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)

x 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	98-0231607
(State or other jurisdiction of incorporation or organization)	(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 x No ¨

In dicate 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 x

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 ¨ (Do not check if a smaller reporting company)	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 x

EXLANATORY 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.

China Natural Gas, Inc.
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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

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				
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, 21,183,904 shares issued and outstanding at March 31, 2010 and December 31, 2009		2,118		2,118
Additional paid-in capital		79,926,097		79,851,251
Cumulative other comprehensive gain		8,675,165		8,714,019
Statutory reserves		6,425,074		5,962,695
Retained earnings		53,116,079		49,583,189
Total stockholders' equity		148,144,533		144,113,272
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	215,897,730	$	197,614,516

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CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009
(Unaudited)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Revenues		
Natural gas revenue	$ 15,483,629	$ 14,965,819
Gasoline revenue	1,468,816	1,174,398
Installation and others	2,414,378	2,387,449
Total revenues	19,366,823	18,527,666
Cost of revenues		
Natural gas cost	7,864,654	6,746,929
Gasoline cost	1,367,278	1,130,057
Installation and others	1,039,923	1,017,028
Total cost of revenues	10,271,855	8,894,014
Gross profit	9,094,968	9,633,652
Operating expenses		
Selling expenses	2,891,790	2,580,825
General and administrative expenses	1,817,656	1,425,324
Total operating expenses	4,709,446	4,006,149
Income from operations	4,385,522	5,627,503
Non-operating income (expense):		
Interest income	89,366	8,908
Interest expense	-	(581,492)
Other income (expense), net	46,569	(2,303)
Change in fair value of warrants	393,068	197,051
Foreign currency exchange loss	(8,110)	(50,788)
Total non-operating income (expense)	520,893	(428,624)
Income before income tax	4,906,415	5,198,879
Provision for income tax	911,145	997,256
Net income	3,995,270	4,201,623
Other comprehensive income		
Foreign currency translation loss	(38,854)	(152,115)
Comprehensive income	$ 3,956,416	$ 4,049,508
Weighted average shares outstanding		
Basic	21,183,904	14,600,152

Diluted		21,595,038		14,600,152
Earnings per share				
Basic	$	0.19	$	0.29
Diluted	$	0.19	$	0.29

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CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009
(Unaudited)

	Three Months Ended March 31, 2010 (As Restated – See Note 2)	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,995,270	$ 4,201,623
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,472,595	1,389,565
Provision for bad debt	32,847	-
Amortization of discount on senior notes	-	170,712
Amortization of financing costs	-	38,578
Stock based compensation	74,847	14,842
Change in fair value of warrants	(393,068)	(197,051)
Change in assets and liabilities:		
Accounts receivable	(257,812)	(41,244)
Other receivable - employee advances	148,593	151,617
Inventories	(32,830)	30,812
Advances to suppliers	(705,460)	151,828
Prepaid expense and other current assets	(167,213)	(100,912)
Accounts payable and accrued liabilities	(111,007)	304,860
Other payables	4,296	212,961
Unearned revenue	386,032	195,435
Accrued interest	(585,543)	(330,003)
Taxes payable	986,599	44,898
Net cash provided by operating activities	4,848,146	6,238,521
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans to third parties	(14,259,140)	-
Repayment of loans receivable	293,300	-
Purchase of property and equipment	(253,844)	(13,484)
Additions to construction in progress	(7,425,192)	(2,552,098)
Prepayment on long term assets	(1,047,327)	(426,913)
Return of acquisition deposit	(124,653)	-
Payment for intangible assets	-	(35,822)
Payment for land use rights	4,722	-
Net cash used in investing activities	(22,812,134)	(3,028,317)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long term loan	13,198,500	-
Increase in restricted cash	(13,198,500)	-
Net cash provided by financing activities	-	-
Effect of exchange rate changes on cash and cash equivalents	(41,415)	(6,226)

