.'s (the "Company") internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company and subsidiaries as of December 31, 2017 and 2016, the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes, and our report dated March 9, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. 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.

Definition and Limitations of Internal Control over Financial Reporting

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.

/s/ BDO USA, LLP

Houston, Texas
March 9, 2018

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, 2017.

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 may be 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, 2017.

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, 2017.

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, 2017.

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, 2017.

PART IV

ITEM 15. EXHIBITS AND CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

(a)(3) Exhibits

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

<u>Exhibit No.</u>	<u>Description</u>
3.1	Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3.1 of the 10-QSB filed and dated November 10, 2004).
3.2	Bylaws, as amended (Incorporated by reference to Exhibit 3.11 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 21, 2016.)
10.1	Lease Agreement, dated January 9, 2018, 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, 2017 and filed with the Securities and Exchange Commission on March 9, 2018)
10.2	2009 Restricted Stock/Unit Plan, as amended (Incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K dated June 3, 2014 and filed with the Securities and Exchange Commission on June 6, 2014.)
10.3	Stock Option Plan, as amended and restated (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 21, 2016.)
10.4	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.)
10.5	Fifth Amendment of Credit Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated August 31, 2017 (Incorporated by reference to Exhibit 10.2 of the Registrant's Current report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.)
10.6	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.)
10.7	Fourth Security Agreement between Natural Gas Services Group, Inc. and JPMorgan Chase Bank, N.A., dated August 31, 2017 (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.)
10.8	Promissory Note in the aggregate amount of \$30,000,000 issued to JPMorgan Chase Bank, N.A., dated August 31, 2017, in connection with the revolving credit line under the Credit Agreement with JPMorgan Chase Bank, N.A. (Incorporated by reference to Exhibit 10.3 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 7, 2017.)
10.9	Amended and restated Employment Agreement dated April 27, 2015 between Natural Gas Services Group, Inc. and Stephen C. Taylor (Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 29, 2015.)
10.10	The Executive Nonqualified Excess Plan Adoption Agreement, referred to as the Nonqualified Deferred Compensation Plan (Incorporated by reference to Exhibit 10.11 of the Registrant's Quarterly report on Form 10-Q filed with the Securities and Exchange Commission on May 6, 2016.)

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

* Filed herewith.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

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

NATURAL GAS SERVICES GROUP, INC.

Date: March 9, 2018

By: /s/ Stephen C. Taylor

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
<u>/s/ Stephen C. Taylor</u> Stephen C. Taylor	Chairman of the Board of Directors, Chief Executive Officer and President (Principal Executive Officer)	March 9, 2018
<u>/s/ G. Larry Lawrence</u> G. Larry Lawrence	Vice President and Chief Financial Officer (Principal Accounting Officer)	March 9, 2018
<u>/s/ Charles G. Curtis</u> Charles G. Curtis	Director	March 9, 2018
<u>/s/ William F. Hughes, Jr.</u> William F. Hughes, Jr.	Director	March 9, 2018
<u>/s/ David L. Bradshaw</u> David L. Bradshaw	Director	March 9, 2018
<u>/s/ John W. Chisholm</u> John W. Chisholm	Director	March 9, 2018

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Report of Independent Registered Public Accounting Firm

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

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Natural Gas Services Group, Inc. (the “Company”) and subsidiaries as of December 31, 2017 and 2016, the related consolidated statements of income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company and subsidiaries at December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 9, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

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

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

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

/s/ BDO USA, LLP

We have served as the Company's auditor since 2010.

Houston, Texas
March 9, 2018

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

December 31,

2017 **2016**

ASSETS

Current Assets:		
Cash and cash equivalents	\$ 69,208	\$ 64,094
Trade accounts receivable, net of allowance for doubtful accounts of \$569 and \$597, respectively	8,534	7,378
Inventory	26,224	21,433
Prepaid income taxes	3,443	1,482
Prepaid expenses and other	817	972
Total current assets	108,226	95,359
Long-Term Inventory, net of allowance for obsolescence of \$15 and \$15, respectively	2,829	2,488
Rental equipment, net of accumulated depreciation of \$145,851 and \$126,096, respectively	167,099	175,972
Property and equipment, net of accumulated depreciation of \$11,274 and \$11,267, respectively	7,652	7,753
Goodwill	10,039	10,039
Intangibles, net of accumulated amortization of \$1,632 and \$1,508, respectively	1,526	1,651
Other assets	939	262
Total assets	\$ 298,310	\$ 293,524
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Line of credit	\$ —	\$ 417
Accounts payable	4,162	971
Accrued liabilities	3,106	2,887
Deferred income	185	2,225
Total current liabilities	7,453	6,500
Line of credit	417	—
Deferred income tax liability	32,163	53,745
Other long-term liabilities	958	325
Total liabilities	40,991	60,570
Commitments and contingencies (Note 11)		
Stockholders' Equity:		
Preferred stock, 5,000 shares authorized, no shares issued or outstanding	—	—
Common stock, 30,000 shares authorized, par value \$0.01; 12,880 and 12,764 shares issued and outstanding, respectively	129	128
Additional paid-in capital	105,325	100,812
Retained earnings	151,865	132,014
Total stockholders' equity	257,319	232,954
Total liabilities and stockholders' equity	\$ 298,310	\$ 293,524

See accompanying notes to these consolidated financial statements.

