China Natural Gas, Inc.
Form 10-K
April 02, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2011

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

For the transition period from ____________ to _________________

Commission File Number: 001-34373

CHINA NATURAL GAS, INC.

(Exact Name of Registrant as specified in its charter)

Delaware	98-0231607
(State or other jurisdiction of	(I.R.S. Employer
Incorporation or organization)	Identification Number)

19th Floor, Building B, Van Metropolis

Tang Yan Road, Hi-Tech Zone

Xi’an, 710065, Shaanxi Province, China

(Address of principal executive office)

Registrant's telephone number, including area code: 86-29-88323325

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, $.0001 par value per share

(Title of Class)

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

Yes ¨ No x

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

Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 (§232.45 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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this

Form 10-K. ¨

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

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

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

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of June 30, 2011, was $60,871,471. All executive officers, directors and holders of 5% or more of our outstanding common stocks have been deemed, solely for the purpose of the foregoing calculation, to be "affiliates" of the registrant.

As of March 23, 2012 there were 21,458,654 shares of the issuer's common stock, $0.0001 par value per share, issued and outstanding.

Documents Incorporated by Reference

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2011. The proxy statement is incorporated herein by reference into the following parts of the Form 10-K:

Part III, Item 10, Directors, Executive Officers and Corporate Governance;

Part III, Item 11, Executive Compensation;

Part III, Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters;

Part III, Item 13, Certain Relationships and Related Transactions, and Director Independence;

Part III, Item 14, Principal Accountant Fees and Services.

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Part I

FORWARD-LOOKING STATEMENTS

Except for the historical information contained herein, some of the statements in this Annual Report on Form 10-K (this “Report”) contain forward-looking statements that involve risks and uncertainties. These statements are found in the sections entitled "Business," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Risk Factors." They include statements concerning: our business strategy; expectations of market and customer response; liquidity and capital expenditures; future sources of revenues; expansion of our product lines; addition of new product lines; and trends in industry activity generally. In some cases, you can identify forward-looking statements by words such as "may," "will," "should," "expect," "plan," "could," "anticipate," "intend," "believe," "estimate," "predict," "potential," "goal," "continue" or similar terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including, but not limited to, the risks outlined under "Risk Factors," that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. For example, assumptions that could cause actual results to vary materially from future results include, but are not limited to: our ability to successfully develop and market our products to customers; our ability to generate customer demand for our products in our target markets; the development of our target markets and market opportunities; our ability to produce and deliver suitable products at competitive cost; market pricing for our products and for competing products; the extent of increasing competition; technological developments in our target markets and the development of alternate, competing technologies in them; and sales of shares by existing stockholders. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Unless we are required to do so under U.S. federal securities laws or other applicable laws, we do not intend to update or revise any forward-looking statements.

ITEM 1. BUSINESS

Overview

We are an integrated natural gas operator in the Peoples’ Republic of China (referred to herein as China or the PRC), primarily involved in the distribution of compressed natural gas, or CNG, through CNG fueling stations owned by our variable interest entity, or VIE, Xi’an Xilan Natural Gas Co., Ltd. (referred to as XXNGC). As of December 31, 2011, we operated 25 CNG fueling stations in Shaanxi Province and 12 CNG fueling stations in Henan Province. Our VIE owns our CNG fueling stations while we lease the land upon which our CNG fueling stations operate. For the year ended December 31, 2011, we sold 162,752,780 cubic meters of CNG through the fueling stations, compared to169,441,928 cubic meters for the year ended December 31, 2010. Our VIE and its subsidiary, Lingbao Yuxi Natural Gas Co. Ltd. (“LYNG”), also install natural gas pipelines for, and distribute and sell piped natural gas to, residential and commercial customers in the city of Xi’an in Shaanxi Province, including Lantian County, and the districts of Lintong and Baqiao, in Shaanxi Province, and in the city of Lingbao in Henan Province, through a high pressure pipeline network of approximately 120 kilometers,

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In addition, we have expanded into liquefied natural gas ("LNG") business and anticipate generating significant revenue from the LNG business. Our first LNG production facility, Shaanxi Jingbian Liquefied Natural Gas Co. Ltd. ("JBLNG"), located in Jingbian County, Shaanxi Province, commenced commercial production and sales on July 16, 2011.

We currently operate five main business lines:

- Distribution and sales of CNG through our VIE-owned CNG fueling stations for hybrid (natural gas/gasoline) powered vehicles (37 stations as of December 31, 2011);
- Installation, distribution and sales of piped natural gas to residential and commercial customers through our VIE-owned pipelines. We distributed and sold piped natural gas to approximately 116,790 residential customers as of December 31, 2011;
- Production and sales of LNG through our LNG production facility in Jingbian County, Shaanxi Province. Revenues from our LNG business started during the third quarter of 2011, as JBLNG commenced commercial production and sale of LNG on July 16, 2011.
- Distribution and sales of gasoline through our VIE-owned CNG fueling stations for gasoline and hybrid (natural gas/gasoline) powered vehicles (two of our CNG fueling stations sold gasoline as of December 31, 2011); and
- Conversion of gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles at our automobile conversion workshops.

We purchase all of the natural gas that we sell and distribute to our customers. We are not directly involved in the mining or production of natural gas and have no plans to do so during 2012. We currently sell our natural gas in three forms: (i) we compress natural gas into CNG and sell it to our customers through CNG fueling stations, (ii) we distribute natural gas through pipelines to commercial and residential customers and (iii) we liquefy natural gas and sell and distribute it to our customers.

On October 24, 2006, our VIE, XXNGC, formed a wholly owned subsidiary, Shaanxi Jingbian Liquefied Natural Gas Co., Ltd., or JBLNG, for the purpose of constructing a liquefied natural gas, or LNG, facility to be located in Jingbian, Shaanxi Province. We estimate an aggregate investment of approximately $68.7 million to construct this facility, which will be funded through the sale of senior notes to Abax Lotus Ltd. (referred to herein as Abax), and our equity financing that was transacted in September 2009, as well as cash flows from our operations. On July 16, 2011, we completed most of the construction of Phase I of the LNG plant and began commercial production and sale of LNG. Phase I of the LNG plant has a processing capacity of 500,000 cubic meters per day, or approximately 150 million cubic meters on an annual basis.

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We had total revenues of $124,221,526, $89,953,623 and $81,066,118 for the years ended December 31, 2011, 2010 and 2009, respectively. We had net income of $15,261,932, $17,220,372 and $18,830,787 for the years ended December 31, 2011, 2010 and 2009, respectively. We had total assets of $276,983,808, $247,448,555 and $197,614,516 as of December 31, 2011, 2010 and 2009, respectively.

Our Corporate History and Structure

On June 28, 2011, our VIE, XXNGC, entered into an Equity Transfer Agreement (the "Transfer Agreement") with five individual shareholders of Xiantao City Jinhua Gas and Oil Co., Ltd. ("XTJH"). Pursuant to the Transfer Agreement, XXNGC will acquire a 58.5284% ownership of XTJH for a total purchase price of $1,905,099 (RMB 12,290,964). The effectiveness of the Transfer Agreement is subject to the satisfaction of certain conditions. During the fourth quarter of 2011, the Company paid $976,500 (RMB 6,300,000), and made a payment of $310,000 (RMB 2,000,000) in January 2012, and then on February 29, 2012, the Company made an additional payment of approximately $337,000(RMB 2,142,857), for the purchase of the equity interest in XTJH. Through the acquisition of XTJH, we will have our own fueling station available locally, which will increase our share in the local market. As of December 31, 2011, the transfer of the assets was under progress and the company had not exercised full control over its operations, therefore, the accounts of XTJH are not included in our consolidated financial statements.