NET (DECREASE) INCREASE IN CASH & CASH EQUIVALENTS		(18,005,403)		3,203,978
CASH & CASH EQUIVALENTS, BEGINNING OF PERIOD		48,177,794		5,854,383
CASH & CASH EQUIVALENTS, END OF PERIOD	$	30,172,391	$	9,058,361
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Interest paid	$	1,085,543	$	1,084,130
Income taxes paid	$	-	$	997,257
Non-cash transactions for investing and financing activities:				
Construction in progress transferred to property and equipment	$	4,106,200	$	-
Capitalized interest - amortization of discount of notes payable and issuance cost	$	863,662	$	-

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2010
(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 HongKong, Shaanxi ,Henan and Hubei 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 February 5, 2010, Jingbian Liquefied Natural Gas Co., Ltd. ("JBLNG") increased the registered capital by $6,026,343 which was invested by Xi'an Xilan Natural Gas Co., Ltd. ("XXNGC") in the form of equipment.

On September 8, 2009, Shaanxi Xilan Natural Gas Equipment Co., Ltd ("SXNGE") increased its registered capital by $26,000,000 from $53,929,260 to $79,929,260. CHNG contributed $10,000,000 and $16,000,000 registered capital to SXNGE on September 29, 2009 and January 13, 2010, respectively.

Note 2 – Restatement of Previously Reported Consolidated Financial Statement

On August 20, 2010, the Company restated its quarterly consolidated financial statements as of March 31, 2010. The Company is hereby restating the August 20, 2010 restatement of its quarterly consolidated financial statements as of March 31, 2010 to reverse all disclosure related to the reported violation of the Indenture for the Company's 5% Guaranteed Senior Notes (the "Senior Notes") issued to Abax Lotus Ltd. ("Abax").

The Company's Audit Committee made a decision to restate the consolidated financial statements upon the recommendation of the board of directors and management following the confirmation by two different independent law firms that the opinion on which the Company had previously relied – the basis of its conclusion that it had violated the Indenture – was incorrect. The general nature and scope of the adjustments are summarized as follows:

- (1) Reverse of reclassification of senior notes payable—— on February 26, 2010, the Company entered into a bank loan of $17.7 million with Pudong Development Bank Xi'an Branch ("SPDB") (the "Bank Loan"). The loan is secured by the Company's variable interest entity Xi'an Xilan Natural Gas Co., Ltd.'s ("XXNGC") equipment and vehicles located within the PRC. The Company was entitled to borrow amounts under the loan between March 1, 2010 to June 30, 2010. In connection with the Bank Loan, XXNGC pledged its equipment and vehicles located in PRC to secure the Bank Loan (the "Pledge") and guaranteed the repayment of the Bank Loan. The original opinion on which the Company relied indicated that the Pledge was prohibited by the Indenture for the Company's 5% Guaranteed Senior Note issued to Abax Lotus Ltd., ("Abax") dated January 26, 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, and consequently, that the Company was required to reclassify from long term liabilities to short term liabilities the Senior Notes. Subsequent to the August

20, 2010 restatement, management of the Company internally revisited the analysis of whether the Pledge was indeed prohibited by the Indenture and determined that it was not. The Company engaged two additional independent law firms who reviewed and confirmed this determination. As a result, the Company reverses the August 20, 2010 reclassification of the Senior Notes in an amount of $28 million from long term liabilities to short term liabilities.

· (2) Reverse of reclassification of fair value of the redeemable warrants—— in connection with the Senior Notes, the Company issued certain warrants to purchase the Company's common stock pursuant to a Warrant Agreement and Warrant Certificates. Under the terms of the Warrant Agreement, in the event of a default under the Indenture for the Senior Notes, the warrant holders are entitled to require the Company to redeem the warrants for a price equal to the pro rata portion of the aggregate redemption price of $17,500,000 applicable to the warrants tendered by such holders. As described above, in connection with the August 20, 2010 restatement, the Company believed the Pledge was prohibited by the Indenture and that Abax had a right to declare an event of default under the Indenture. Accordingly, the Company also believed that the warrant holders were entitled to require the Company to redeem their warrants and, consequently, that the Company was required to reclassify from long term liabilities to short term liabilities the fair value of the redeemable warrants. As a result of the Company's conclusion that the Pledge was not prohibited by the Indenture, the Company reverses the August 20, 2010 reclassification of the warrants in an amount of $17.5 million from long term liabilities to short term liabilities.