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

	For the Years Ended December 31,		
	2017	2016	2015
Revenue:			
Rental income	\$ 46,046	\$ 56,717	\$ 76,432
Sales	20,208	13,621	18,519
Service and maintenance income	1,439	1,316	968
Total revenue	<u>67,693</u>	<u>71,654</u>	<u>95,919</u>
Operating costs and expenses:			
Cost of rentals, exclusive of depreciation stated separately below	18,087	20,350	28,750
Cost of sales, exclusive of depreciation stated separately below	16,286	11,124	13,633
Cost of service and maintenance, exclusive of depreciation stated separately below	370	398	272
Loss on retirement of rental equipment	—	545	4,370
Selling, general, and administrative expenses	10,081	9,011	10,989
Depreciation and amortization	21,302	21,796	22,758
Total operating costs and expenses	<u>66,126</u>	<u>63,224</u>	<u>80,772</u>
Operating income	<u>1,567</u>	<u>8,430</u>	<u>15,147</u>
Other income (expense):			
Interest expense	(14)	(8)	(15)
Other income	50	43	132
Total other income, net	<u>36</u>	<u>35</u>	<u>117</u>
Income before provision for income taxes	<u>1,603</u>	<u>8,465</u>	<u>15,264</u>
Provision for income taxes:			
Current	3,334	4,709	6,963
Deferred	(21,582)	(2,713)	(1,846)
Total income tax expense (benefit)	<u>(18,248)</u>	<u>1,996</u>	<u>5,117</u>
Net income	<u>\$ 19,851</u>	<u>\$ 6,469</u>	<u>\$ 10,147</u>
Earnings per share:			
Basic	\$ 1.55	\$ 0.51	\$ 0.81
Diluted	\$ 1.51	\$ 0.50	\$ 0.79
Weighted average shares outstanding:			
Basic	12,831	12,702	12,567
Diluted	13,110	12,935	12,793

See accompanying notes to these consolidated financial statements.

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

	Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity
	Shares	Amount	Shares	Amount			
BALANCES , December 31, 2014	—	\$ —	12,466	\$ 124	\$ 95,065	\$ 115,398	\$ 210,587
Exercise of common stock options	—	—	66	1	775	—	776
Compensation expense on common stock options	—	—	—	—	601	—	601
Issuance of restricted stock	—	—	71	—	—	—	—
Tax benefit of equity compensation	—	—	—	—	(379)	—	(379)
Compensation expense on restricted common stock	—	—	—	1	2,943	—	2,944
Taxes paid related to net shares settlement of equity awards	—	—	—	—	(695)	—	(695)
Net income	—	—	—	—	—	10,147	10,147
BALANCES , December 31, 2015	—	\$ —	12,603	\$ 126	\$ 98,310	\$ 125,545	\$ 223,981
Exercise of common stock options	—	—	62	1	1,041	—	1,042
Compensation expense on common stock options	—	—	—	—	506	—	506
Issuance of restricted stock	—	—	99	—	—	—	—
Tax expense of equity compensation	—	—	—	—	72	—	72
Compensation expense on restricted common stock	—	—	—	1	1,792	—	1,793
Taxes paid related to net shares settlement of equity awards	—	—	—	—	(909)	—	(909)
Net income	—	—	—	—	—	6,469	6,469
BALANCES , December 31, 2016	—	\$ —	12,764	\$ 128	\$ 100,812	\$ 132,014	\$ 232,954
Exercise of common stock options	—	—	56	—	1,120	—	1,120
Compensation expense on common stock options	—	—	—	—	363	—	363
Issuance of restricted stock	—	—	60	—	—	—	—
Compensation expense on restricted common stock	—	—	—	1	3,674	—	3,675
Taxes paid related to net shares settlement of equity awards	—	—	—	—	(644)	—	(644)
Net income	—	—	—	—	—	19,851	19,851
BALANCES , December 31, 2017	—	\$ —	12,880	\$ 129	\$ 105,325	\$ 151,865	\$ 257,319

See accompanying notes to these consolidated financial statements.

