

China Natural Gas, Inc.
Form 10-Q/A
October 01, 2010

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

FORM 10-Q/A
(Amendment No. 2)

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2010

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
(State or other jurisdiction of incorporation or organization)

98-0231607
(IRS Employer of Identification No.)

19th Floor, Building B, Van Metropolis
Tang Yan Road, Hi-Tech Zone
Xi'an, 710065, Shaanxi Province, China
(Address of principal executive offices)

(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 No

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 No

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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
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Number of shares of Common Stock outstanding as of May 6, 2010: 21,183,904

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

EXPLANATORY NOTE

This Amendment No. 2 on Form 10-Q/A (the "Amended Filing") amends Amendment No. 1 to the Quarterly Report of China Natural Gas, Inc. (the "Company") (as amended, the "Amended 10-Q"), which in turn had amended the Quarterly Report on Form 10-Q for the quarter ended March 31, 2010, originally filed on May 7, 2010 (the "Original Filing").

As previously disclosed in the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, in February 2010, the Company obtained a bank loan in the amount of \$17.7 million (the "Loan") and, in connection with the Loan, Xi'an Xilan Natural Gas Co. Ltd., the Company's variable interest entity, pledged its equipment and vehicles located within China to secure the Loan (the "Pledge") and guaranteed the repayment of the Loan (the "Guarantee").

By August 8, 2010, the Company's former outside counsel determined that the Pledge was prohibited by the indenture (the "Indenture") for the Company's 5% guaranteed senior note issued to Abax Lotus Ltd. ("Abax") dated January 29, 2008 (the "Senior Notes"). As a result, the Company believed that Abax had the right to declare a default under the Indenture and could thereafter accelerate the Senior Notes, which would cause a simultaneous default under the warrant agreement governing the Company's warrants issued in connection with the Senior Notes, thereby entitling the warrant holders to require the Company to redeem their warrants. In view of the potential default under the Indenture and warrant agreement, the Board, in consultation with management and the Audit Committee, determined that the Company was required to restate its annual financial statements for the year ended December 31, 2009 and the quarter ended March 31, 2010 to reclassify from long term liabilities to short term liabilities the Senior Notes and the fair value of the redeemable warrants (the "Reclassification").

Therefore, the Company filed a Current Report on Form 8-K on August 19, 2010 to disclose that its financial statements contained in its Annual Report on Form 10-K for the year ended December 31, 2009 (the "Annual Report") and the Original Filing should not be relied upon, and, on August 20, 2010, the Company filed:

- Amendment No. 1 to the Annual Report (as amended, the "Amended 10-K") to (i) restate the financial statements contained therein to make the Reclassification and disclose as subsequent events the Loan, the Pledge and the Guarantee as well as the initial determination that the Pledge was not permitted under the Indenture, (ii) make other amendments to the Annual Report to give effect to the foregoing and (iii) amend Part II, Item 9A, Controls and Procedures of the Annual Report; and
- the Amended 10-Q to (i) amend Part II, Item 4, Other Information, of the Original Filing to disclose the Loan, the Pledge and the Guarantee as well as the initial determination that the Pledge was not permitted under the Indenture, (ii) restate the financial statements contained therein to make the Reclassification, record the Loan as a long term liability and record an increase in restricted cash as a result of obtaining the proceeds of the Loan; (iii) make other amendments to the Original Filing to give effect to the foregoing; (iv) amend Part I, Item 4, Controls and Procedures, of the Original Filing; and (v) file the Loan, the Pledge and the Guarantee as exhibits to the Amended 10-Q.

Also, in its Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, the Company (i) recorded the Senior Notes and warrants, which were described as redeemable, as current liabilities in the financial statements contained therein; (ii) made other disclosures in such quarterly report to give effect to the foregoing; and (iii) disclosed in Part II, Item 4, Other Information, of such quarterly report the Loan, the Pledge and the Guarantee as well as the initial determination that the Pledge was not permitted under the Indenture.

