China Natural Gas, Inc.
Form 10-Q/A
July 20, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A
(Amendment No. 1)

(Mark One)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2009

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from ____________ to __________

000-31539
(Commission file number)

CHINA NATURAL GAS, INC.
(Exact name of registrant as specified in its charter)

Delaware	98-0231607
(State or other jurisdiction of incorporation or organization)	(IRS Employer of Identification No.)

Tang Xing Shu Ma Building, Suite 418
Tang Xing Road , Xian High Tech Area
Xian, Shaanxi Province, China
(Address of principal executive offices)
710065
(zip code)

86-29-8832-7391
(registrant 's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required 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 o No o

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨	Smaller reporting company ¨
(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

Number of shares of Common Stock outstanding as of May 4, 2009: 14,600,154

EXPLANATORY NOTE

We are filing this Amendment No.1 on Form 10-Q/A, or this Amendment, to amend certain sections in our Form 10-Q for the three months ended March 31, 2009, originally filed on May 11, 2009 (the "Original Filing"). This Amendment amends Part 1., Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations and Part II, Item 1. Legal Proceedings and Item 6. Exhibits. This Amendment does not otherwise amend the Original Filing. We have also corrected certain minor grammatical or typographical errors throughout this Amendment. As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, new certifications by our Chief Executive Officer and Chief Financial Officer are being filed as exhibits to this Amendment under Item 15 of Part IV

China Natural Gas, Inc.

Index

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF MARCH 31, 2009 AND DECEMBER 31, 2008

	March 31, 2009 (Unaudited)	December, 31 2008
ASSETS		
CURRENT ASSETS:		
Cash & cash equivalents	$ 9,058,361	$ 5,854,383
Accounts receivable	946,047	906,042
Other receivable - employee advances	180,205	332,263
Inventories	488,221	519,739
Advances to suppliers	684,632	837,592
Prepaid expense and other current assets	953,578	838,294
Loan receivable	293,000	293,400
Total current assets	12,604,044	9,581,713
PROPERTY AND EQUIPMENT, NET	74,549,788	76,028,272
CONSTRUCTION IN PROGRESS	25,110,473	22,061,414
DEFERRED FINANCING COSTS	1,644,372	1,746,830
OTHER ASSETS	9,278,092	8,844,062
TOTAL ASSETS	$ 123,186,769	$ 118,262,291
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 1,103,837	$ 800,013
Other payables	336,936	124,151
Unearned revenue	1,138,536	944,402
Accrued interest	531,111	861,114
Taxes payable	1,904,943	1,862,585
Total current liabilities	5,015,363	4,592,265
LONG TERM LIABILITIES:		
Notes payable, net of discount $14,844,315 and $15,478,395 as of March 31, 2009 and December 31, 2008, respectively	25,155,685	24,521,605
Redeemable liabilities - warrants	17,500,000	17,500,000
Derivative liabilities - warrants	817,257	-
Total long term liabilities	43,472,942	42,021,605
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
	-	-

Preferred stock, $0.0001 per share; 5,000,000 shares authorized; none issued				
Common stock, $0.0001 per share; 45,000,000 shares authorized, 14,600,152 shares issued and outstanding at March 31, 2009 and December 31, 2008		1,460		1,460
Additional paid-in capital		25,271,339		32,115,043
Cumulative translation adjustment		8,508,945		8,661,060
Statutory reserves		4,284,815		3,730,083
Retained earnings		36,631,905		27,140,775
Total stockholders' equity		74,698,464		71,648,421
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	123,186,769	$	118,262,291

The accompanying notes are an integral part of these statements

CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2009 AND 2008
(Unaudited)

	Three Months Ended March 31, 2009	2008
Revenue		
Natural gas revenue	$ 14,965,819	$ 11,345,319
Gasoline revenue	1,174,398	1,130,750
Installation and other	2,387,449	1,549,605
Total revenue	18,527,666	14,025,674
Cost of revenue		
Natural gas cost	6,746,929	6,182,274
Gasoline cost	1,130,057	1,068,037
Installation and other	1,017,028	686,887
Total cost of revenue	8,894,014	7,937,198
Gross profit	9,633,652	6,088,476
Operating expenses		
Selling expenses	2,324,228	1,341,614
General and administrative expenses	1,681,921	939,325
Total operating expenses	4,006,149	2,280,939
Income from operations	5,627,503	3,807,537
Non-operating income (expense)		
Interest income	8,908	55,285
Interest expense	(581,492)	(359,660)
Other income (expense), net	(2,303)	304
Change in fair value of warrant	197,051	-
Foreign currency exchange loss	(50,788)	(7,430)
Total non-operating expense	(428,624)	(311,501)
Income before income tax	5,198,879	3,496,036
Provision for income tax	997,256	687,465
Net income	4,201,623	2,808,571
Other comprehensive income		
Foreign currency translation gain (loss)	(152,115)	2,303,002
Comprehensive income	$ 4,049,508	$ 5,111,573
Weighted average shares outstanding		
Basic	14,600,152	14,600,152