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

	For the Years Ended December 31,		
	2017	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 19,851	\$ 6,469	\$ 10,147
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	21,302	21,796	22,758
Deferred taxes	(21,582)	(2,713)	(1,846)
Gain on disposal of assets	(87)	(86)	(179)
Loss on retirement of rental equipment	—	545	4,370
Bad debt allowance	90	61	477
Inventory allowance	273	566	205
Stock based compensation	4,038	2,299	3,545
Gain on company owned life insurance	(67)	(14)	—
Changes in assets (increase) decrease in:			
Trade accounts receivables	(1,246)	1,668	824
Inventory	(5,350)	1,131	5,337
Prepaid income taxes and prepaid expenses	(1,806)	(1,539)	5,774
Changes in liabilities increase (decrease) in:			
Accounts payable and accrued liabilities	3,410	(439)	(7,220)
Current income tax liability	—	—	(1,230)
Deferred income	(2,040)	1,954	(1,364)
Other	666	159	(32)
Tax benefit from equity compensation	—	(72)	—
NET CASH PROVIDED BY OPERATING ACTIVITIES	17,452	31,785	41,566
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of rental, property and equipment	(13,489)	(3,321)	(12,459)
Purchase of company owned life insurance	(620)	(194)	—
Proceeds from insurance claim	1,231	—	—
Proceeds from sale of property and equipment	87	101	189
NET CASH USED IN INVESTING ACTIVITIES	(12,791)	(3,414)	(12,270)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments of other long-term liabilities	(23)	(14)	(26)
Proceeds from exercise of stock options	1,120	1,042	776
Tax benefit from equity compensation	—	72	—
Taxes paid related to net share settlement of equity awards	(644)	(909)	(695)
NET CASH PROVIDED BY FINANCING ACTIVITIES	453	191	55
NET CHANGE IN CASH AND CASH EQUIVALENTS	5,114	28,562	29,351
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	64,094	35,532	6,181
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 69,208	\$ 64,094	\$ 35,532
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Interest paid	\$ 14	\$ 8	\$ 15
Income taxes paid	\$ 3,725	\$ 5,825	\$ 6,530
NON-CASH TRANSACTIONS			
Transfer of rental equipment to inventory	\$ 55	\$ 724	\$ 2,309
Transfer of inventory to property and equipment	\$ —	\$ —	\$ 1,624

See accompanying notes to these consolidated financial statements.

**NATURAL GAS SERVICES GROUP INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. Summary of Significant Accounting Policies

Organization and Principles of Consolidation

These notes apply to the consolidated 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 was formed on December 17, 1998 for the purposes of combining the operations of certain manufacturing, service and leasing entities. The accompanying consolidated financial statements include the accounts of the Company, its subsidiary, NGSG Properties, LLC and the rabbi trust associated with the Company's deferred compensation plan, see Note 5. All significant intercompany accounts and transactions for the periods presented have been eliminated in consolidation.

Nature of Operations

Natural Gas Services Group is a leading provider of small to medium horsepower compression equipment to the natural gas industry, with an emerging position in the large horsepower market. 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 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 consolidated 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 consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates include fixed asset lives, bad debt allowance and the allowance for inventory obsolescence. 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% or use of progress payments for large custom sales 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 \$569,000 and \$597,000 at December 31, 2017 and 2016, 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.

From time to time, upon the customer's written request, we recognize revenue when manufacturing is complete and the equipment is ready for shipment. At the customer's request, we will bill the customer upon completing all performance obligations, but before shipment. The customer will formally request we ship the equipment per their direction from our manufacturing facility at a later specified date and that we segregate the equipment from our finished goods, such that they are not available to fill other orders. Title of the equipment and risk of loss passes to the customer when the equipment is complete and ready for shipment, per the customer's agreement. At the transfer of title, all risks of ownership has passed to the customer on the manufactured items that have not yet been shipped. We have operated using bill and hold agreements with certain customers for many years, with consistent satisfactory results for both the customer and us. The credit terms on this agreement are consistent with the credit terms on all other sales. All risks of loss are shouldered by the customer, and there are no exceptions to the customer's commitment to accept and pay for this manufactured equipment. Revenues recognized at the completion of manufacturing in 2017 and 2016 were approximately \$4.6 million and \$5.6 million, respectively.

Major Customers and Concentration of Credit Risk

Sales and rental income to Occidental Permian, LTD. ("Oxy") and Devon Energy Production, Inc. ("Devon") in 2017 amounted to 20% and 15% of revenue, respectively. Sales and rental income to Devon and Oxy in 2016 amounted to 21% and 19% of revenue, respectively. Sales and rental income to Devon and Oxy in 2015 amounted to 21% and 10% of revenue. No other single customer accounted for more than 10% of our revenues in 2017, 2016 or 2015. Oxy amounted to 14% of our accounts receivable as of December 31, 2017. Oxy, APR Energy, LLC and BP America Inc. amounted to 15%, 15% and 14%, respectively, of our accounts receivable as of December 31, 2016. No other customers amounted to more than 10% of our accounts receivable as of December 31, 2017 and 2016.