During the third quarter of 2010, we completed the acquisition of Hanchuan Makou Yuntong Compressed Natural Gas Co., Ltd., or Makou, for a purchase price of $3,648,080 (RMB 24,800,000). Makou owns and operates a CNG compressor station in Hanchuan City, Hubei Province. Natural gas is transferred via high pressure pipelines, compressed on-site and sold on a wholesale basis, delivered by tankers to fueling stations in Hubei Province.

During the second quarter of 2010, XXNGC effectively acquired 100% of assets and operating rights of four natural gas stations in Xi'an, PRC, for a total combined cash consideration of $10,502,490 (RMB 71,300,000), which consists of approximately $5.6 million for plant and equipment and approximately $4.9 million for operating rights.

On December 17, 2009, XXNGC formed Hubei Xilan Natural Gas Co., Ltd., or HBXNGC, as a wholly owned limited liability company in Hubei Province, PRC. HBXNGC was established to construct harbor LNG fueling stations and LNG fueling ships in Hubei, PRC.

On October 27, 2009, CHNG formed Xilan Energy Co., Ltd., or XEC, as a wholly owned limited liability company in Hong Kong. XEC was established for the purpose of importing LNG into PRC.

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On October 27, 2009, XXNGC formed Henan CNPC Kunlun Xilan Compressed Natural Gas Co., Ltd., or the JV, as a joint venture with China National Petroleum Corporation Kunlun Natural Gas Co., Ltd., or CNPC Kunlun, in Henan province, PRC. The JV was established to build and operate 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 Province, PRC. CNPC Kunlun holds 51% ownership of the JV and XXNGC holds 49% ownership.

On October 2, 2008, XXNGC acquired a 100% equity interest in Lingbao Yuxi Natural Gas Co., Ltd., or LBNGC, that possesses the right to operate CNG fueling stations and pipelines in the city of Lingbao, from the former shareholders of LBNGC, Zhihe Zhang, who held a 90% ownership interest in Henan Province, and Lingjun Hu, who held a 10% ownership interest in Henan Province.

On July 3, 2008, XXNGC formed a wholly owned subsidiary, Henan Xilan Natural Gas Co., Ltd., or HXNGC, for the purpose of improving the efficiency of our natural gas fueling station operations, pipeline construction, engineering design, construction and technical advisory work services in Henan Province. HXNGC also operates our CNG fueling stations in Henan Province.

On December 1, 2006, XXNGC formed a wholly owned subsidiary, Shaanxi Xilan Auto Body Shop Co., Ltd., or SXABC, that converts gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles.

On October 24, 2006, XXNGC formed JBLNG, a limited liability company organized under the laws of the PRC to administer the production and sales of LNG.

On February 22, 2006, we formed Shaanxi Xilan Natural Gas Equipment Co., Ltd., or SXNGE, as a wholly foreign owned enterprise, or WFOE. SXNGE entered into exclusive arrangements with XXNGC and its shareholders, providing us with the ability to substantially influence XXNGC's daily operations and financial affairs, appoint its senior executives and approve all matters requiring shareholder approval. We executed these arrangements on August 17, 2007. As a result, we consolidate the financial results of XXNGC as a VIE.

We were incorporated in the State of Delaware on March 31, 1999, as Bullet Environmental Systems, Inc. On May 25, 2000 we changed our name to Liquidpure Corp. and on February 14, 2002 we changed our name to Coventure International, Inc., or Coventure.

On December 6, 2005, Coventure issued an aggregate of 4 million shares to all of the registered shareholders of XXNGC, and entered into exclusive arrangements with XXNGC and such shareholders, providing us with the ability to substantially influence XXNGC's daily operations and financial affairs, appoint its senior executives and approve all matters requiring shareholder approval. On December 19, 2005, we changed our name to China Natural Gas, Inc.

The following illustrates our corporate and share ownership structure as of December 31, 2011:

Our Variable Interest Entity Agreements

The following is a summary of the agreements we have with our VIE, XXNGC:

Consulting Service Agreement, dated August 17, 2007 entered into between SXNGE and XXNGC. Pursuant to the agreement, SXNGE provides XXNGC exclusive consulting services with respect to XXNGC's general business operation, human resources and research and development. In return, XXNGC pays a quarterly service fee to SXNGE, which is equal to XXNGC's revenue for such quarter. The term of the agreement is indefinite, but SXNGE and XXNGC may terminate this agreement if both parties agree to terminate it after negotiation. This agreement is retroactive to March 8, 2006.

Operating Agreement, dated August 17, 2007. Under this agreement entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand. Pursuant to the agreement, SXNGE agrees to act as a guarantor for XXNGC in the contracts, agreements or transactions in connection with XXNGC's operation between XXNGC and any other third party, to provide full guarantee for the performance of such contracts. XXNGC agrees, as a counter-guarantee, to pledge all of its assets, including accounts receivable to SXNGE. The XXNGC shareholders party to the operating agreement agree to, among other things, appoint as XXNGC's director, individuals recommended by XXNGC and appoint SXNGE's senior officers as XXNGC's general manager, chief financial officer and other senior officers. The term of the agreement is indefinite, but SXNGE and XXNGC may terminate this agreement if both parties agree to terminate it after negotiation. This agreement is retroactive to March 8, 2006.

Equity Pledge Agreement, dated August 17, 2007, entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand. Pursuant to the agreement, to secure the payment obligations of XXNGC under the Consulting Service Agreement described above, the XXNGC shareholders party to this equity pledge agreement have pledged to SXNGE their entire equity ownership interests in XXNGC. Upon the occurrence of certain events of default specified in this agreement, SXNGE may exercise its rights and foreclose on the pledged equity interest. Under the agreement, the pledgors may not transfer the pledged equity interest without SXNGE's prior written consent. The agreement will also be binding upon successors of the pledger and transferees of the pledged equity interest. The term of the pledge is two years after the obligations under the Consulting Service Agreement have been fulfilled. This agreement is retroactive to March 8, 2006.

Option Agreement, dated August 17, 2007, entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand. Pursuant to the agreement, the XXNGC shareholders party thereto irrevocably granted to SXNGE, or any third party designated by SXNGE, the right to acquire, in whole or in part, the respective equity interests in XXNGC of these XXNGC shareholders. The option agreement can be terminated by SXNGE by written notice to XXNGC of its intention to terminate the agreement with 30 days prior notice. The option agreement is retroactive to March 8, 2006.

Addendum to the Option Agreement, dated August 8, 2008, entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand. Pursuant to the addendum to the option agreement, the XXNGC shareholders (referred to as the Transferors) irrevocably granted to SXNGE an option to purchase the XXNGC shareholders' additional equity share in XXNGC (referred to as the Additional Equity Interest) in connection with an increase in XXNGC's registered capital since the execution of the option agreement at $1.00 or the lowest price permissible under the applicable laws at the time that SXNGE exercises the option to purchase the Additional Equity Interest. The option agreement can be terminated by SXNGE by written notice to XXNGC of its intention to terminate the agreement with 30 days prior notice. The addendum is retroactive to June 30, 2008.