The Company is not restating the August 20, 2010 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 Amendment No. 1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010.

The following tables present the adjustments due to the restatements made herein of the Company’s previously issued consolidated balance sheet as of March 31, 2010.

	Consolidated Balance Sheet March 31, 2010 (Unaudited)		
	Previously Reported	Adjustments	As Restated
ASSETS			
CURRENT ASSETS:			
Cash & cash equivalents	$ 30,172,391	$ -	$ 30,172,391
Restricted cash	13,203,000	-	13,203,000
Accounts receivable	1,514,070	-	1,514,070
Other receivables	491,020	-	491,020
Other receivable - employee advances	190,045	-	190,045
Inventories	874,678	-	874,678
Advances to suppliers	1,302,568	-	1,302,568
Prepaid expense and other current assets	1,546,556	-	1,546,556
Loans receivable	14,259,240	-	14,259,240
Total current assets	63,553,568	-	63,553,568
INVESTMENT IN UNCONSOLIDATED JOINT VENTURES	1,467,000	-	1,467,000
PROPERTY AND EQUIPMENT, NET	75,603,216	-	75,603,216
CONSTRUCTION IN PROGRESS	57,102,317	-	57,102,317
DEFERRED FINANCING COSTS	1,234,540	-	1,234,540
OTHER ASSETS	16,937,089	-	16,937,089
TOTAL ASSETS	$ 215,897,730		$ 215,897,730
LIABILITIES AND STOCKHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable and accrued liabilities	$ 1,970,228	-	$ 1,970,228
Other payables	85,082	-	85,082
Unearned revenue	2,199,805	-	2,199,805
Accrued interest	200,509	-	200,509
Taxes payable	2,888,511	-	2,888,511
Notes payable	28,053,492	(1) (28,053,492)	-
Redeemable liabilities-warrants	17,500,000	(2) (17,500,000)	-
Total current liabilities	52,897,627	(45,553,492)	7,344,135
LONG TERM LIABILITIES:			
Notes payable	-	(1) 28,053,492	28,053,492
Derivative liabilities - warrants	1,652,570	(2) 17,500,000	19,152,570
Long term debt	13,203,000	-	13,203,000
Total long term liabilities	14,855,570	45,553,492	60,409,062
COMMITMENTS AND CONTINGENCIES			

STOCKHOLDERS' EQUITY:			
Preferred stock	-	-	-
Common stock	2,118	-	2,118
Additional paid-in capital	79,926,097	-	79,926,097
Cumulative other comprehensive gain	8,675,165	-	8,675,165
Statutory reserves	6,425,074	-	6,425,074
Retained earnings	53,116,079	-	53,116,079
Total stockholders' equity	148,144,533	-	148,144,533
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 215,897,730	-	$ 215,897,730

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Note 3 – 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, 2010 are not necessary indicative of the results that may be expected for the year ended December 31, 2010. The information included in this Form 10-Q should be read in conjunction with information included in the 2009 annual report filed on Form 10-K.

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 subsidiaries, and its 100% variable interest entities ("VIE"),. All inter-company accounts and transactions have been eliminated in the consolidation.

Consolidation of Variable Interest Entity

In accordance with Financial Accounting Standards Board's ("FASB") accounting standard regarding consolidation, 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 SXNGE as a wholly-owned foreign enterprise (WOFE). Then through SXNGE, the Company entered into exclusive arrangements with XXNGC and its shareholders that give the Company the ability to substantially influence XXNGC's 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 XXNGC as VIE .The arrangements consist of the following agreements:

a. XXNGC 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 XXNGC in return for a consulting services fee which is equal to XXNGC's revenue.

c. XXNGC' shareholders have pledged their equity interests in XXNGC 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 XXNGC 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 ("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.