Inventory

Inventory (current and long-term) is valued at the lower of cost and net realizable value. The cost of inventories is determined by the weighted average method. A reserve is recorded against inventory balances for estimated obsolescence. This reserve is based on specific identification and historical experience and totaled \$15,000 and \$15,000 at December 31, 2017 and 2016, respectively. There were 7 newly completed compressor units at December 31, 2017 and December 31, 2016 available for sale or for use in our rental fleet. Our long-term inventory consists of raw materials that remain viable but that the Company does not expect to sell within the next year. At December 31, 2017 and 2016, inventory consisted of the following (in thousands):

	2017	2016
Raw materials -current	\$ 22,813	\$ 15,877
Raw materials - long term	2,829	2,488
Finished Goods	1,022	2,558
Work in process	2,389	2,998
Total	<u>\$ 29,053</u>	<u>\$ 23,921</u>

Rental Equipment and Property and Equipment

Rental equipment and property and equipment are recorded at cost less accumulated depreciation, except for work-in-progress on new rental equipment which is recorded at cost until it's complete and added to the fleet. At December 31 2017 and 2016, we had \$6.4 million and \$1.9 million in rental equipment work-in-progress, respectively. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Our rental equipment has an estimated useful life of 15 years, while our property and equipment has an estimate useful lives which range from three to thirty-nine years. The majority of our property and equipment, including rental equipment, is a direct cost to generating revenue and the following table depicts the depreciation associated with each product line at December 31, 2017 , 2016 and 2015 (in thousands):

	2017	2016	2015
Rentals	\$ 20,861	\$ 21,325	\$ 22,308
Sales	265	291	281
Service & Maintenance	21	25	16
Total	<u>\$ 21,147</u>	<u>\$ 21,641</u>	<u>\$ 22,605</u>

We assess the impairment of rental equipment and property and equipment whenever events or changes in circumstances indicate that the net recorded amount may not be recoverable. The following factors could trigger an impairment review: significant

underperformance relative to historical or projected future cash flows, significant adverse changes in the extent or manner in which asset is being used or its condition, significant negative industry trends or legislative changes prohibiting us from leasing our units or flares. An impairment loss is recognized if the future undiscounted cash flows associated with the asset and the estimated fair value of the asset are less than the asset's carrying value. We recognized no impairments in years ended December 31, 2017, 2016 or 2015.

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. Due to continued low oil and natural gas prices, we determined a triggering event occurred during each quarter and we performed a goodwill impairment test each quarter of 2017 and our annual goodwill impairment test was performed in the fourth quarter of 2017. We experienced no impairment of goodwill during the years ended December 31, 2017 or 2016.

Intangibles

At December 31, 2017, NGSB had intangible assets, which relate to developed technology and a trade name. The carrying amount net of accumulated amortization at December 31, 2017 and 2016 was \$1.5 million and \$1.7 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 seven years as of December 31, 2017. Amortization expense recognized in each of the years ending December 31, 2017, 2016, and 2015 was \$125,000. Estimated amortization expense for the years 2018-2024 is \$125,000 per year. NGSB has an intangible asset with a gross carrying value of \$654,000 at December 31, 2017 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, 2017				December 31, 2016		
	Useful Life (years)	Gross Carrying Value	Accumulated Amortization	Net Book Value	Gross Carrying Value	Accumulated Amortization	Net Book Value
Developed Technology	20	\$ 2,505	\$ 1,633	\$ 872	\$ 2,505	\$ 1,508	\$ 997
Trade Name	Indefinite	654	—	654	654	—	654
Total		\$ 3,159	\$ 1,633	\$ 1,526	\$ 3,159	\$ 1,508	\$ 1,651

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 during the years ended December 31, 2017 or 2016. Separately, we reviewed our indefinite life intangible for impairment with our goodwill impairment review, which we performed each quarter in 2017 due to a continued decline in our rental utilization and then annually in the fourth quarter of 2017. Based on this analysis, we experienced no impairment on our indefinite life intangible during the years ended December 31, 2017 or 2016.

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 \$65,000 and \$103,000 for December 31, 2017 and 2016, respectively, and is included in accrued liabilities on the consolidated 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 anti-dilutive securities in 2017, 2016 and 2015.

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

	Year Ended December 31,		
	2017	2016	2015
Numerator:			
Net income	\$ 19,851	\$ 6,469	\$ 10,147
Denominator for basic net income per common share:			
Weighted average common shares outstanding	12,831	12,702	12,567
Denominator for diluted net income per share:			
Weighted average common shares outstanding	12,831	12,702	12,567
Dilutive effect of stock options and restricted shares	279	233	226
Diluted weighted average shares	13,110	12,935	12,793
Earnings per common share:			
Basic	\$ 1.55	\$ 0.51	\$ 0.81
Diluted	\$ 1.51	\$ 0.50	\$ 0.79

In the year-ended December 31, 2017, options to purchase 83,917 shares of common stock with exercise prices ranging from \$28.15 to \$33.36 were not included in the computation of dilutive income per share, due to their anti-dilutive effect.

In the year-ended December 31, 2016, options to purchase 51,167 shares of common stock with exercise prices ranging from \$30.41 to \$33.36 were not included in the computation of dilutive income per share, due to their anti-dilutive effect.

In the year-ended December 31, 2015, options to purchase 107,500 shares of common stock with exercise prices ranging from \$22.90 to \$33.36 were not included in the computation of dilutive income per share, due to their anti-dilutive effect.

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, 2017 or 2016.