Proxy Agreement, dated August 17, 2007, entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand. Pursuant to the agreement, the XXNGC shareholders irrevocably granted to SXNGE the right to exercise their shareholder voting rights, including attendance at and voting of their shares at shareholders meetings in accordance with the applicable laws and XXNGC’s articles of associations. The agreement is retroactive to March 8, 2006.

Our Products, Services and Customers

CNG and Gasoline Fueling Stations

As of December 31, 2011, our VIE operated 25 CNG fueling stations in the Shaanxi Province and 12 CNG fueling stations in Henan Province. Through these VIE-owned fueling stations, CNG is sold to taxis, buses and private cars that operate with CNG technology. During the year ended December 31, 2011, we purchased natural gas at an average cost of $0.26(RMB1.68) per cubic meter and sold each cubic meter for $0.49(RMB3.13), net of value-added taxes, in Shaanxi Province, and we purchased natural gas at an average cost of $0.29(RMB1.86) per cubic meter and sold each cubic meter for $0.49(RMB3.15), net of value-added taxes, in Henan Province.

We continue to expand the number of our VIE-owned CNG fueling station by constructing new stations as well as acquiring existing stations. We are currently evaluating additional sites for CNG fueling stations in Hubei Province.

Our VIE and its subsidiary, Makou, own three natural gas compressor stations as of December 31, 2011. The first one, Hongqing station, is located in Xi’an City and was acquired in July 2005, near our pipeline network; the second station is located in Xianyang City and was acquired in January 2008; the third station is located in Hanchuan City, Hubei Province and was acquired in the third quarter of 2010. We sold the Changsheng station, which was acquired in September 2008, on May 31, 2010, for a consideration of $1.63 million (RMB 11 million). A compressor station compresses natural gas and allows trucks to transport CNG to fueling stations. We currently have a daily processing capacity of 250,000 cubic meters of CNG.

We began to distribute and sell gasoline during the fourth quarter of 2007 in an effort to support our sales of CNG by attracting more natural gas/gasoline hybrid car owners through providing a one-stop refueling option for such customers. Our gasoline facilities were either installed by us at our existing CNG stations or acquired through our acquisition of CNG fueling stations that have both CNG and gasoline-fueling capability. As of December 31, 2011, we distributed and sold gasoline at two of our VIE-owned CNG fueling stations for gasoline and hybrid (natural gas/gasoline) powered vehicles in Xi'an City. During the year ended December 31, 2011, we purchased gasoline at an average cost of $0.90(RMB5.82) per liter and sold each liter at an average price of $0.94(RMB6.08), net of VAT, in Xi'an City.

Our Pipeline Distribution System

Our VIE owns and operates a high pressure pipeline network of approximately 120 kilometers in Xi’an City area. The network connects to a high pressure government-owned pipeline network operated by Shaanxi Natural Gas Company, which supplies natural gas directly from a gas field in the northern region of the province. Our high pressure pipeline then feeds into city-gate "let-down" stations in Hongqing and Lantian County, where the pressure is reduced and natural gas is transported through a network of low-pressure distribution pipes to supply our residential and commercial customers in Lantian County and Lintong and Baqiao Districts. The gas is also supplied to our compressor stations at Hongqing and Xianyang where CNG is delivered by tankers to our CNG fueling stations.

Each of our pipeline customers is physically connected to our pipeline network through Company-installed and maintained piping and natural gas usage gauges. We generate revenues both from the sale of natural gas to these customers and the installation and maintenance of the equipment.

We believe that we are currently the sole authorized provider of natural gas to residential customers in our service areas and the only non-state-owned company in Shaanxi Province to own and operate this type of high pressure pipeline.

Our Automobile Conversion Sites

We began our automobile conversion business during the second quarter of 2007. Our automobile conversion sites convert gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles. As of December 31, 2011, we have four automobile conversion sites, all of which operate in the Xi'an City area.

Our Liquefied Natural Gas Business

On July 16, 2011, we completed most of the construction of Phase I of the LNG plant and began commercial production and sale of LNG. Phase I of the LNG plant has a processing capacity of 500,000 cubic meters of LNG per day, or approximately 150 million cubic meters of LNG per year. During the year ended December 31, 2011, the average cost of LNG per cubic meter was $0.26(RMB1.70), and we sold each cubic meter at an average price of $0.35(RMB2.27), net of value-added taxes. Customers of our LNG business mainly include city gas companies supplying industrial, commercial and residential pipeline end users, such as ENN Energy Holdings Ltd., Shaanxi Sanxin Energy & Chemical Ltd. and Changsha Ruihua Energy Equipment Ltd. The launch of the LNG plant is an important part of our integration strategies, which include strategic plans to develop our own network of LNG fueling stations in Shaanxi, Henan and Hubei Provinces.

On September 2, 2010, we announced the completion of our first LNG fueling station. The station is located in Hongqing District, Xi'an, and we believe it is the first LNG fueling station in Shaanxi Province. The LNG fueling station initially serves as a working model to showcase the market potential of LNG to future users rather than to generate revenues. As of December 31, 2011, ten LNG fueling stations were under construction in various locations in Shaanxi and Henan Provinces.

Our CNG Market

As of December 31, 2011, there were approximately 8,000 buses and 13,800 taxis powered by CNG in Xi’an City, that accounts for approximately 99% of the total number of all buses and taxis in Xi’an City, respectively. According to the PRC Ministry of Science and Technology, each bus uses an average of approximately 100 cubic meters of CNG per day and each taxi uses an average of approximately 30 cubic meters of CNG per day (source: PRC Ministry of Science and Technology). Compared to gasoline and diesel, we believe that natural gas, as one kind of vehicular fuel, is cheaper, cleaner and safer. The PRC government's Clean Energy Policy encourages the use of CNG as a vehicular fuel.

We estimate that each of the CNG fueling stations in Xi'an City, including ours, sold approximately 11,000 cubic meters of CNG on average per day in 2011. As of December 31, 2011, there were 75 CNG fueling stations in Xi'an City and, accordingly, we estimate that in total approximately 825,000 cubic meters of CNG was sold per day during 2011. We believe that there is unmet demand for CNG as vehicular fuel in Xi'an City area.

According to Zhengzhou Evenings, a local newspaper published in Zhengzhou, Henan Province, as of December 31, 2011, there were approximately 5,000 buses and 10,607 taxis powered by CNG in Zhengzhou City, which accounts for approximately 85% of the total number of all buses and taxis in Zhengzhou City, respectively. We estimate that each bus uses an average of approximately 100 cubic meters of CNG per day and each taxi uses an average of approximately 30 cubic meters of CNG per day.

We estimate that on average each CNG station in Henan Province sold approximately 11,000 cubic meters of CNG per day in 2011. As of December 31, 2011, there were 46 CNG fueling stations in Henan Province and we estimate that approximately 506,000 cubic meters of CNG was pumped per day during 2011. We believe that there is unmet demand for CNG as vehicular fuel in Henan Province.