Diluted		14,600,152		14,667,042
Earnings per share				
Basic	$	0.29	$	0.19
Diluted	$	0.29	$	0.19

The accompanying notes are an integral part of these statements

2

CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2009 AND 2008
(Unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 4,201,623	$ 2,808,571
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,389,565	656,587
Loss on disposal of building improvements and equipment	-	11,957
Amortization of discount on senior notes	170,712	146,663
Amortization of financing costs	38,578	56,270
Stock based compensation	14,842	-
Change in fair value of warrants	(197,051)	-
Change in assets and liabilities:		
Accounts receivable	(41,244)	(163,656)
Other receivable - employee advances	151,617	-
Inventories	30,812	(782,687)
Advances to suppliers	151,828	63,341
Prepaid expense and other current assets	(100,912)	(257,016)
Accounts payable and accrued liabilities	304,860	95,847
Other payables	212,961	1,129
Unearned revenue	195,435	22,709
Accrued interest	(330,003)	73,717
Taxes payable	44,898	768,939
Net cash provided by operating activities	6,238,521	3,502,371
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(13,484)	(555,720)
Proceeds from short term investments	-	243,200
Additions to construction in progress	(2,552,098)	(9,586,215)
Prepayment on long term assets	(426,913)	(4,128,711)
Payment for intangible assets	(35,822)	-
Payment for land use rights	-	(25,091)
Net cash used in investing activities	(3,028,317)	(14,052,537)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from senior notes	-	40,000,000
Payment for offering costs	-	(2,122,509)
Net cash provided by financing activities	-	37,877,491
Effect of exchange rate changes on cash and cash equivalents	(6,226)	635,076
NET INCREASE IN CASH & CASH EQUIVALENTS	3,203,978	27,962,401

CASH & CASH EQUIVALENTS, BEGINNING OF PERIOD		5,854,383		13,291,729
CASH & CASH EQUIVALENTS, END OF PERIOD	$	9,058,361	$	41,254,130
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Interest paid, net of capitalized interest	$	1,084,130	$	-
Income taxes paid	$	997,257	$	57,893

The accompanying notes are an integral part of these statements

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Note 1 - Organization

Organization and Line of Business

China Natural Gas, Inc. (the "Company" or "CHNG") was incorporated in the state of Delaware on March 31, 1999. The Company through its wholly-owned subsidiaries and variable interest entities, located in Shaanxi and Henan Province in the People's Republic of China ("PRC"), engages in sales and distribution of natural gas and gasoline to commercial, industrial and residential customers, construction of pipeline networks, installation of natural gas fittings and parts for end-users, and modification of automobiles services for vehicles to be able to use natural gas.

Recent Developments

On March 18, 2008, Shaanxi Xilan Natural Gas Equipment Co., Ltd ("SXNGE") increased its registered capital from $30,000,000 to $53,929,260. The additional $14,429,260 of registered capital was contributed by China Natural Gas, Inc. on April 17, 2008 and $9,500,000 of registered capital was contributed by China Natural Gas, Inc. as a payment to Chemtex International Inc. on January 31, 2008, for the purchase of license, know-how, and design of constructing the Liquefied Natural Gas ("LNG") processing plant.

On April 22, 2008, Jingbian Liquefied Natural Gas Co., Ltd. ("JBLNG") increased its registered capital by $2,862,000. JBLNG is 100% owned by Xi'an Xilan Natural Gas Co., Ltd.

