

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

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

FORM 10-Q
(Amendment No. 1)

(Mark One)

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

For the quarterly period ended June 30, 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 August 6: 21,215,337

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. 1 on Form 10-Q/A (the "Amended Filing") amends the Quarterly Report of China Natural Gas, Inc. (the "Company") for the quarter ended June 30, 2010, originally filed on August 13, 2010 (the "Original Filing").

As previously disclosed in the Original Filing, 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 its Quarterly Report for the quarter ended March 31, 2010 (the "Quarterly Report") 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
- Amendment No. 1 to the Quarterly Report (as amended, the "Amended 10-Q") to (i) amend Part II, Item 4, Other Information, of the Quarterly Report 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 Quarterly Report to give effect to the foregoing; (iv) amend Part I, Item 4, Controls and Procedures, of the Quarterly Report; and (v) file the Loan, the Pledge and the Guarantee as exhibits to the Amended 10-Q.

Also, in the Original Filing, 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 the Original Filing to give effect to the foregoing; and (iii) disclosed in Part II, Item 4, Other Information, of the Original Filing 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 of 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 Original Filing 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) reclassification of the Company's Senior Notes payable and the fair value of the redeemable warrants from current liabilities 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 Original Filing to give effect to the foregoing.

In accordance with Rule 12b-15 under the Exchange Act, each item of the Original Filing 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, and does not reflect events occurring after the filing of the Original Filing, including as to any exhibits to the Original Filing 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. 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 any 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 JUNE 30, 2010 AND DECEMBER 31, 2009

	June 30, 2010 (Unaudited)	December, 31 2009
ASSETS		
CURRENT ASSETS:		
Cash & cash equivalents	\$ 42,606,410	\$ 48,177,794
Accounts receivable, net of allowance for doubtful accounts of \$206,514 and \$163,280 as of June 30, 2010 and December 31, 2009, respectively	1,174,673	1,289,116
Other receivables	36,942	709,741
Other receivable - employee advances	303,887	338,689
Inventories	842,259	841,837
Advances to suppliers	1,385,058	596,868
Prepaid expense and other current assets	3,769,977	1,076,915
Loans receivable	-	293,400
Total current assets	50,119,206	53,324,360
INVESTMENT IN UNCONSOLIDATED JOINT VENTURES	1,467,000	1,467,000
PROPERTY AND EQUIPMENT, NET	80,342,000	72,713,012
CONSTRUCTION IN PROGRESS	78,363,718	52,918,236
DEFERRED FINANCING COSTS	1,132,082	1,336,998
OTHER ASSETS	17,262,417	15,854,910
TOTAL ASSETS	\$ 228,686,423	\$ 197,614,516
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 3,550,860	\$ 2,081,261
Other payables	96,412	80,788
Unearned revenue	2,282,024	1,813,641
Accrued interest	706,065	786,052
Taxes payable	2,051,374	1,901,577
Total current liabilities	8,686,735	6,663,319
LONG TERM LIABILITIES:		
Notes payable, net of discount \$11,135,111 and \$12,707,713 as of June 30, 2010 and December 31, 2009, respectively	28,864,889	27,292,287
Derivative liabilities - warrants	18,487,455	19,545,638
Long term debt	17,676,000	-
Total long term liabilities	65,028,344	46,837,925
Total liabilities	73,715,079	53,501,244
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, 21,321,904 shares issued and outstanding at June 30, 2010 and December 31, 2009	2,132	2,118
Additional paid-in capital	81,394,533	79,851,251
Cumulative other comprehensive gain	9,473,023	8,714,019
Statutory reserves	6,925,689	5,962,695
Retained earnings	57,175,967	49,583,189
Total stockholders' equity	154,971,344	144,113,272
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 228,686,423	\$ 197,614,516

The accompanying notes are an integral part of these consolidated statements.

CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME
FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2010 AND 2009
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenues				
Natural gas revenue	\$ 16,221,003	\$ 15,720,679	\$ 31,704,632	\$ 30,686,498
Gasoline revenue	2,033,840	1,633,016	3,502,656	2,807,414
Installation and others	2,880,756	3,388,825	5,295,134	5,776,274
Total revenues	21,135,599	20,742,520	40,502,422	39,270,186
Cost of revenues				
Natural gas cost	8,357,990	7,490,518	16,222,644	14,237,447
Gasoline cost	1,910,294	1,529,752	3,277,572	2,659,809
Installation and others	1,251,783	1,444,060	2,291,706	2,461,088
Total cost of revenues	11,520,067	10,464,330	21,791,922	19,358,344
Gross profit	9,615,532	10,278,190	18,710,500	19,911,842
Operating expenses				
Selling expenses	3,054,992	2,596,784	5,946,782	5,177,609
General and administrative expenses	1,913,866	917,354	3,731,522	2,342,678
Total operating expenses	4,968,858	3,514,138	9,678,304	7,520,287
Income from operations	4,646,674	6,764,052	9,032,196	12,391,555
Non-operating income (expense):				
Interest income	260,021	7,784	349,387	16,692
Interest expense	-	(388,618)	-	(970,110)
Other income (expense), net	(3,031)	(20,926)	43,538	(23,229)
Change in fair value of warrants	665,115	(1,312,834)	1,058,183	(1,115,783)
Foreign currency exchange loss	(34,665)	(19)	(42,775)	(50,807)
Total non-operating income (expense)	887,440	(1,714,613)	1,408,333	(2,143,237)
Income before income tax	5,534,114	5,049,439	10,440,529	10,248,318