According to Xinhua News, the official press agency of the PRC, as of December 31, 2011, there were approximately 2,500 buses and 15,000 taxis powered by CNG in Wuhan City, Hubei Province, which accounts for approximately 35% and 95% of the total number of all buses and taxis in Wuhan City, respectively. We estimate that each bus uses an average of approximately 100 cubic meters of CNG per day and each taxi uses an average of approximately 30 cubic meters of CNG per day.

While there are many competitors in the distribution and sale of CNG in China, we believe that we are well positioned in the market through our cooperation with local natural gas suppliers and our operational experience in Shaanxi and Henan Provinces.

Our Pipeline Network Customers

As of December 31, 2011, we had 116,790 customers for our pipeline network, including residential and commercial customers. We continue to expand our customer base in Xi’an City's newly developed business and residential areas including Baqiao, Hongqing and Xihang as well as Lingbao in Henan Province. Our industrial customers, including Xiwei Aluminum Company and Hungtian Company, use natural gas as a raw material for their production process. We are not dependent upon any single customer or group of customers for a material portion of our natural gas sales or revenues.

Our pipeline customers purchase natural gas by prepaid cards that can be inserted into the connection equipment to initiate gas flow.

We entered into agreements with Xi’an International Port Administrative Committee, the Port Committee, and the town of Tangyu, China, in April 2008 and October 2008, respectively, to provide natural gas to local residents and businesses. The international port project is estimated to involve the development of approximately 28 square miles of business district and the investment of up to $30 million over the next several years, based on the Port Committee’s planning schedule. The Tangyu project involves supplying natural gas to potentially 50,000 residential and commercial users at a tourist site undergoing development and expansion. Our agreement with the Port Committee is currently being challenged by Xi'an Municipal Administration Commission for violating an exclusive agreement between the municipal government and Qin Hua Gas Company, one of our major competitors in our pipeline natural gas business. We disagree with the Xi'an Municipal Administration Commission's assessment and are currently in negotiations with it to resolve the issue. We do not anticipate that this event will create a contingent liability for us.

Our LNG Project

In September 2007, we began the construction of an LNG processing and distribution plant in Jingbian, Shaanxi Province, or the LNG Project. We expect the construction of all facilities of Phase I of the LNG plant to be completed by September 2012, and estimate an aggregate investment of approximately $68.7 million for Phase I of the LNG plant, that was funded through the sales of senior notes to Abax and our September 2009 equity financing, as well as cash flows from operations. On July 16, 2011, we completed most of the construction of Phase I of the LNG plant and began commercial production and sale of LNG. We believe that adding LNG to our product offerings expands our geographic sales footprint and improves our revenues and profitability as well as diversifies sources of our revenue and profit.

Both CNG and LNG are natural gas compressed into canisters for convenient transportation, usually by tankers, to locations of distribution or consumption. Typically, CNG is compressed at 200 kilograms per cubic centimeter and LNG is compressed at up to 625 times atmospheric pressure per normal cubic meter and must be transported at sub-zero temperatures. The costs of compressing and processing LNG is higher than CNG, but LNG can be transported in larger volumes and over longer distances per tanker and the per unit transportation costs are therefore lower than CNG.

We believe we are well positioned in the LNG business because the National Development and Reform Commission, or the NDRC, is no longer approving new LNG projects based on onshore gas fields that involve the processing of domestic natural gas supplies since August 2007.

Suppliers

We purchase our natural gas mainly from four vendors, namely, Petrochina Chang Qing Oil Field Branch, Shaanxi Natural Gas Co. Ltd, Qinshui Lanyan Coal Bed Methane Co., Ltd and Zhongyou Hengran Petrochemical Co., Ltd. Our supply contract with one of our suppliers, Shaanxi Natural Gas Co. Ltd., is renewed on an annual basis. We continued to seek lower-cost sources of supply and did not have commitments for the purchasing volume of natural gas from any suppliers except Qinshui Lanyan. Pursuant to the agreement with Qinshui Lanyan, we would purchase from Qinshui Lanyan a daily volume of approximately 200,000 cubic meters of coal bed gas. Our average procurement price in Henan Province increased from $0.25(RMB 1.69) per cubic meter in 2010 to $0.29(RMB 1.86) per cubic meter in 2011. Two of our major vendors in Henan Province are Qinshui Lanyan Coal Bed Methane Co., Ltd and Zhongyou Hengran Petrochemical Co., Ltd. Our average procurement price in Xi'an City increased from $0.18(RMB 1.23) per cubic meter in 2010 to $0.26(RMB1.68) per cubic meter in 2011. Two of our major vendors in Xi'an City are Petrochina Chang Qing Oil Field Branch and Shaanxi Natural Gas Co. Ltd. We do not anticipate the procurement price to increase materially in 2012.

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On October 19, 2006, we received a letter from PetroChina Company Limited, or PetroChina (also known as CNPC), pursuant to which PetroChina agreed in principle to supply up to 150 million cubic meters of natural gas annually to our LNG Project subsidiary subject to the negotiation of a final agreement once our LNG plant is near completion. Once an agreement is signed, the quota of supply of natural gas can be used as long as the agreement is in effect. Pursuant to the above arrangement, we entered into an agreement with CNPC Changqing Oil Field Branch Company, or CNPC Changqing, dated November 25, 2010. The agreement between CNPC Changqing and JBLNG, one of our wholly owned subsidiaries, provided that CNPC Changqing would supply us with natural gas for JBLNG effective through to December 31, 2011, and the agreement would be renewed on an annual basis thereafter. Under the terms of the agreement, we have the option to purchase up to 500,000 cubic meters of natural gas per day, or 150 million cubic meters per year, from CNPC Changqing at a purchase price of $0.21(RMB 1.355) per cubic meter. The agreement was renewed on December 23, 2011, effective through December 31, 2012.

We do not expect any difficulty in continuing to renew our supply contracts during the next 12 months.

Intellectual Property

We have applied for a service mark on the “Xilan” name, which is used in connection with all our products and services. XXNGC is currently preparing to apply for the “CNG” trademark. XXNGC has also applied for the registration of its corporate name as a trademark under Application No. 5055703. Our corporate name has already been registered as a trademark with a useful life of 10 years, which took effect on September 21, 2010.

Governmental and Environmental Regulation

To date, we have complied with, or are in the process of renewing, all registrations and requirements for the issuance and maintenance of all licenses required by the applicable governing authorities in China. These licenses include:

· Xi’an Natural Gas Operations License, authorized by the Shaanxi Municipal Management Committee, effective from February 29, 2012 to February 28, 2013.

· License to Supply and Install Equipment and Maintain Gas Fuel Pipelines issued by the local Bureau of Gas Fuels for Heating, an agency under the Ministry of Construction and the Xi’an Natural Gas Management Bureau. (License number: XIRAN 136)

· Safety and Inspection Regulation under Special Equipment Safety Inspection Standards for High Pressure Pipeline and Technical Safety Inspection Regulations by Shaanxi Quality and Technology Inspection Bureau for compressor stations and pressure storage tank systems. (Approval letter reference: 2004SHAANGUOCHUHAN033)

· Annual Safety Inspection of Lightning Conductor Equipment approved by the Shaanxi Meteorology Bureau. (Certificate number 0005274)

· Business license to operate Shaanxi Xilan Natural Gas Equipment Co., Ltd. effective from February 22, 2006 to February 21, 2021.