Foreign Currency Translation

The Company's reporting currency is the US dollar. The functional currency of PRC subsidiaries is the Chinese Renminbi ("RMB"). Our results of operations and financial position of the PRC subsidiaries are translated to United States dollars using the quarter end exchange rates as to assets and liabilities and weighted average exchange rates as to revenues, expenses and cash flows. Capital accounts are translated at their historical exchange rates when the capital transaction occurred. The resulting currency translation adjustments are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity. As a result, translation adjustments amount 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. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations as incurred.

The balance sheet amounts with the exception of equity were translated 6.82 RMB to $1.00 at March 31, 2010 and December 31, 2009. 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, 2010 and 2009 were 6.82 RMB and RMB 6.83 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, Hong Kong 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 Hong Kong Deposit Protection Board ("HKDPB") insured limits for the banks located in Hong Kong or may exceed Federal Deposit Insurance Corporation ("FDIC") 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, 2010 and December 31, 2009, the Company had total deposits of $29,435,016 and $47,459,560, respectively, without insurance coverage or in excess of HKDPB or FDIC insured limits. 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.

Restricted Cash

Restricted cash represents $13.2 million received by the Company pursuant to the Bank Loan with SPDB on March 17, 2010. This cash amount is temporally held by SPDB due to the pending of loan processing and the Company is not entitled to use these proceeds as of March 31, 2010. Due to the short-term nature of the pending period, the corresponding restricted cash balances have been classified as current in the consolidated balance sheets.

Accounts Receivable

Accounts 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 recorded allowance for bad debts of $196,138 and $163,280 as of March 31, 2010 and December 31, 2009, respectively.

Other Receivables

Other receivables mainly include security deposits for equipment storage. This security deposit will be refunded to the Company after the equipment had been removed from the storage area for construction.

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, 2010 and December 31, 2009, no allowance for the uncollectible accounts was deemed necessary.

Inventories

Inventories 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. Inventories consist of materials used in the construction of pipelines and in repairing and modifying vehicles. Inventories also consist of gasoline.

The following are the details of the inventories:

	March 31, 2010 (Unaudited)	December 31, 2009
Materials and supplies	$ 453,382	$ 345,611
Gasoline	421,296	496,226
Total	$ 874,678	$ 841,837

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Advances to Suppliers

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

Loans Receivable

Loans receivable consists of the following:

	March 31, 2010 (unaudited)	December 31, 2009
Shanxi Yuojin Mining Company, due on November 30, 2009, extended to November 30, 2010, annual interest at 5.84% (1)	$ -	$ 293,400
Shanxi JunTai Housing Purchase Ltd., due on January 10, 2011, annual interest at 5.84% (2)	4,401,000	-
Ms. Taoxiang Wang, due on February 19, 2011, annual interest at 5.84% (3)	9,858,240	-
	$ 14,259,240	$ 293,400

(1) This Company paid off this loan on March 11, 2010.

(2) The applicable interest rate of this loan is the People's Bank of China's standard one-year rate, 5.31% at inception of the loan, which is subject to change with the government policy, plus an additional 10% interest rate float. Pursuant to these terms, the interest rates were 5.84% at the inception date and March 31, 2010. This loan is guaranteed by a third-party individual.

(3) This one-year loan was secured by Ms. Taoxiang Wang's 40% of ownership in Xi'an Demaoxing Real Estate Co. On April 22 and April 27, 2010, Ms. Wang repaid $ 5,868,000 and $4,130,962, respectively, of which $140,722 was the interest payments. As of April 27, 2010, this loan was paid off.