On April 30, 2008, the Industrial and Commercial Administration Bureau approved Xi'an Xilan Natural Gas Co., ("XXNGC") to increase registered capital from $8,336,856 to $43,443,640 as an additional contribution by the shareholders of XXNGC under PRC Law. $15,513,526 was approved by the Industrial and Commercial Administration Bureau to be transferred out from the surplus reserve and retained earnings as an increase of registered capital. Another $19,593,258 was contributed by SXNGE cumulatively prior to April 30, 2008, which was previously classified as an intercompany payable in XXNGC and was eliminated in the consolidated financial statements. The increase in registered capital in XXNGC was in compliance with the Addendum to Option Agreement entered by the Company through SXNGE and XXNGC, Mr. Qinan Ji, chairman and shareholder of XXNGC, and each of the shareholders of XXNGC (hereafter collectively referred to as the "Transferor") on August 8, 2008, and made retroactive to June 30, 2008. See "Consolidation of Variable Interest Entity" section for further detail on the Addendum to Option Agreement.

On July 3, 2008, XXNGC formed Henan Xilan Natural Gas Co., Ltd. ("HXNGC") as a wholly owned limited liability company, with registered capital of $4,383,000 in Henan province, PRC. HXNGC was established for the purpose of natural gas city gasification engineering design, construction and technical advisory work services in Henan, PRC.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

On October 2, 2008, China Natural Gas, Inc. (the "Company") through its wholly-owned subsidiary, XXNGC, entered into an Equity Ownership Transfer Agreement (the "Acquisition Agreement") with Lingbao Yuxi Natural Gas Co., Ltd. ("LBNGC") and the shareholders of LBNGC (the "Sellers"). Pursuant to the term of the Acquisition Agreement, XXNGC acquired for cash consideration of approximately $19,604,200 (RMB 134 million), 100% of all outstanding registered equity interest in LBNGC and all assets held by LBNGC, including the land use right to 0.44 acres and all of LBNGC's local business' exclusive operating right. LBNGC owns the exclusive rights to operate CNG fueling stations and pipelines in Lingbao City. In conjunction with this acquisition, XXNGC has also secured abundant supply of natural gas to support its future expansion in the Henan province. The Acquisition Agreement was fully executed in November, 2008.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The Company's functional currency is the Chinese Renminbi ("RMB"); however, the Company's reporting currency is the United States Dollar ("USD"); therefore, the accompanying consolidated financial statements have been translated and presented in USD.

In the opinion of management, the unaudited consolidated financial statements furnished herein include all adjustments, all of which are of a normal recurring nature, necessary for a fair statements of the results for the interim period presented. Operating results for the period ended March 31, 2009 are not necessary indicative of the results that may be expected for the year ended December 31, 2009. The information included in this Form 10-Q should be read in conjunction with information included in the 2008 annual report filed on Form 10-K/A.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of China Natural Gas, Inc. and its wholly owned subsidiary, Shaanxi Xilan Natural Gas Equipment Co., Ltd and its 100% variable interest entities ("VIE"), Xi'an Xilan Natural Gas Co. Ltd., Jingbian Liquefied Natural Gas Co., Ltd., Shaanxi Xilan Auto Bodyshop Co., Ltd. ("SXABC"), Henan Xilan Natural Gas Co., Ltd., and Lingbao Yuxi Natural Gas Co., Ltd. All inter-company accounts and transactions have been eliminated in the consolidation.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Consolidation of Variable Interest Entity

In accordance with Financial Interpretation No. 46R, Consolidation of Variable Interest Entities ("FIN 46R"), VIEs are generally entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders lack adequate decision making ability. All VIEs with which the Company is involved must be evaluated to determine the primary beneficiary of the risks and rewards of the VIE. The primary beneficiary is required to consolidate the VIE for financial reporting purposes.

On February 21, 2006, the Company formed Shaanxi Xilan Natural Gas Equipment Co., Ltd as a wholly-owned foreign enterprise (WOFE). Then through SXNGE, the Company entered into exclusive arrangements with Xi'an Xilan Natural Gas and its shareholders that give the Company the ability to substantially influence Xi'an Xilan Natural Gas' daily operations and financial affairs, appoint its senior executives and approve all matters requiring shareholder approval. The Company memorialized these arrangements on August 17, 2007 and made retroactive to March 8, 2006. As a result, the Company consolidates the financial results of Xi'an Xilan Natural Gas as variable interest entity pursuant to Financial Interpretation No. 46R, "Consolidation of Variable Interest Entities." The arrangements consist of the following agreements:

a. Xi'an Xilan Natural Gas holds the licenses and approvals necessary to operate its natural gas business in China.

b. SXNGE provides exclusive technology consulting and other general business operation services to Xi'an Xilan Natural Gas in return for a consulting services fee which is equal to Xi'an Xilan Natural Gas's revenue.

c. Xi'an Xilan Natural Gas' shareholders have pledged their equity interests in Xi'an Xilan Natural Gas to the Company.

d. Irrevocably granted the Company an exclusive option to purchase, to the extent permitted under PRC law, all or part of the equity interests in Xi'an Xilan Natural Gas and agreed to entrust all the rights to exercise their voting power to the person appointed by the Company.