· Business license to operate Xi'an Xilan Natural Gas Co., Ltd., effective on January 8, 2000. It is a long term license and only needs annual inspection to keep it valid.

· Business license to operate Xi'an Xilan Auto Body Shop Co., Ltd., effective on December 1, 2006. It is a long term license and only needs annual inspection to keep it valid.

· Business license to operate Shaanxi Jingbian Liquefied Natural Gas Co. Ltd. effective from October 24, 2006 to October 23, 2036.

· Business license to operate Henan Xilan Natural Gas Co. Ltd. effective from July 3, 2008 to June 25, 2018.

· Business license to operate Lingbao Yuxi Natural Gas Co., Ltd. effective from June 13, 2008 to June 12, 2012.

· Business license to operate Hubei Xilan Natural Gas Co., Ltd., effective from December 17, 2009 to December 16, 2012.

· Business license to operate Xilan Energy Co., Ltd., effective from October 27, 2011 to October 26, 2012.

· Business license to operate Henan CNPC Kunlun Xilan Compressed Natural Gas Co., Ltd. effective from October 27, 2009 to October 22, 2029.

Fuel service station standards are subject to regulation by the Ministry of Construction, the General Administration of Quality Supervision and the Bureau of Inspection and Quarantine of the People's Republic of China. Upon satisfactory inspection of service stations, service certificates will be issued.

Various standards must be met by fueling stations, including the handling and storage of CNG, tanker handling and compressor operation. The Local Ministry of Construction and the Gas Field Operation Department of the Municipal Administration Committee regulate these standards. The Municipal Development and Reform Commission, which issues certificates for the handling of dangerous chemical agents, carries out the inspections.

Standards for the design and construction of fueling stations must conform to GB50156-2202 and technology standard BJJ84-2000.

Employees

As of December 31, 2011, we had 1,063 employees, including 96 in management, 29 in finance and accounting, and 938 in sales and operations. We have not experienced any labor disputes and we believe we have good relationships with our employees. We are not a party to any collective bargaining agreements.

Available Information

Our website is *http://www.naturalgaschina.com/*. We provide free access to various reports that we file with, or furnish to, the U.S. Securities and Exchange Commission, or the SEC, through our website, as soon as reasonably practicable after they have been filed or furnished. These reports include, but are not limited to, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports. Information on our website does not constitute part of and is not incorporated by reference into this Annual Report on Form 10-K or any other report we file or furnish with the SEC. You may also read and copy any document that we file at the public reference facilities of the SEC in Washington, D.C. You may call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public from the SEC's *website at http://www.sec.gov ..*

ITEM 1A. RISK FACTORS

RISK FACTORS

An investment in our common stock involves a high degree of risk and uncertainty. You should carefully consider the risks described below, together with the other information contained in this Report, including our consolidated financial statements and notes thereto, before deciding to invest in our common stock. The risks described below are not the only ones facing us. Additional risks not presently known to us or that we presently consider immaterial may also adversely affect us. If any of the following risks occur, our business, financial condition and results of operations and the value of our common stock could be materially and adversely affected.

Risks Related to Our Business and the PRC Natural Gas Industry

We may be adversely affected by the general conditions and overall environment of China’s economy and any changes related thereto.

Our business and operations are located mostly within China, and we rely on domestic demand for natural gas in China for our revenue, so our financial conditions and performance results are materially affected by the general conditions of China’s economy and the overall environment under which it is operating. The key factors in the economy that assert most significant impact on our performance include the growth of the industrial base, increase in residential and vehicle consumption, the overall economic growth of China and related factors. While China’s economy has grown significantly in the past two decades, the growth has been uneven geographically, among various sectors of the economy and during different periods. We cannot assure you that the Chinese economy will continue to grow or to do so at the pace that has prevailed in recent years, or that if there is growth, such growth will be steady and uniform. Such uncertainties and fluctuation in China’s economy may have a major impact on our business, operations, financial conditions and performance.

In particular, we have been seriously affected by the slowdown of China's economy caused in part by the recent global economic crisis in the financial services and credit market, starting late 2007. We believe a number of factors contributed to this slowdown, including appreciation of the Renminbi against the U.S. dollar and the Euro, which has adversely affected China's exports, and tightening macroeconomic measures and monetary policies adopted by the PRC government aimed at preventing the overheating of China's economy and controlling China's high level of inflation. The slowdown was further exacerbated by the recent global crisis in the financial services and credit markets that have resulted in extreme volatility and dislocation of the global capital markets.

It is uncertain how long the global crisis in the financial services and credit markets will continue and the impact this will have on the global economy in general and the economy of China in particular. We are currently unable to estimate the impact the slowing of the PRC economy will have on our business as the impact of the decline in international trade is being offset in part through domestic spending stimulus measures, expanded bank lending, increase in the speed of regulatory approvals of new construction projects and other economic policies. We do not believe that we have experienced reduced demand for natural gas to date. If the economic downturn continues, our business may be negatively affected by any decrease in demand for our natural gas products and services. Reduction in demand for natural gas would have a material and adverse effect on our financial condition and results of operations. In particular, if customers of taxis come to rely more on mass transit rather than taxis, a decline in demand for taxis may result in a decline of CNG as a vehicle fuel that would adversely affect our revenue and ability to sustain and grow our operations.

We have benefited from the natural gas procurement and sale prices set by government authorities.

Natural gas sales accounted for 85.5%, 79.3% and 76.8% of our revenue for the years ended December 31, 2011, 2010 and 2009, respectively. However, the prices at which we purchase our natural gas supplies and sell our natural gas products are strictly regulated by the PRC central government, including the NDRC, and the local state price bureaus that have the discretion to set natural gas prices within the boundaries set by the PRC central government. Our results of operations for the periods reviewed have benefited from the natural gas procurement and sale prices set by government authorities. There is no assurance that the government authorities will continue to set natural gas procurement and sale prices at levels that will allow us to improve or even maintain our margins. Increased natural gas prices affect the cost of natural gas to us and will adversely impact our margins in cases where we are unable to pass on the increased costs to our customers. In addition, higher natural gas prices may adversely impact the adoption of CNG and LNG by consumers and have a material and adverse effect on our financial condition and results of operations.

Our competitors and potential competitors may be larger than us and have greater financial and other resources than we do and those advantages could make it difficult for us to compete with them.

We expect to face intense competition in the natural gas industry, including in both the CNG and LNG industries. Our current, and potential, competitors include companies that are part of much larger companies, including state-owned enterprises. These companies are likely to have greater resources than we do, including longer operating history, larger customer base, stronger customer relationships, greater brand or name recognition and greater financial, technical, marketing, relationship and other resources and may be able to use these greater resources to enter into the CNG and LNG industries and gain substantial market share. Competition could result in price reductions, fewer purchases, reduced gross margins and loss of market share. If we are unable to remain competitive, we may not be able to establish our LNG business and enlarge its client base, expand our CNG business into new areas or even maintain our current share of the CNG market in China.