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

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "2017 Tax Act"), which makes broad and complex changes to the U.S. tax code. Certain income tax effects

of the 2017 Tax Act are reflected in the Company's financial results in accordance with Staff Accounting Bulletin No. 118 ("SAB 118"), which provides SEC staff guidance regarding the application of Accounting Standards Codification Topic 740 *Income Taxes* ("ASC 740"). As we do not have all of the necessary information to analyze all income tax effects of the 2017 Tax Act, we will continue to evaluate tax reform and adjust the provisional amounts as additional information is obtained. We expect to complete our detailed analysis no later than the fourth quarter of 2018. See Note 7, "Income Taxes," for further information on the financial statement impact of the 2017 Tax Act.

Fair Value Measurement

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

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

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

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

Management believes that the fair value of our cash and cash equivalents, trade receivables, accounts payable and line of credit at December 31, 2017 and 2016 approximate their carrying values due to the short-term nature of the instruments or the use of prevailing market interest rates.

Segments and Related Information

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

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

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

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

Recently Issued Accounting Pronouncements

On February 25, 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for capital and operating leases with lease terms of more than 12 months. Additionally, this ASU will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases, including qualitative and quantitative requirements. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The new standard will be effective during our first quarter ending March 31, 2019. We are currently determining the impacts of the new standard on our consolidated financial statements and the additional applicable disclosure requirements.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This update provides a five-step analysis on how 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. This guidance also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued an accounting standards update for a one-year deferral of the revenue recognition standard's effective date for all entities, which changed the effectiveness to interim and annual reporting periods beginning after December 15, 2017. As a result, we adopted the guidance on January 1, 2018. The guidance offered two transition methods: a full retrospective approach to be applied to each prior reporting period presented or a modified retrospective approach where the cumulative effect of initially applying the standard is recognized at the date of initial application. We have selected the modified retrospective transition method. We have determined the impact of the new standard on our consolidated financial statements. Our approach included performing a detailed review of key contracts that are representative of our various revenue streams and comparing our historical accounting policies and practices to the new standard. Based upon our analysis, we have determined there will be no material financial impact upon adoption, but we will have a change in our disclosures under the new standard and have implemented new internal controls to ensure compliance under this new standard.

Reclassification of Prior Period Balances

Certain reclassifications have been made to prior period amounts to conform to the current-year presentation. These reclassifications had no effect on the reported results of operations.

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 twenty-four months and continue on a month-to-month basis thereafter. Depreciation expense for rental equipment was \$20.0 million, \$20.2 million and \$21.0 million for the years ended December 31, 2017, 2016 and 2015, respectively. Future minimum rent payments for arrangements not on a month-to-month basis at December 31, 2017 are as follows :

Years Ending December 31, (in thousands)		
2018	\$	6,494
2019		976
2020		543
2021		542
2022		542
Total	\$	9,097

3. Property and Equipment

Property and equipment consists of the following at December 31, 2017 and 2016 (in thousands):

	Useful Lives (Years)	2017	2016
Land	—	\$ 1,290	\$ 169
Building	39	6,116	6,856
Leasehold improvements	39	808	794
Office equipment and furniture	5	1,490	1,454
Software	5	573	573
Machinery and equipment	7	3,133	3,111
Vehicles	3	5,516	6,063
Total		18,926	19,020
Less accumulated depreciation		(11,274)	(11,267)
Total		\$ 7,652	\$ 7,753

Depreciation expense for property and equipment was \$1.2 million, \$1.4 million and \$1.6 million for the year ended December 31, 2017, 2016 and 2015, respectively.

In 2017, the Midland fabrication facility suffered two separate damages, due to hailstorms. We did not incur a loss, as our insurance proceed fully cover the estimated cost for the repair. In accordance with ASC 605-40, we reduced the value of the building for these damages.

4. Retirement of Long-Lived Assets

During the annual review of our rental compressor units, management looks for any units that are not of the type, configuration, make or model that our customers are demanding or that were not cost efficient to refurbish, maintain and/or operate. We had no retirement from our rental fleet in 2017. From our review in 2016, we determined 63 units should be retired from our rental fleet with key components from those units being re-utilized in future unit builds and/or repairs. We performed an optimization review and recorded a \$545,000 loss on retirement of rental equipment to reduce the book value of each unit to the estimated fair value of approximately \$242,000 for key components being kept. As a result of our 2015 review, we retired 258 units from our rental fleet with key components from those units being re-utilized in future unit builds and/or repairs. Based on our optimization review we recorded a \$4.4 million loss on the retirement of rental equipment to reduce the book value of each unit to the estimated fair value of approximately \$967,000 for the key components being kept. These retirements are recorded in the consolidated income statement under loss on retirement of rental equipment.