On August 8, 2008, the Company through SXNGE entered into an Addendum to Option Agreement with Mr. Qinan Ji, chairman and shareholder of XXNGC, and each of the shareholders of XXNGC (hereafter collectively referred to as the "Transferor"), and made retroactive to June 30, 2008. According to the Agreement, the Chairman and the Shareholders of XXNGC irrevocably grants to SXNGE an option to purchase each Transferor's Purchased Equity Interest at $1.00 or the lowest price permissible under the applicable laws at the time that SXNGE exercises the Option. The Agreement limits XXNGC and the transferors' right to make all equity interest related decisions.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Foreign Currency Translation

As of March 31, 2009 and December 31, 2008, the accounts of the Company were maintained, and their consolidated financial statements were expressed in RMB. Such consolidated financial statements were translated into USD in accordance with Statement of Financial Accounts Standards ("SFAS") 52, "Foreign Currency Translation," with the RMB as the functional currency. According to SFAS 52, all assets and liabilities were translated at the exchange rate as of the balance sheet date, stockholders' equity were translated at the historical rates and statement of income and cash flow items were translated at the weighted average exchange rate for the year. The resulting translation adjustments are reported under other comprehensive income in accordance with SFAS 130, "Reporting Comprehensive Income." In accordance with SFAS 95, "Statement of Cash Flows," cash flows from the Company's operations is calculated based upon the local currencies and translated to USD at average translation rates for the period. As a result, translation adjustments amounts related to assets and liabilities reported on the consolidated statement of cash flows will not necessarily agree with changes in the corresponding consolidated balances on the balance sheet.

The balance sheet amounts with the exception of equity at March 31, 2009 were translated 6.83 RMB to $1.00 as compared to 6.82 RMB at December 31, 2008. The equity accounts were stated at their historical rate. The average translation rates applied to income and cash flow statement amounts for the three months ended March 31, 2009 and 2008 were 6.83 RMB and 7.15 RMB to $1.00, respectively.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and demand deposits in accounts maintained with state-owned banks within the PRC and the United States. The Company considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents.

Certain financial instruments, which subject the Company to concentration of credit risk, consist of cash. The Company maintains balances at financial institutions which, from time to time, may exceed Federal Deposit Insurance Corporation insured limits for the banks located in the United States. Balances at financial institutions or state-owned banks within the PRC are not covered by insurance. As of March 31, 2009 and December 31, 2008, the Company had total deposits of $8,902,519 and $5,604,383 without insurance coverage. And as of March 31, 2009 and December 31, 2008, the Company has deposits in United States of $0 and $1,273,639 in excess of federally insured limits, respectively. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risks on its cash in bank accounts.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Accounts Receivable

Accounts and other receivable are netted against an allowance for uncollectible accounts, as needed. The Company maintains reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Reserves are recorded primarily on a specific identification basis in the period of the related sales. Delinquent account balances are written-off after management has determined that the likelihood of collection is not probable, and known bad debts are written off against allowance for doubtful accounts when identified. The Company's management has determined that all receivables are collectible and there is no need for an allowance for uncollectible accounts of March 31, 2009 and December 31, 2008.

Other Receivable – Employee Advances

From time to time, the Company advances predetermined amounts based upon internal Company policy to certain employees and internal units to ensure certain transactions are performed in a timely manner. The Company has full oversight and control over the advanced accounts. As of March 31, 2009 and December 31, 2008, no allowance for the uncollectible accounts was deemed necessary.

Inventory

Inventory is stated at the lower of cost, as determined on a first-in, first-out basis, or market. Management compares the cost of inventories with the market value, and an allowance is made for writing down the inventories to their market value, if lower. Inventory consists of material used in the construction of pipelines and material used in repairing and modifying of vehicles. Inventory also consists of natural gas and gasoline.