Prices of natural gas in the PRC are subject to government regulation and can be subject to significant fluctuations.

Although regulated by the PRC central government, natural gas prices in China can be subject to significant fluctuations. Natural gas prices may be increased by the government for policy or other reasons including in response to changing national or international market forces, such as changes in domestic and foreign supplies of natural gas, domestic storage levels, crude oil prices, the price difference between crude oil and natural gas, price and availability of alternative fuels, weather conditions, level of consumer demand, economic conditions, price of imports of foreign natural gas, and domestic and foreign governmental regulations and political conditions. The volatility of natural gas prices could adversely impact the adoption of CNG as a vehicle fuel and our business.

Natural gas operations entail inherent safety and environmental risks that may result in substantial liability to us.

Natural gas operations entail inherent risks, including equipment defects, malfunctions and failures, human error and natural disasters, which could result in uncontrollable flows of natural gas, fires, explosions, property damage, injury and death. For example, a competitor of ours in Xi'an City providing natural gas to residences experienced an accident resulting in significant property damage, injury and death. CNG fuel tanks, if damaged or improperly maintained, may rupture and the contents of the tank may rapidly decompress and result in death or injury. Also, operation of LNG pumps requires special training and protective equipment because of the extreme low temperatures of LNG. LNG tanker trailers have also in the past been, and may in the future be, involved in accidents that result in explosions, causing loss of life, injury and property damage. Improper loading of LNG vehicles can result in venting of methane gas, leading to explosions.

Inherent in our natural gas pipeline business are a variety of hazards and operational risks, such as leaks, ruptures and mechanical problems. The location of pipelines near populated areas, including residential areas, commercial business centers, industrial sites and other public gathering places, could increase the level of damage resulting from these risks, including the loss of human life, significant damage to property, environmental damage, impairment of our operations and substantial loss to us. The risks associated with our natural gas businesses may expose us to liability for personal injury, wrongful death, property damage, pollution and other environmental damage. We may incur substantial liability and cost if damages are not covered by insurance or are in excess of insurance policy limits.

We are dependent on a limited number of suppliers of natural gas, which may affect our ability to supply natural gas to our customers.

With the exception of certain compressed and liquid natural gas supplies, we obtain our supplies of natural gas primarily from four suppliers. The ability to deliver our product is dependent on a sufficient supply of natural gas and if we are unable to obtain a sufficient natural gas supply, we may be prevented from making deliveries to our customers. While we have supply contracts, we do not control our suppliers, nor are we able to control the amount of time and efforts our suppliers put forth for us. It is possible that our suppliers will not perform as expected by us and that they may breach or terminate their agreements with us. In addition, it is possible that, after a review of our supply contract, a supplier may choose to provide its services to one or more of our competitors. Any failure to obtain supplies of natural gas could prevent us from delivering our products to our customers and could have a material adverse affect on our business and financial conditions.

Our growth depends in part on environmental regulations and programs mandating the use of cleaner burning fuels, and modification or repeal of these regulations may adversely impact our business.

Our business depends in part on environmental regulations and programs in China that promote the use of cleaner burning fuels, including natural gas, for vehicles. China has made plans to double the share of natural gas in its total energy consumption from the current 4 per cent to 8 per cent during its 12th Five-Year Plan period (2010 to 2015). In order to meet the demand for natural gas, the PRC government has encouraged private companies to invest in and build the necessary transportation, distribution and sales infrastructure for natural gas. On February 24, 2005, China’s State Council issued an opinion encouraging and supporting private sector businesses to become involved in industries that were previously controlled by state-owned enterprises, including oil and natural gas distribution. In 2007, China's State Development and Reform Commission officially included CNG/gasoline hybrid vehicles in the country's "encouraged development" category. In addition, local governments, including those in Chongqing, Hangzhou, Nanjing, Lanzhou and Dongguan have enacted policies providing subsidies to taxis and buses which covert their gasoline vehicles to CNG/gasoline hybrid vehicles. Any delay, repeal or modification of these regulations or programs that encourage the use of natural gas for vehicles could have a detrimental effect on the PRC natural gas industry, which, in turn, could slow our growth and materially and adversely affect our business.

The infrastructure to support coal, gasoline and diesel consumption is vastly more developed than the infrastructure for consumption of natural gas as vehicle and industrial fuels.

Coal, gasoline and diesel fueling stations and service infrastructure are widely available in China. For natural gas to become more widely used as vehicle and industrial fuels in China, promotional and educational efforts and the development and supply of more natural-gas-driven vehicles and fueling stations will be required. This will require significant continuous efforts by us, by the natural gas industry as well as by the government, and we may face resistance from oil companies, coal companies and gasoline station operators. Also, a prolonged economic recession and continued disruption in the capital markets may make it difficult or impossible to obtain financing to expand the natural gas vehicle and industrial fuel infrastructure and impair our ability to grow our business. There is no assurance natural gas will ever achieve the level of acceptance as a vehicle and industrial fuel necessary for us to expand our business significantly.

The expansion of our business into LNG may not be as successful as our CNG business, or at all.

Although a similar business to CNG, our expansion into the LNG business entails different technology and requires us to expand into new markets where permitting, environmental issues, lack of materials and lack of human resources, among other factors, could complicate our ability to operate our LNG processing facility and successfully compete in the LNG segment. In contrast to CNG, the compression and production costs of LNG are higher than CNG due to LNG's more complicated technical process and we may be unable to complete and operate our LNG expansion successfully due to the advanced technology involved in its production and sale. In addition, the construction of the LNG processing facility could also create increased financial exposure through start-up delays, the need for unforeseen repairs and failure to ramp up to full capacity. If the new plant has higher than expected operating costs or is not able to produce the expected amounts of LNG, we may be forced to sell LNG at a price below processing costs and we may make a loss. Additionally, if the quality of LNG produced at the facility does not meet customer specifications, we may be unable to compete with other LNG producers, that would harm our business. As our target market for our LNG expansion is outside Shaanxi and Henan Provinces, there is no assurance that we will be able to establish a strong customer base in our LNG target markets. While we currently also benefit from the NDRC's decision in August 2007 to cease approval of LNG projects based on onshore gas fields that involve the processing of domestic natural gas supplies, there is no assurance that the NDRC will continue such a moratorium and should the NDRC resume such approvals, any expansion of our LNG business may be adversely affected.

We failed to comply with PRC law in our recent contribution of capital to JBLNG and will be subject to possible fines, penalties and administrative actions until the capital contribution is registered in compliance with PRC law.

In August 2008, the board of directors of XXNGC passed a resolution to increase the registered capital of JBLNG to RMB118, 305,000 through the form of intangible asset contributions. In September 2008, JBLNG obtained its updated business license reflecting the increased registered capital. Pursuant to XXNGC's board resolution, China Natural Gas, Inc. transferred its right to use the two licenses it obtained relating to the design of our LNG facility directly to JBLNG as JBLNG's registered capital. However, we are not a shareholder of JBLNG and are therefore not permitted under PRC law to contribute capital to JBLNG. In addition, PRC law does not allow the contribution of capital in the form of an intangible asset, such as the licenses in issue, where the assets are not owned by the contributor. We are restructuring the capital contribution as a cash contribution and revising our LNG licenses so that the licensee is JBLNG and believe that this capital contribution and license restructuring will comply with PRC laws. However, until we have completed this process, the relevant regulatory authorities may impose fines or penalties, or require us to cease the operations of JBLNG, until such time as these defects are remedied. Any such fines, penalties or delay in operations could have a material and adverse effect on our LNG business in terms of our future growth, financial conditions and results of operations.