5. Deferred Compensation Plans

Effective January 1, 2016, the Company established a non-qualified deferred compensation plan for executive officers, directors and certain eligible employees. The assets of the deferred compensation plan are held in a rabbi trust and are subject to additional risk of loss in the event of bankruptcy or insolvency of the Company. The plan allows for deferral up to 90% of a participant's base salary, bonus, commissions, director fees and restricted stock awards. A Company owned life insurance policy held in a rabbi trust is utilized as a source of funding for the plan. The cash surrender value of the life insurance policy is \$894,000 and \$207,000 as of December 31, 2017 and 2016, respectively, with a gain related to the policy of \$66,400 and \$13,900 reported in other income in our consolidated income statement for the year ended December 31, 2017 and 2016, respectively.

For deferrals of base salary, bonus, commissions and director fees, settlement payments are made to participants in cash, either in a lump sum or in periodic installments. The deferred obligation to pay the deferred compensation and the deferred director fees is adjusted to reflect the positive or negative performance of investment measurement options selected by each participant and was \$866,000 and \$208,000 as of December 31, 2017 and 2016, respectively. The deferred obligation is included in other long-term liabilities in the consolidated balance sheet.

For deferrals of restricted stock, the plan does not allow for diversification, therefore, distributions are paid in shares and the obligation is carried at grant value. As of December 31, 2017, a total of \$97,011 unvested restricted stock units have been deferred.

6. Credit Facility

We have a senior secured revolving credit agreement with JP Morgan Chase Bank, N.A (the "Amended Credit Agreement") aggregate commitment of \$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). On August 31, 2017, we amended and renewed the Amended Credit Agreement, which was set to expire on December 31, 2017. The Credit Agreement Amendment extends the maturity date to December 31, 2020. No other material revisions were made to the credit facility.

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 \$29.5 million borrowing base availability at December 31, 2017 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, 2020, 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 lease receivables, along with a first priority lien on a variable number of our leased compressor equipment the book value of must be maintained at a minimum of 2.00 to 1.00 commitment coverage ratio (such ratio being equal to (i) the amount of the borrowing base as of such date to (ii) the amount of the commitment as of such date.)

Covenants. The Amended Credit Agreement 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, 2017, 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, 2017 our balance on the line of credit was \$417,000. Our weighted average interest rate for the year ended December 31, 2017 was 1.60%.

7. Income Taxes

The provision for income taxes for the years ended December 31, 2017, 2016 and 2015, consists of the following (in thousands):

	2017	2016	2015
Current provision:			
Federal	\$ 3,074	\$ 4,280	\$ 6,440
State	260	429	523
Total current provision	<u>3,334</u>	<u>4,709</u>	<u>6,963</u>
Deferred provision:			
Federal benefit	(21,582)	(2,713)	(1,846)
Total deferred benefit	<u>(21,582)</u>	<u>(2,713)</u>	<u>(1,846)</u>
Total (benefit) provision	<u>\$ (18,248)</u>	<u>\$ 1,996</u>	<u>\$ 5,117</u>

On December 22, 2017, the U.S. government enacted the 2017 Tax Act. The 2017 Tax Act makes broad and complex changes to the U.S. tax code that affects the Company's 2017 financial results. The 2017 Tax Act also establishes new tax laws that will affect the Company's financial results after 2017, including a reduction in the U.S. federal corporate income tax rate from 35 percent to 21 percent; additional limitations on the deductibility of executive compensation; limitations on the deductibility of interest; and repeal of the domestic manufacturing deduction. As such, the Company recognized a \$18.4 income tax benefit related to the re-measurement of our deferred tax assets and liabilities in our 2017 financial statements in accordance with SAB 118, which provides SEC staff guidance for the application of ASC 740 in the reporting period in which the 2017 Tax Act was signed into law. As we do not have all of the necessary information to analyze all income tax effects of the 2017 Tax Act, we will continue to evaluate tax reform and adjust the provisional amounts as additional information is obtained. We expect to complete our detailed analysis no later than the fourth quarter of 2018.

The income tax effects of temporary differences that give rise to significant portions of deferred income tax assets and (liabilities) as of December 31, 2017 and 2016, are as follows (in thousands):

	2017	2016
Deferred income tax assets:		
Stock Compensation	\$ 843	\$ 664
Other	201	84
Total deferred income tax assets	<u>\$ 1,044</u>	<u>\$ 748</u>
Deferred income tax liabilities:		
Property and equipment	\$ (32,377)	(53,120)
Goodwill and other intangible assets	(604)	(973)
Other	(226)	(400)
Total deferred income tax liabilities	<u>(33,207)</u>	<u>(54,493)</u>
Net deferred income tax liabilities	<u>\$ (32,163)</u>	<u>\$ (53,745)</u>

The effective tax rate for the years ended December 31, 2017, 2016 and 2015, differs from the statutory rate as follows:

	2017	2016	2015
Statutory rate	34.0 %	34.0 %	34.0 %
State and local taxes	1.5 %	1.6 %	1.5 %
Domestic production credit	(14.3)%	(5.4)%	(3.6)%
Permanent stock differences	(13.4)%	0.3 %	1.1 %
Other	(1.5)%	(6.9)%	0.5 %
Effective rate prior to tax act	6.3 %	23.6 %	33.5 %
Deferred re-measurement for rate change	(1,144.4)%	— %	— %
Effective rate	(1,138.1)%	23.6 %	33.5 %

Our policy regarding income tax interest and penalties is to expense those items as general and administrative expense. During the years ended December 31, 2017, 2016 and 2015, there were no significant income tax interest or penalty items in the statement of income.