Investments in Unconsolidated Joint Ventures

Investee companies that are not consolidated, but over which the Company exercises significant influence, are accounted for under the equity method of accounting. Whether or not the Company exercises significant influence with respect to an Investee depends on an evaluation of several factors including, among others, representation on the Investee company's board of directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the Investee company. Under the equity method of accounting, an Investee company's accounts are not reflected within the Company's consolidated balance sheets and statements of income and other comprehensive income; however, the Company's share of the earnings or losses of the Investee company is reflected in the caption "Earnings (loss) on equity investment" in the consolidated statements of income and other comprehensive income. The Company's carrying value in an equity method Investee company is reflected in the caption "Investments in Unconsolidated Joint Ventures" in the Company's consolidated balance sheets.

When the Company's carrying value in an equity method, the investee company is reduced to zero and no further losses are recorded in the Company's consolidated financial statements unless the Company guaranteed obligations of the Investee company or has committed additional funding. When the Investee company subsequently reports income, the Company will not record its share of such income until it equals the amount of its share of losses not previously recognized.

The Company's investment in unconsolidated joint ventures that are accounted for on the equity method of accounting represents the 49% interest in Henan CNPC Kunlun Xilan Compressed Natural Gas Co., Ltd. ("JV"), which is engaged in building and operating CNG compressor stations and fueling stations, sell CNG, provide vehicle conversion services from gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles and technical advisory work services in Henan, PRC. The investment in this company amounted to $1,467,000 at March 31, 2010 and December 31, 2009. The JV does not have any operations as of March 31, 2010.

The results of financial position of the JV as of March 31, 2010 are summarized below:

	March 31, 2010 (unaudited)	December 31, 2009
Condensed balance sheet information:		
Current assets	$ 2,993,878	$ 2,993,878
Noncurrent assets	-	-
Total assets	$ 2,993,878	$ 2,993,878
Current liabilities	-	-
Noncurrent liabilities	-	-
Equity	$ 2,993,878	$ 2,993,878
Total liabilities and equity	$ 2,993,878	$ 2,993,878

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, 2010 (unaudited)	December 31, 2009
Office equipment	$ 478,423	$ 439,055
Operating equipment	63,032,066	61,350,503
Vehicles	2,486,614	2,486,614
Buildings and improvements	24,055,153	21,414,553
Total property and equipment	90,052,256	85,690,725
Less accumulated depreciation	(14,449,040)	(12,977,713)
Property and equipment, net	$ 75,603,216	$ 72,713,012

Depreciation expense for the three months ended March 31, 2010 and 2009 was $1,470,826 and $1,389,565, respectively.

Construction in Progress

Construction in progress ("CIP") consists of the cost of constructing property and equipment for the Company's gas stations and a new project of processing, distribution and sale of LNG. The major cost of construction in progress relates to technology licensing fees, equipment purchases, land use rights requisition cost, capitalized interest and other construction fees. 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, 2010 and December 31, 2009, the Company had construction in progress in the amount of $57,102,317 and $52,918,236, respectively. Interest cost capitalized into construction in progress for the three months ended March 31, 2010 and 2009, amounted to $1,363,663 and $858,379, respectively.

Construction in progress at March 31, 2010 consisted of the following:

No.	Project Description	Location	March 31, 2010 (unaudited)	Commencement Date	Expected completion date	Estimated additional cost to complete
1	Jingbian LNG (1)	JBLNG	$ 45,882,038	Dec-06	Jun-10	$ 9,873,000
2	Sa Pu mother station	HXNGC	840,799	Jul-08	Jun-11	6,300,000
3	Xi'an Cangsheng mother station	XXNGC	1,925,557	Sep-08	May-11	3,220,000
4	Sanhuanbei fueling station	XXNGC	1,725,563	Mar-10	May -10	1,126,656
5	Sanyao fueling station	XXNGC	1,662,652	Mar-10	May-10	1,085,580
6	Matengkong fueling station	XXNGC	1,581,766	Mar-10	May -10	1,164,798
7	International port	XXNGC	1,376,406	May-09	Dec -10	2,800,000
8	Other CIP projects	XXNGC	2,107,536	Various	Various	500,000
			$ 57,102,317			$ 26,070,034

(1) Phase I of the LNG project cost $48,963,000 to construct and the additional $6,792,038 represent costs incurred in connection with phase II and phase III of the LNG plant

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. 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, 2010, 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.