China-based companies listed on U.S. stock exchanges have increasingly become the subject of negative media reports. These reports often focus on discrepancies between financial information set forth in such a company's filings with the U.S. SEC and filings with the PRC's State Administration for Industry and Commerce. The price of our common stock may be adversely affected if we are associated with such companies or become the subject of such negative media reports.

During the second half of 2010 and continuing into 2011, numerous media reports in the United States and elsewhere made negative claims or suggestions regarding China-based companies listed on U.S. stock exchanges, including claims and suggestions relating to the accuracy and completeness of such companies' financial information. Many of these reports appear to have been based, at least in part, on discrepancies between financial information set forth in a company's filings with the U.S. SEC and filings with the PRC's State Administration for Industry and Commerce. If we are associated with companies that are the subject of negative media reports because our operating entities are based in China or otherwise, or if we become the subject of such a report, the price of our common stock may be adversely affected.

Moreover, we can offer no assurance that the financial information set forth in our filings with the U.S. SEC will be substantially similar to the financial information set forth in the filings that our subsidiaries, our VIE, XXNGC, and XXNGC's subsidiaries are required to make with the PRC's States Administration for Industry and Commerce, because the financial information:

Ÿ we are required to include in our filings with the U.S. SEC financial statements prepared in accordance with U.S. GAAP, whereas the financial information that our subsidiaries, XXNGC and XXNGC's subsidiaries are required to include in their filings with the PRC's State Administration for Industry and Commerce financial statements that are prepared in accordance with PRC GAAP;

Ÿ included in our subsidiaries', XXNGC's, and XXNGC's subsidiaries' filings with the PRC's State Administration for Industry and Commerce does not reflect our consolidated financial information as a whole; and

Ÿ in our subsidiaries' filings with the PRC's State Administration for Industry and Commerce may relate to different periods compared to the financial information set forth in our filings with the U.S. SEC.

Any discrepancies between the financial information we disclose in our U.S. SEC filings and the financial information set forth in the filings that our subsidiaries, XXNGC and XXNGC's subsidiaries are required to make with the PRC's State Administration for Industry and Commerce due to the above factors, or otherwise, may be identified by short sellers or media who may publish negative claims or suggestions about us or our financial results, which could negatively affect the price of our common stock.

We rely on suppliers of LNG technology.

Due to the fact that advanced technologies are involved in the production, loading and transport of LNG, we have relied on suppliers of LNG technologies for the construction of our LNG plant, and we anticipate we will rely on such suppliers of technologies and know-how in connection with the operation and maintenance of our LNG plant. There are a limited number of suppliers of LNG technologies and we may be unable to obtain alternate suppliers at acceptable prices, in a timely manner or at all. If we should lose the assistance of our LNG technology licensors for any reason, we may be unable to complete or operate our planned LNG plant, which could have a material and adverse effect on our future growth, financial conditions and results of operations.

If there are advances in other alternative vehicle and industrial fuels or technologies, or if there are improvements in gasoline, diesel or hybrid engines, demand for natural gas vehicle and industrial fuels may decline and our business may suffer.

Technological advances in the production, delivery and use of alternative fuels that are, or are perceived to be, cleaner, more cost-effective or more readily available than CNG or LNG have the potential to slow adoption of natural gas vehicles and industrial facilities. In addition, advances in gasoline and diesel engine technologies, especially hybrids, may offer a cleaner, more cost-effective option and make vehicle users less likely to convert their vehicles to natural gas. Technological advances related to ethanol or biodiesel, which are increasingly used as an additive to, or substitute for, gasoline and diesel fuel, may slow the need to diversify fuels and affect the growth of the natural gas vehicle market. In addition, hydrogen and other alternative fuels in experimental or developmental stages may eventually offer a cleaner, more cost-effective alternative to gasoline and diesel than natural gas. Advances in technologies that slow the growth of or conversion to natural gas vehicles or industrial facilities or which otherwise reduce demand for natural gas as a vehicle or industrial fuel will have an adverse effect on our business.

We may need to raise capital to fund our operations and our failure to obtain funding when needed may force us to delay, reduce or eliminate our business development plans.

We may require additional cash resources in order to carry out our business development plans, including constructing and acquiring CNG and LNG fueling and compression stations. If the cost of any such construction or acquisition that our management deems appropriate is higher than our existing cash balance, we will need to seek additional cash resources, and may seek to sell additional equity or debt securities or borrow under credit facilities. The sale or issuance of additional equity securities could result in dilution to our shareholders. The incurrence of indebtedness would result in increased debt obligations and could result in operating and financing covenants that would restrict our operations. If we are unable to raise additional capital on terms favorable to us or at all, we may have to delay, scale back, or discontinue our planned facility construction or acquisitions, or obtain funds by entering into agreements on terms not favorable to us. We may also not be able to secure or repay debt incurred to fund facility construction or acquisition, especially if the construction or acquisition does not result in the benefits we anticipated. As a result, our future growth, financial conditions and results of operations may be materially and adversely affected.

We have limited insurance coverage and may incur losses due to business interruptions resulting from natural and man-made disasters, and our insurance may not be adequate to cover liabilities resulting from accidents or injuries that may occur.

The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited commercial insurance products. We carry auto insurance on our vehicles and maintain workers compensation insurance for our fueling station workers. We do not carry any product liability insurance or property insurance on our office buildings, fueling stations, other industrial sites or other property. We believe that current facilities are adequate for our current and immediately foreseeable operating needs. We do not have any policies regarding investments in real estate, securities or other forms of property. We have determined that balancing the risks of disruption or liability from our business, or the loss or damage to our property, including our facilities and equipment, the cost of insuring for these risks on the one hand, and the difficulties associated with acquiring such insurance on commercially reasonable terms on the other hand, makes it impractical for us to have such insurance.

Should any natural catastrophes such as earthquakes, floods or any acts of terrorism occur in Shaanxi, Henan, or Hubei Provinces, where our primary operations are located and most of our employees are based, or elsewhere, we might suffer not only significant property damage, but also loss of revenues due to interruptions in our business operations. In addition, the provision of our services depends on the continuing operation of our natural gas pipelines and fueling stations, which are also vulnerable to damage or interruption from natural catastrophes such as earthquakes and acts of terrorism.

The occurrence of a significant event for which we are not fully insured or indemnified, and/or the failure of a party to meet its underwriting or indemnification obligations, could materially and adversely affect our operations and financial conditions. Moreover, no assurance can be given that we will be able to maintain adequate insurance in the future at rates we consider reasonable.

Qinan Ji, our Chairman of the Board, has played an important role in the growth and development of our business since its inception, and a loss of his services in the future could severely disrupt our business and negatively affect investor confidence in us, which may also cause the market price of our common stock to go down.