We file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, we are no longer subject to U.S. federal or state income tax examination by tax authorities for years before 2013.

8. Other Long-term Liabilities

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 \$92,000 and \$115,000 as of December 31, 2017 and 2016, respectively.

9. 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, 2017 and 2016, there were no issued or outstanding preferred shares.

10. Stock-Based Compensation

Restricted Stock/Units

On June 18, 2014, at our annual meeting of shareholders, our shareholders approved a proposed amendment to the 2009 Restricted Stock/Unit Plan (the "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. 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 2016 performance, Mr. Taylor, was awarded 70,464 restricted shares/units on February 14, 2017, which vest over three years, in equal installments beginning February 14, 2018. On March 23, 2017, the Compensation Committee awarded 20,000 restricted shares/units to each G. Larry Lawrence, our CFO, and James Hazlett, our Vice President of Technical Services. The restricted shares/units to Messrs. Hazlett and Lawrence vest over three years, in equal installments, beginning March 23, 2018. We also awarded and issued 15,968 shares of restricted common stock/units to our Board of Directors as partial payment for 2017 directors' fees. The restricted stock/units issued to our directors vests over one year, in quarterly installments, beginning March 31, 2018. Compensation expense related to the restricted shares/units was approximately \$3,675,000, \$1,793,000 and \$2,944,000 for the years ended December 31, 2017, 2016, and 2015, respectively. As of December 31, 2017, there was a total of approximately

\$1,385,000 of unrecognized compensation expense related to the nonvested portion of these restricted shares/units. This expense is expected to be recognized over the next one year and a quarter. As of December 31, 2017, 162,770 shares were still available for issuance under the Plan.

A summary of all restricted stock/units activity as of December 31, 2015, 2016 and 2017 and changes during the years then ended are presented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, December 31, 2014	99,238	\$ 28.22	9.00	\$ 2,286
Granted	145,558	\$ 19.17	—	\$ 2,886
Vested	(99,238)	\$ 28.22	—	\$ 2,100
Canceled/Forfeited	—	\$ —	—	\$ —
Outstanding, December 31, 2015	145,588	\$ 19.17	9.12	\$ 3,246
Granted	139,451	\$ 21.34	—	\$ 3,007
Vested	(145,558)	\$ 19.17	—	\$ 2,963
Canceled/Forfeited	—	\$ —	—	\$ —
Outstanding, December 31, 2016	139,451	\$ 21.34	9.13	\$ 4,483
Granted	126,432	27.06	—	3,421
Vested	(81,494)	21.20	—	2,361
Canceled/Forfeited	—	—	—	—
Outstanding, December 31, 2017	184,389	\$ 25.32	8.83	\$ 4,831

Stock Option Plan

Our Stock Option Plan which is stockholder approved, permits the granting 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 to add an additional 200,000 shares of common stock to the Stock Option Plan. On June 16, 2016, at our annual meeting of shareholders, our shareholders approved a proposed amendment to the Stock Option Plan to add an additional 250,000 shares of common stock of the Stock Option Plan, thereby authorizing the issuance of up to 1.0 million shares of common stock under the Stock Option 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 Stock Option Plan). The last date that grants can be made under the Stock Option Plan is February 28, 2026. As of December 31, 2017, 313,169 shares were still available for issue under the Stock Option Plan.

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

Weighted average Black -Scholes fair value assumption during the years ended December 31, are as follows:

	2017	2015
Risk free rate	2.12%	1.56%
Expected life	6 years	6 years
Expected volatility	39.59%	45.07%
Expected dividend yield	—	—

There were no stock option grants made in 2016.

A summary of all option activity as of December 31, 2015, 2016 and 2017 and changes during the years then ended are 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, 2014	432,269	\$ 17.55	4.89	\$ 2,786
Granted	50,000	\$ 22.90		
Exercised	(66,000)	\$ 11.76		481
Canceled/Forfeited	(1,500)	\$ 30.41		\$ —
Outstanding, December 31, 2015	414,769	\$ 19.07	5.08	\$ 1,814
Granted	—	\$ —		
Exercised	(62,083)	\$ 16.79		625
Canceled/Forfeited	(2,500)	\$ 22.90		—
Outstanding, December 31, 2016	350,186	\$ 19.45	4.25	\$ 4,453
Granted	32,750	28.15		
Exercised	(55,666)	20.12		446
Outstanding, December 31, 2017	327,270	\$ 20.21	4.28	\$ 2,255
Exercisable, December 31, 2017	278,689	\$ 19.12	3.54	\$ 2,203

The weighted average grant date fair value of options granted during the years 2017 and 2015 was \$11.93 and \$10.33, 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, 2017, 2016, and 2015 was approximately \$446,000, \$625,000, and \$481,000 respectively. Cash received from stock options exercised during the years ended December 31, 2017, 2016, and 2015 was approximately \$1,120,000, \$1,042,000, and \$776,000, respectively.