Subsequent to restating its financial statements and filing the Amended 10-K and Amended 10-Q, management of the Company internally revisited the analysis of whether the Pledge was indeed prohibited by the Indenture and

determined that it was not. In late August 2010, the Company engaged the law firm DLA Piper, which had not previously advised the Company or management on these matters, to review the Company's analysis, and DLA Piper subsequently confirmed the Company's analysis. At the request of the Company's independent auditors, the Company engaged another law firm with no prior relationship to the Company to review the Company's analysis, and that law firm subsequently confirmed the Company's analysis. The Company engaged DLA Piper as its regular outside counsel for SEC reporting and other public company matters in early September 2010. The Board of Directors of the Company, in consultation with management and the Audit Committee, determined on September 15, 2010, that none the Loan, the Pledge or the Guarantee, individually or together, were prohibited by the Indenture.

The purpose of this Amended Filing is to reverse all disclosure in the Amended 10-Q related to the Reclassification and to further amend Part I, Item 4, Controls and Procedures. With respect to the former, the amendments herein include: (i) reversal of the reclassification of the Company's Senior Notes payable and the fair value of the redeemable warrants from current liabilities back to long term liabilities, (ii) removal of the statements indicating that the Pledge was not permitted under the Indenture, and (iii) other amendments to the Amended 10-Q to give effect to the foregoing. The Company is not restating the Amended 10-Q's restatement of long term liabilities and restricted cash on the Company's consolidated balance sheet as of March 31, 2010 or the restatement of financing activities in consolidated statements of cash flow for the three months ended March 31, 2010, which restatements were made to record the Loan as a long term liability and record an increase in restricted cash as a result of obtaining the proceeds of the Loan, and are described in the Amended 10-Q.

In accordance with Rule 12b-15 under the Exchange Act, each item of the Original Filing, as amended by the Amended 10-Q, that is amended by this Amended Filing is also restated in its entirety, and this Amended Filing is accompanied by currently dated certifications on Exhibits 31.1, 31.2, 32.1 and 32.2 by the Company's Chief Executive Officer and Chief Financial Officer. Except as described above, this Amended Filing does not amend, update, or change any items, financial statements, or other disclosures in the Original Filing, as amended by the Amended 10-Q, and does not reflect events occurring after the filing of the Original Filing, including as to any exhibits to the Original Filing, as amended by the Amended 10-Q, affected by subsequent events. Information not affected by the changes described above is unchanged and reflects the disclosures made at the time of the Original Filing, as amended by the Amended 10-Q. Accordingly, this Amended Filing should be read in conjunction with the Original Filing and our other SEC filings subsequent to the filing of the Original Filing, including the Amended 10-Q and any other amendments to those filings. Capitalized terms not defined in the Amended Filing are as defined by the Original Filing.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CHINA NATURAL GAS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF MARCH 31, 2010 AND DECEMBER 31, 2009

	March 31, 2010 (Unaudited) (As Restated – See Note 2)	December, 31 2009
ASSETS		
CURRENT ASSETS:		
Cash & cash equivalents	\$ 30,172,391	\$ 48,177,794
Restricted cash	13,203,000	-
Accounts receivable, net of allowance for doubtful accounts of \$196,138 and \$163,280 as of March 31, 2010 and December 31, 2009, respectively.	1,514,070	1,289,116
Other receivables	491,020	709,741
Other receivable - employee advances	190,045	338,689
Inventories	874,678	841,837
Advances to suppliers	1,302,568	596,868
Prepaid expense and other current assets	1,546,556	1,076,915
Loans receivable	14,259,240	293,400
Total current assets	63,553,568	53,324,360
INVESTMENT IN UNCONSOLIDATED JOINT VENTURES	1,467,000	1,467,000
PROPERTY AND EQUIPMENT, NET	75,603,216	72,713,012
CONSTRUCTION IN PROGRESS	57,102,317	52,918,236
DEFERRED FINANCING COSTS	1,234,540	1,336,998
OTHER ASSETS	16,937,089	15,854,910
TOTAL ASSETS	\$ 215,897,730	\$ 197,614,516
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 1,970,228	\$ 2,081,261
Other payables	85,082	80,788
Unearned revenue	2,199,805	1,813,641
Accrued interest	200,509	786,052
Taxes payable	2,888,511	1,901,577
Total current liabilities	7,344,135	6,663,319
LONG TERM LIABILITIES:		
Notes payable, net of discount \$11,946,508 and \$12,707,713 as of March 31, 2010 and December 31, 2009, respectively	28,053,492	27,292,287

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Derivative liabilities - warrants	19,152,570	19,545,638
Long term debt	13,203,000	
Total long term liabilities	60,409,062	46,837,925

COMMITMENTS AND CONTINGENCIES