Fair Value of Financial Instruments

The accounting standards regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy for disclosures of fair value measurement, and enhance 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.

FASB accounting standard regarding derivatives and hedging 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. This FASB accounting standard also 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 exception.

As a result of adopting this FASB accounting standard, 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.

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, $5,844,239 to beginning retained earnings and $1,014,308 to warrant liabilities to recognize the fair value of such warrants. The fair value of the warrants was $1,652,570 and $2,045,638 on March 31, 2010 and December 31, 2009, respectively. The Company recognized a gain of $393,068 and $197,051 for the three months ended March 31, 2010 and 2009, respectively.

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, 2010 (unaudited)	December 31, 2009
Annual dividend yield	-	-
Expected life (years)	2.57	2.82
Risk-free interest rate	1.34%	1.49%
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 is 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.

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 derivative liabilities was 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 of the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2010.

	Carrying Value at March 31, 2010 (unaudited)	Fair Value Measurement at March 31, 2010 Level 1	Level 2	Level 3
Long-term debt	$ 13,203,000	$ -	$ -	$ 12,530,130
Senior notes	28,053,492			35,764,078
Redeemable liability - warrants	17,500,000			15,468,681
Derivative liability - warrants	1,652,570	-	1,652,570	-
Total liability measured at fair value	$ 60,409,062	$ -	$ 1,652,570	$ 63,762,889

Other than the table set forth above, the Company did not identify any other assets and liabilities that are required to be presented on the balance sheet.

Revenue Recognition

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 the FASB's accounting standard for segment reporting, 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, 2010 and 2009, were insignificant.

Stock-Based Compensation

The Company records and reports stock-based compensation pursuant to FASB's accounting standard regarding stock 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 this accounting standard, as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

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Income Taxes

FASB's accounting standard regarding income taxes 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, 2010 and 2009, 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. 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, LBNGC and HBXNGC 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	
	2010	2009
Tax provision (credit) at statutory rate	34%	34%
Foreign tax rate difference	(9)%	(9)%
Effect of favorable tax rate	(7)%	(10)%
Other item (1)	1%	4%
Total provision for income taxes	19%	19%

(1) The 1% represents the $288,192 expenses incurred by CHNG that are not deductible in PRC for the three months ended March 31, 2010. 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 estimated tax savings for the three months ended March 31, 2010 and 2009 amounted to approximately $498,624 and $510,331, respectively. The net effect on earnings per share had the income tax been applied would decrease basic earnings per share from $0.19 to $0.17, and the diluted earnings per share from $0.19 to $0.16 for the three months ended March 31, 2010. For the three months ended March 31, 2009, the basic and diluted earnings per share would decrease from $0.29 to $0.26 if the income tax had been applied.

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, 2010. The estimated net operating loss carry forwards for United States income tax purposes amounted to $3,574,888 and $3,232,855 as of March 31, 2010 and December 31 2009, 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, 2010. Management reviews this valuation allowance periodically and makes adjustments as warranted. The valuation allowances were as follow:

Valuation allowance	For the three months end March 31,2010 (unaudited)	Year ended December 31,2009
Balance, beginning of period	$ 1,099,171	$ 563,541
Increase	116,291	535,630
Balance, end of period	$ 1,215,462	$ 1,099,171

The Company has cumulative undistributed earnings of foreign subsidiaries of approximately $34,110,704 as of March 31, 2010, which is included in consolidated retained earnings and will continue to be indefinitely reinvested in international operations. Accordingly, no provision has been made for U.S. deferred taxes related to future repatriation of these earnings, nor is it practicable to estimate the amount of income taxes that would have to be provided if we concluded that such earnings will be remitted in the future.