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

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$0.01-15.70	65,852	1.56	\$ 9.82	65,852	\$ 9.82
\$15.71-17.81	72,750	1.79	\$ 17.53	72,750	\$ 17.53
\$17.82-20.48	56,750	3.54	\$ 19.36	56,750	\$ 19.36
\$20.49-33.36	131,918	7.34	\$ 27.23	83,337	\$ 27.70
	<u>327,270</u>	4.28	\$ 20.21	<u>278,689</u>	\$ 19.12

The summary of the status of our unvested stock options as of December 31, 2017 and changes during the year then ended is presented below.

Unvested stock options:	Shares	Weighted Average Grant Date Fair Value
Unvested at December 31, 2016	50,833	\$ 12.67
Granted	32,750	\$ 11.93
Vested	(35,002)	\$ 13.73
Unvested at December 31, 2017	48,581	\$ 11.41

We recognized stock compensation expense from stock options vesting of \$363,000, \$506,000, and \$601,000 for the years ended December 31, 2017, 2016 and 2015, respectively. As of December 31, 2017, there was approximately \$282,000 of total unamortized compensation cost related to unvested stock options. We expect to recognize such cost over a weighted-average period of 2.0 years.

11. 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 \$301,000, \$295,000, and \$387,000 to the 401(k) Plan in 2017, 2016 and 2015, 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 (excluding month to month) due under these leases are as follows:

Years Ending December 31, (in thousands)		
2018	\$	484
2019		122
2020		9
2021		1
Total	\$	616

Rent expense under such leases was \$310,000, \$325,000, and \$375,000 for the years ended December 31, 2017, 2016 and 2015, 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.

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

2017	Q1	Q2	Q3	Q4	Total
Total revenue	\$ 18,902	\$ 16,218	\$ 15,913	\$ 16,660	\$ 67,693
Operating income	343	414	593	217	1,567
Net income ⁽¹⁾	252	375	522	18,702	19,851
Net income per share - Basic	0.02	0.03	0.04	1.46	1.55
Net income per share - Diluted	0.02	0.03	0.04	1.42	1.51

(1) The increase in fourth quarter net income is largely a result of the 2017 Tax Act, see Note 7.

2016	Q1	Q2	Q3	Q4	Total
Total revenue	\$ 21,576	\$ 17,194	\$ 16,181	\$ 16,703	\$ 71,654
Operating income	3,767	1,873	1,823	967	8,430
Net income	2,541	1,259	1,509	1,160	6,469
Net income per share - Basic	0.20	0.10	0.12	0.09	0.51
Net income per share - Diluted	0.20	0.10	0.12	0.09	0.50

Amounts may not add due to rounding differences.

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EXECUTIVE OFFICERS & DIRECTORS

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**Chairman of the Board, President
and Chief Executive Officer**

G. LARRY LAWRENCE

**Vice President and Chief Financial
Officer**

JAMES R. HAZLETT

Vice President –Technical Services

DAVID L. BRADSHAW

**Director, Oil and Gas Investor,
Former Chairman and CEO,
Tipperary Corporation**

JOHN W. CHISHOLM

**Director, Founder, Wellogix, Inc.;
President, CEO, Chairman of the
Board, Flotek Industries**

CHARLES G. CURTIS

**Director, Retired, Former President
and Chief Executive
Officer of Curtis One Inc. dba
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ABOUT NATURAL GAS SERVICES GROUP, INC.

Headquartered in Midland, TX, Natural Gas Services Group (NGS) maintains a growing rental fleet of high quality rotary screw and reciprocating wellhead compressors in the 50-1500 horsepower range. At the end of 2017 the rental fleet totaled 2,546 compressor units...the largest rental compressor fleet in the U.S. dedicated to the small-medium horsepower, wellhead market. Repair and maintenance services for rental fleet units is provided through a network of district offices in Midland, Bridgeport and Godley, TX, Farmington, NM, Vernal, UT, Tulsa, OK, Loveland, CO, Carrollton, OH and Lewiston, MI. Rental compressor fabrication facilities are located primarily in Midland, TX. NGS designs, fabricates and sells custom engineered rotary screw and reciprocating compressor packages through our Engineered Products line in Tulsa, OK. This custom equipment ranges up to 2,500 horsepower per unit and can be natural gas engine or electric motor driven. NGS also designs, manufactures and fabricates a proprietary reciprocating compressor product line. The CiP (Cylinders in Plane) reciprocating compressor is a unique and efficient, small horsepower design that is utilized in our rental fleet and sold to compressor packagers, distributors and end-users throughout North America. Additionally, the Company designs, fabricates, sells, installs and services technologically advanced and patented industrial flare and combustion systems through our Flare King product line for use in onshore and offshore oil and natural gas production facilities. NGS is a public company and has been listed on the New York Stock Exchange (NYSE:NGS) since 2008.