The following are the details of the inventories:

	March 31, 2009 (Unaudited)	December 31, 2008
Materials and supplies	$ 314,251	$ 318,069
Natural gas and gasoline	173,970	201,670
	$ 488,221	$ 519,739

Advances to Suppliers

The Company advances to certain vendors for purchase of its materials. The advances are interest-free and unsecured.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Loan Receivable

Loan receivable consists of the following:

	March 31, 2009 (Unaudited)	December 31, 2008
Shanxi Yuojin Mining Company, due on November 26, 2008, extended to November 30, 2009, annual interest at 6.57%	$ 293,000	$ 293,400

Property and Equipment

Property and equipment are stated at cost. Expenditures for maintenance and repairs are charged to earnings as incurred while additions, renewals and betterments are capitalized. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method for substantially all assets with estimated lives as follows:

Office equipment	5 years
Operating equipment	5-20 years
Vehicles	5 years
Buildings and improvements	5-30 years

The following are the details of the property and equipment:

	March 31, 2009 (Unaudited)	December 31, 2008
Office equipment	$ 420,275	$ 412,490
Operating equipment	59,396,509	59,473,283
Vehicles	2,412,337	2,414,756
Buildings and improvements	21,161,710	21,190,599
Total property and equipment	83,390,831	83,491,128
Less accumulated depreciation	(8,841,043)	(7,462,856)
Property and equipment, net	$ 74,549,788	$ 76,028,272

Depreciation expense for the three months ended March 31, 2009 and 2008 was $1,389,565 and $656,587, respectively.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Construction in Progress

Construction in progress consists of the cost of constructing property and equipment for the Company's gas stations and new project of processing, distribution and sale of LNG. The major cost of construction in progress relates to technology licensing fees, equipment purchase, land use rights requisition cost, capitalized interest and other construction fees. The facility construction work is expected to be completed around June 2009, and processing equipment installation and testing will be finished by October 2009. No depreciation is provided for construction in progress until such time as the assets are completed and placed into service. Interest incurred during construction is capitalized into construction in progress. All other interest is expensed as incurred.

As of March 31, 2009 and December 31, 2008, the company had construction in progress in the amount of $25,110,473 and 22,061,414, respectively. Interest cost capitalized into construction in progress for the three months ended March 31, 2009 and 2008 amounted to $858,379 and $190,648, respectively.

Long-Lived Assets

The Company applies the provision of SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" to all long lived assets. SFAS 144 addresses accounting and reporting for impairment and disposal of long-lived assets. The Company evaluates at least annually, more often when circumstances require, the carrying value of long-lived assets to be held and used in accordance with SFAS 144. SFAS 144 requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal. Based on its review, the Company believes that, as of March 31, 2009, there were no significant impairments of its long-lived assets.

Unearned Revenue

Unearned revenue represents prepayments by customers for gas purchases and advance payments on installation of pipeline contracts. The Company records such prepayment as unearned revenue when the payments are received.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Fair Value of Financial Instruments

FAS 107, "Disclosure About Fair Value of Financial Instruments" defines financial instruments and requires fair value disclosure of applicable financial instruments. FAS 157, "Fair Value Measurements," adopted January 1, 2008, defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosure requirements for fair value measures. The carrying amounts reported in the consolidated balance sheets for current receivables and payables qualify as financial instruments. Management concluded the carrying values are a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization and if applicable, their stated interest rate approximates current rates available. The three levels are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

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

The Company analyzes all financial instruments with features of both liabilities and equity under SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" and EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."

Effective January 1, 2009, the Company adopted the provisions of EITF 07-5, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock", which is effective for financial statements for fiscal years beginning after December 15, 2008 and which replaced the previous guidance on this topic in EITF 01-6. Paragraph 11(a) of FAS 133 specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the FAS 133 paragraph 11(a) scope exception.