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 are 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.

Taxes Payable

Taxes payable at March 31, 2010 and December 31, 2009 consisted of the following:

	March 31, 2010 (unaudited)	December 31, 2009
Value added tax payable	$ 810,976	$ 740,772
Business tax payable	-	1,540
Income tax payable	2,039,416	1,127,961
Urban maintenance tax payable	34,357	27,442
Income tax for individual payable	3,762	3,862
Total tax payable	$ 2,888,511	$ 1,901,577

Basic and Diluted Earnings Per Share

Earnings per share is calculated in accordance with the FASB’s accounting standard regarding 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 were effective on April 28, 2009.

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Recently issued accounting pronouncements

In January 2010, FASB issued ASU No. 2010-01- Accounting for Distributions to Shareholders with Components of Stock and Cash. The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The adoption of this ASU did not have a material impact on its consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 – Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification. The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51." If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. These disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company is currently evaluating the impact of this ASU, however, the Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In February 2010, FASB issued ASU No. 2010-9 –Amendments to Certain Recognition and Disclosure Requirements. This update addresses certain implementation issues related to an entity's requirement to perform and disclose subsequent-events procedures, removes the requirement that public companies disclose the date of their financial statements in both issued and revised financial statements. According to the FASB, the revised statements include those that have been changed to correct an error or conform to a retrospective application of U.S. GAAP. The amendment is effective for interim and annual reporting periods in fiscal year ending after June 15, 2010. The

Company does not expect the adoption of this ASU to have a material impact on the Company's consolidated financial statements.

In March 2010, FASB issued ASU No. 2010-10 –Amendments for Certain Investment Funds. This update defers the effective date of the amendments to the consolidation requirements made by FASB Statement 167 to a reporting entity's interest in certain types of entities. The deferral will mainly impact the evaluation of reporting enterprises' interests in mutual funds, private equity funds, hedge funds, real estate investment entities that measure their investment at fair value, real estate investment trusts, and venture capital funds. The ASU also clarifies guidance in Statement 167 that addresses whether fee arrangements represent a variable interest for all service providers and decision makers. The ASU is effective for interim and annual reporting periods in fiscal year beginning after November 15, 2009. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In March 2010, FASB issued ASU No. 2010-11 –Scope Exception Related to Embedded Credit Derivatives. Embedded credit-derivative features related only to the transfer of credit risk in the form of subordination of one financial instrument to another are not subject to potential bifurcation and separate accounting as clarified by recently issued FASB guidance. Other embedded credit-derivative features are required to be analyzed to determine whether they must be accounted for separately. This update provides guidance on whether embedded credit-derivative features in financial instruments issued by structures such as collateralized debt obligations (CDOs) and synthetic CDOs are subject to bifurcation and separate accounting. The guidance is effective at the beginning of a company's first fiscal quarter beginning after June 15, 2010. The Company does not expect the adoption of this ASU to have a material impact on the Company's consolidated financial statements.

Reclassification

Certain prior period expense amounts have been reclassified to conform to the current period presentation. These reclassifications have no effect on net income or cash flows.

Note 4 – Other Assets

Other assets consisted of the following:

		March 31, 2010 (unaudited)		December 31, 2009
Prepaid rent – natural gas stations	$	335,487	$	340,211
Prepayment for acquiring land use right		1,936,440		1,936,440
Advances on purchasing equipment and construction in progress		13,104,648		12,056,964
Refundable security deposits		1,388,978		1,264,283
Others		171,536		257,012
Total	$	16,937,089	$	15,854,910

All land in the PRC is government owned. However, the government grants users land use rights. As of March 31, 2010 and December 31, 2009, the Company prepaid $1,936,440 to the PRC local government to purchase land use rights. The Company is in the process of negotiating the final purchase price with the local government and the land use rights have not yet been granted to the Company. Therefore, the Company did not amortize the prepaid land use rights.