As a result of adopting EITF 07-5, 383,654 warrants previously treated as equity pursuant to the derivative treatment exemption are no longer afforded equity treatment because the strike price of the warrants is denominated in US dollar, a currency other than the Company's functional currency, the Chinese Renminbi. As a result, the warrants are not considered indexed to the Company's own stock, and as such, all future changes in the fair value of these warrants will be recognized currently in earnings until such time as the warrants are exercised or expire.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

As such, effective January 1, 2009, the Company reclassified the fair value of these warrants from equity to liability, as if these warrants were treated as a derivative liability since their issuance in October 2007. On January 1, 2009, the Company reclassified from additional paid-in capital, as a cumulative effect adjustment, $5.8 million to beginning retained earnings and $1.0 million to warrant liabilities to recognize the fair value of such warrants. The fair value of the warrants was $0.8 million on March 31, 2009. Therefore, the Company recognized a $0.2 million gain from the change in fair value of for the three months ended March 31, 2009.

These common stock purchase warrants do not trade in an active securities market, and as such, we estimate the fair value of these warrants using the Black-Scholes Option Pricing Model using the following assumptions:

	March 31, 2009 (Unaudited)	January 1, 2009
Annual dividend yield	-	-
Expected life (years)	3.57	3.82
Risk-free interest rate	0.88%	1.13%
Expected volatility	90%	90%

Expected volatility is based on historical volatility. Historical volatility was computed using daily pricing observations for recent periods that correspond to the term of the warrants. The Company believes this method produces an estimate that is representative of our expectations of future volatility over the expected term of these warrants. The Company has no reason to believe future volatility over the expected remaining life of these warrants likely to differ materially from historical volatility. The expected life is based on the remaining term of the warrants. The risk-free interest rate is based on U.S. Treasury securities according to the remaining term of the warrants.

As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Depending on the product and the terms of the transaction, the fair value of the notes payable and derivative liabilities were modeled using a series of techniques, including closed-form analytic formula, such as the Black-Scholes Option Pricing Model, which does not entail material subjectivity because the methodology employed does not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets.

The following table sets forth by level within the fair value hierarchy our financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2009.

	Carrying Value at March 31, 2009	Fair Value Measurement at March 31, 2009		
		Level 1	Level 2	Level 3
Senior notes	$ 25,155,685	$ -	$ -	$ 35,470,728
Redeemable liability - warrants	17,500,000	-	-	15,587,407
Derivative liability - warrants	817,257	-	817,257	-
Total liability measured at fair value	$ 43,472,942	$ -	$ 817,257	$ 51,058135

Other than the derivative liabilities - warrants carried at fair value, the Company did not identify any other assets and liabilities that are required to be presented on the balance sheet at fair value in accordance with SFAS 157.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Revenue Recognition

The Company's revenue recognition policies are in accordance with Staff Accounting Bulletin (SAB) 104. Revenue is recognized when services are rendered to customers when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of the Company exist and collectability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as unearned revenue. Revenue from gas and gasoline sales is recognized when gas and gasoline is pumped through pipelines to the end users. Revenue from installation of pipelines is recorded when the contract is completed and accepted by the customers. The construction contracts are usually completed within one to two months. Revenue from repairing and modifying vehicles is recorded when services are rendered to and accepted by the customers.

Enterprise Wide Disclosure

The Company's chief operating decision-makers (i.e. chief executive officer and his direct reports) review financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by business lines for purposes of allocating resources and evaluating financial performance. There are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Based on qualitative and quantitative criteria established by SFAS 131, "Disclosures about Segments of an Enterprise and Related Information", the Company considers itself to be operating within one reportable segment.

Advertising Costs

The Company expenses the cost of advertising as incurred or, as appropriate, the first time the advertising takes place. Advertising costs for the three months ended March 31, 2009 and 2008 were insignificant.

Stock-Based Compensation

The Company records and reports stock-based compensation pursuant to SFAS 123R "Accounting for Stock-Based Compensation", which defines a fair-value-based method of accounting for stock-based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from non-employees. Stock compensation for stock granted to non-employees has been determined in accordance with SFAS 123R and the EITF 96-18, "Accounting for Equity Instruments that are issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services", as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Income Taxes

The Company utilizes SFAS 109, "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of temporary differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. At March 31, 2009 and December 31, 2008, there was no significant book to tax differences. There is no difference between book depreciation and tax depreciation as the Company uses the same method for both book and tax. The Company adopted FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no affect on the Company's consolidated financial statements.