Advances on the purchase of equipment and construction in progress are monies deposited or advanced to outside vendors/subcontractors for the purchase of operating equipment or for services to be provided for constructions in progress.

Refundable security deposits are monies deposited with one of the Company's major vendors and gas station landlord. These amounts will be returned to the Company if they terminate the business relationship or at the end of the lease.

Note 5 – Senior Notes Payable

On March 30, 2007, the Company entered into a Securities Purchase Agreement with Abax Lotus Ltd. (the "Investor"). The Purchase Agreement was subsequently amended on January 29, 2008, pursuant to which the Company (i) agreed to issue 5.00% Guaranteed Senior Notes due 2014 (the "Senior Notes") of approximately $20,000,000, (ii) agreed to issue to the Investor Senior Notes in aggregate principal amount of approximately $20,000,000 on or before March 3, 2008 subject to the Company meeting certain closing conditions, (iii) granted the Investor an option to purchase up to approximately $10,000,000 in principal amount of its Senior Notes and (iv) agreed to issue to the Investor seven-year warrants exercisable for up to 1,450,000 shares of the Company's common stock (the "Warrants") at an initial exercise price equal to $14.7304 per share, subject to certain adjustments, which adjusted to $7.3652 on January 29, 2009. On January 29, 2008, the Company issued $20,000,000 Senior Notes and 1,450,000 warrants pursuant to the Purchase Agreement. On March 3, 2008, the Investor exercised its first option for an additional $20,000,000 of Senior Notes. On March 10, 2008, the Company issued $20,000,000 in additional Senior Notes resulting in total Senior Notes of $40,000,000.

At the closing, the Company entered into:

- An indenture for the 5.00% Guaranteed Senior Notes due 2014;
- An investor rights agreement;
- A registration rights agreement covering the shares of common stock issuable upon exercise of the warrants;
- An information rights agreement that grants to the Investor, subject to applicable law, the right to receive certain information regarding the Company;
- A share-pledge agreement whereby the Company granted to the Collateral Agent (on behalf of the holders of the Senior Notes) a pledge on 65% of the Company's equity interest in SXNGE, a PRC corporation and wholly-owned subsidiary of the Company; and
- An account pledge and security agreement whereby the Company granted to the Collateral Agent a security interest in the account where the proceeds from the Senior Notes are deposited.

In addition, Qinan Ji, Chief Executive Officer and Chairman of the Board of the Company, executed a non-compete agreement for the benefit of the Investor.

The Senior Notes were issued pursuant to an indenture between the Company and DB Trustees (Hong Kong) Limited, as trustee, at the closing. The Senior Notes will mature on January 30, 2014 and will initially bear interest at the stated interest rate of 5.00% per annum, subject to an increase in the event of certain circumstances. The Company is required to make mandatory repayments on the Senior Notes on the following dates and in the following amounts, expressed as a percentage of the aggregate principal amount of Notes that will be outstanding on the first such payment date:

Date	Repayment Percentage
July 30, 2011	8.3333%
January 30, 2012	8.3333%
July 30, 2012	16.6667%
January 30, 2013	16.6667%
July 30, 2013	25.0000%

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During the twelve month period commencing January 30 of the years set forth below, the Company may redeem the Senior Notes at the following principal amount:

Year	Principal
2009	$ 43,200,000
2010	42,400,000
2011	41,600,000
2012	40,800,000
2013 and thereafter	40,000,000

Upon the occurrence of certain events defined in the indenture, the Company must offer the holders of the Senior Notes the right to require the Company to purchase the Senior Notes in an amount equal to 105% of the aggregate principal amount purchased plus accrued and unpaid interest on the Senior Notes purchased.

The indenture requires the Company to pay additional interest at the rate of 3.0% per annum of the Senior Notes if the Company has not obtained a listing of its common stock on the Nasdaq Global Market, the Nasdaq Capital Market or the New York Stock Exchange by January 29, 2009 and maintained such listing continuously thereafter as long as the Senior Notes are outstanding. As of January