Local PRC Income Tax

The Company's subsidiary and VIEs operate in China. Starting January 1, 2008, pursuant to the tax laws of China, general enterprises are subject to income tax at an effective rate of 25% compared to 33% prior to 2008. The Company's VIE, XXNGC, is in the natural gas industry whose development is encouraged by the government. According to the income tax regulation, any company engaged in the natural gas industry enjoys a favorable tax rate. Accordingly, except for income from SXNGE, JBLNG, SXABC, HXNGC and LBNGC which subjects to 25% PRC income tax rate, XXNGC's income is subject to a reduced tax rate of 15%. A reconciliation of tax at the United States federal statutory rate to the provision for income tax recorded in the financial statements is as follows:

	For the three months ended March 31,	
	2009 (Unaudited)	2008 (Unaudited)
Tax provision (credit) at statutory rate	34%	34%
Foreign tax rate difference	(9)%	(9)%
Effect of favorable tax rate	(10)%	(11)%
Other item (1)	4%	6%
Total provision for income taxes	19%	20%

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

(1) The 4% represents the $926,195 expenses incurred by CHNG that are not deductible in PRC for the three months ended March 31, 2009. The 6% represents $1,005,323 expenses incurred by CHNG that are not deductible in PRC for the three months ended March 31, 2008.

The estimated tax savings for the three months ended March 31, 2009 and 2008 amounted to approximately $510,331 and $402,051, respectively. The net effect on earnings per share had the income tax been applied would decrease basic and diluted earnings per share for the three months ended March 31, 2009 and 2008 from $0.29 to $0.26 and $0.19 to $0.17, respectively.

China Natural Gas, Inc. was incorporated in the United States and has incurred net operating loss for income tax purpose for the period ended March 31, 2009. The estimated net operating loss carry forwards for United States income tax purposes amounted to $4,262,057 and $3,378,131 at March 31, 2009 and December 31, 2008, respectively, which may be available to reduce future years' taxable income. These carry forwards will expire, if not utilized, beginning in 2027 through 2029. Management believes that the realization of the benefits arising from this loss appear to be uncertain due to Company's limited operating history and continuing losses for United States income tax purposes. Accordingly, the Company has provided a 100% valuation allowance at March 31, 2009. Management reviews this valuation allowance periodically and makes adjustments as warranted. The valuation allowances were as follow:

Valuation allowance	Three months ended March 31, 2009 (Unaudited)	Year ended December 31, 2008
Balance, beginning of period	$ 1,148,565	$ 322,614
Increase	300,534	825,951
Balance, end of period	$ 1,449,099	$ 1,148,565

Value added tax

Sales revenue represents the invoiced value of goods, net of a value-added tax (“VAT”). All of the Company’s variable interest entity XXNGC’s products that are sold in the PRC are subject to a Chinese value-added tax at a rate of 13% of the gross sales price. This VAT may be offset by VAT paid by the XXNGC on raw materials and other materials included in the cost of producing their finished product. XXNGC recorded VAT payable and VAT receivable net of payments in the financial statements. The VAT tax return is filed offsetting the payables against the receivables.

All revenues from SXABC subject to a Chinese VAT at a rate of 6%. This VAT cannot offset with VAT paid for materials included in the cost of revenues.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Basic and Diluted Earning Per Share

Earning per share is calculated in accordance with the SFAS 128, "Earnings per share". Basic net earnings per share is based upon the weighted average number of common shares outstanding. Diluted net earnings per share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

All share and per share amounts used in the Company's consolidated financial statements and notes thereto have been retroactively restated to reflect the 1-for-2 reverse stock split, which are effective on April 28, 2009. Although this reverse stock split has already occurred under Delaware corporate law, the Company advises that as of April 28 2009, the Company's common stock on the OTC Bulletin Board ("OTCBB") does not yet reflect this stock split. The Company's common stock trades under the OTCBB ticker symbol, "CHNG" on a pre 1-for-2 reverse stock split basis .

Reclassifications

Certain prior period amounts have been reclassified to conform to current period's presentation. These reclassifications had no material effect on net income or cash flows as previously reported.

Recently issued accounting pronouncements and adopted accounting

In March 2008, the FASB issued SFAS 161, "Disclosures about Derivative Instruments and Hedging Activities – An Amendment of SFAS No. 133." SFAS 161 seeks to improve financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures regarding the impact on financial position, financial performance, and cash flows. To achieve this increased transparency, SFAS 161 requires (1) the disclosure of the fair value of derivative instruments and gains and losses in a tabular format; (2) the disclosure of derivative features that are credit risk-related; and (3) cross-referencing within the footnotes. SFAS 161 is effective on January 1, 2009 and the adoption of SFAS 161 did not impact the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." Management is currently evaluating SFAS 162 and do not believe that it will have a significant impact on the determination or reporting of the financial results.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

In June 2008, the FASB issued FSP EITF 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.” The FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in the earnings allocation in calculating earnings per share under the two-class method described in SFAS 128, “Earnings per Share.” The FSP requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share. The FSP is effective for fiscal years beginning after December 15, 2008; earlier application is not permitted. The adoption of EITF 03-6-1 did not have material impact on the Company’s financial position or results.

In October 2008, the FASB issued FSP FAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active.” FSP FAS 157-3 clarifies the application of SFAS 157 in an inactive market, without changing its existing principles. The FSP was effective immediately upon issuance. The adoption of FSP FAS 157-3 did not have an effect on the Company’s financial condition, results of operations or cash flows.

In January 2009, the FASB issued FSP EITF 99-20-1, “Amendments to the Impairment Guidance of EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets.” FSP EITF 99-20-1 changes the impairment model included within EITF 99-20 to be more consistent with the impairment model of SFAS No. 115. FSP EITF 99-20-1 achieves this by amending the impairment model in EITF 99-20 to remove its exclusive reliance on “market participant” estimates of future cash flows used in determining fair value. Changing the cash flows used to analyze other-than-temporary impairment from the “market participant” view to a holder’s estimate of whether there has been a “probable” adverse change in estimated cash flows allows companies to apply reasonable judgment in assessing whether an other-than-temporary impairment has occurred. The adoption of FSP EITF 99-20-1 did not have a material impact on the Company’s consolidated financial statements because all of the investments in debt securities are classified as trading securities.

In April 2009, the FASB issued FSP FAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (FSP FAS 157-4). FSP FAS 157-4 amends SFAS 157 and provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased and also includes guidance on identifying circumstances that indicate a transaction is not orderly for fair value measurements. This FSP shall be applied prospectively with retrospective application not permitted. This FSP shall be effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity early adopting this FSP must also early adopt FSP FAS 115-2 and FAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments” (FSP FAS 115-2 and FAS 124-2). Additionally, if an entity elects to early adopt either FSP FAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments” (FSP FAS 107-1 and APB 28-1) or FSP FAS 115-2 and FAS 124-2, it must also elect to early adopt this FSP. Management is currently evaluating this new FSP but do not believe that it will have a significant impact on the determination or reporting of the financial results.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2. This FSP amends SFAS 115, “Accounting for Certain Investments in Debt and Equity Securities,” SFAS 124, “Accounting for Certain Investments Held by Not-for-Profit Organizations,” and EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets,” to make the other-than-temporary impairments guidance more operational and to improve the presentation of other-than-temporary impairments in the financial statements. This FSP will replace the existing requirement that the entity’s management assert it has both the intent and ability to hold an impaired debt security until recovery with a requirement that management assert it does not have the intent to sell the security, and it is more likely than not it will not have to sell the security before recovery of its cost basis. This FSP provides increased disclosure about the credit and noncredit components of impaired debt securities that are not expected to be sold and also requires increased and more frequent disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. Although this FSP does not result in a change in the carrying amount of debt securities, it does require that the portion of an other-than-temporary impairment not related to a credit loss for a held-to-maturity security be recognized in a new category of other comprehensive income and be amortized over the remaining life of the debt security as an increase in the carrying value of the security. This FSP shall be effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity may early adopt this FSP only if it also elects to early adopt FSP FAS 157-4. Also, if an entity elects to early adopt either FSP FAS 157-4 or FSP FAS 107-1 and APB 28-1, the entity also is required to early adopt this FSP. Management is currently evaluating this new FSP but do not believe that it will have a significant impact on the determination or reporting of the financial results.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1. This FSP amends SFAS No. 107, “Disclosures about Fair Value of Financial Instruments,” to require disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this FSP, fair values for these assets and liabilities were only disclosed annually. This FSP applies to all financial instruments within the scope of SFAS 107 and requires all entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. This FSP shall be effective for interim periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. An entity may early adopt this FSP only if it also elects to early adopt FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption. Management is currently evaluating the disclosure requirements of this new FSP.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

Note 3 – Other Assets

Other assets consisted of the following:

	March 31, 2009	December 31, 2008