Qinan Ji, our Chairman of the Board, has played an important role in the growth and development of our business since its inception. To date, we have relied heavily on Mr. Ji’s expertise in, and familiarity with, our business operations, his relationships within the natural gas industry, including with our suppliers, and his reputation and experience. In addition, Mr. Ji continues to be primarily responsible for formulating our overall business strategies and spearheading the growth of our operations. If Mr. Ji were unable or unwilling to continue in his present positions, we may not be able to easily replace him and may incur additional expenses to identify and train his successor. In addition, if Mr. Ji were to join a competitor or form a competing business, it could severely disrupt our business and negatively affect our financial conditions and results of operations. Although Mr. Ji is subject to certain non-competition restrictions during and after termination of his employment with us, we cannot assure you that such non-competition restrictions will be effective or enforceable under PRC laws. Moreover, even if the departure of Mr. Ji from our company would not have any actual impact on our operations and the growth of our business, it could create the perception among investors or the marketplace that his departure could severely damage our business and operations and could negatively affect investor confidence in us, which may cause the market price of our common stock to go down. We do not maintain key executive insurance for Mr. Ji.

Failure to attract and retain qualified personnel and experienced senior management could disrupt our operations and adversely affect our business and competitiveness.

Our continuing success is dependent, to a large extent, on our ability to attract and retain qualified personnel, including well-trained technicians for the operation and maintenance of our compressing stations, fueling stations, pipeline and delivery trucks and experienced senior management. Due to the intense market competition for highly skilled workers and experienced senior management and our geographical location, we have faced difficulties locating experienced and skilled personnel in certain functions, such as engineers, station and truck operators, administration, marketing, product development, sales, finance and accounting. We cannot assure you that we will be able to attract or retain the key personnel that we will need to achieve our business objectives and if one or more of our key personnel are unable or unwilling to continue to work for us, we may not be able to replace them within a reasonable period of time or at all. Our business may be severely disrupted, our financial conditions and results of operations may be materially and adversely affected, and we may incur additional expenses in recruiting and training additional personnel. Although our employees and senior management members are subject to certain non-competition restrictions during and after termination of their employment, we cannot assure you that such non-competition restrictions will be effective or enforceable under PRC laws. If any of our key personnel joins a competitor or forms a competing business, our business may be severely disrupted. We have no key staff insurance with respect to our key personnel that would provide insurance coverage payable to us for loss of their employment due to death or otherwise.

The expansion of our business into new provinces may not be as successful as in Shaanxi and Henan Provinces, or at all.

We plan to expand our business into additional provinces throughout China. However, our experience in operating CNG fueling stations in Shaanxi and Henan may not be applicable in other parts of China. We cannot assure you that we will be able to leverage such experience to expand into other parts of China. When we enter new markets, we may face intense competition from natural gas operators with established experience or presence in the geographical areas in which we plan to expand and from other natural gas operators with similar expansion targets. In addition, expansion or acquisition may require a significant amount of capital investment, divert the resources and time of our management and, if we fail to integrate the new businesses effectively, affect our operating efficiency. Demand for natural gas and government regulations may also be different in other provinces. The distribution of natural gas and operations of fueling stations are highly regulated industries requiring registration for licenses required by various governing authorities in China. Additionally, various standards must be met for fueling stations, including handling and storage of natural gas, tanker handling and compressor operation. While we have benefited from quicker permitting and licensing processes and stable access to the supply of natural gas in Shaanxi, there is no assurance that we will have similar success in other provinces. Our failure to manage any of our planned expansion or acquisitions may have a material adverse effect on our business, financial conditions and results of operations and we may not have the same degree of success in other provinces that we have had so far to date, or at all.

Growth in our CNG business may depend on the increased adoption of CNG technologies by buses and private cars and/or the expansion of taxi fleets.

Our revenue from CNG comes primarily from the sale of CNG as a fuel for vehicles and we expect that this trend will continue. As many of the taxis in our core CNG markets have adopted CNG technologies, growth in our CNG business may depend more on the increased adoption of CNG technologies by buses and private cars. If buses and private cars do not increasingly adopt CNG technologies, growth in our CNG business may be adversely affected.

To expand our business, we must develop new customers. Whether we will be able to expand our customer base will depend on a number of factors, including the level of acceptance and availability of natural gas vehicles, the level of acceptance of natural gas as a vehicular and industrial fuel, the growth in our target markets of natural gas infrastructure that supports CNG and LNG sales and our ability to supply CNG and LNG at competitive prices. If the prices of oil, diesel and gasoline decline materially, interest in alternative fuels like CNG and LNG may be decreased. If our potential customers are unable to receive credit for purchasing natural gas vehicles, it may be difficult or impossible for them to invest in natural gas vehicles and the conversion of industrial facilities to using natural gas, which would impair our ability to grow our business.

If the prices of CNG do not remain sufficiently below the prices of gasoline and diesel, potential vehicle fleet customers will have less incentive to purchase natural gas vehicles or convert their fleets to natural gas, which would decrease demand for CNG and limit our growth, including our expansion into LNG .

Natural gas vehicles cost more than comparable gasoline or diesel powered vehicles because converting a vehicle to use natural gas as fuel will increase its cost. If the prices of CNG do not remain sufficiently below the prices of gasoline or diesel, fleet operators may be unable to recover the additional costs of acquiring or converting to natural gas vehicles in a timely manner, and they may choose not to use natural gas vehicles. The recently extreme volatility in oil and gasoline prices demonstrates that it is difficult to predict future transportation fuel costs. The decline in the price of oil, diesel fuel and gasoline has reduced the economic advantages that our existing or potential customers may enjoy by using less expensive CNG fuel as an alternative to gasoline or diesel. The reduced prices of gasoline and diesel and the continuing uncertainty about fuel prices, combined with higher costs of natural gas vehicles, may cause potential customers to delay or reject converting their fleets to operate on natural gas, which may limit our growth and cause our business to decline.

Our acquisition and investment in other lines of business may be unsuccessful.

We intend to selectively pursue strategic acquisition and investment opportunities which complement or enhance our current businesses with new product lines or customers at the appropriate time. However, we may encounter strong competition during the acquisition or investment process and we may fail to select or evaluate targets appropriately, that may result in our experiencing difficulties in completing such acquisitions or investments at reasonable costs or at all. Even if an acquisition or investment is successful, we may have to allocate additional capital and human resources to implement the integration of the new business line into existing businesses. There is no assurance that such integration will be completed within a reasonable period of time or at all or that it will generate the expected economic benefits.

If we are unable to adequately protect our intellectual property, our business could be harmed.

We protect our intellectual property through a combination of trademark laws, confidentiality procedures and contractual provisions, when appropriate. Nonetheless, our intellectual property rights may not be successfully asserted in the future or may be invalidated, circumvented or challenged. Enforcement of intellectual property rights can lead to costly litigation and counterclaims. There is a risk that the outcome of such potential litigation will not be in our favor. Such litigation may be costly and may divert management attention as well as cost other resources, which could be otherwise devoted to our business and operations. An adverse judgment in any such litigation will impair our intellectual property rights and may harm our business, prospects and reputation. In addition, historically, implementation of PRC intellectual property-related laws has been known for being difficult, primarily because of ambiguities in the PRC laws and difficulties in enforcement. Accordingly, intellectual property rights and confidentiality protections in China may not be as effective as in the United States or other countries, which increases the risk that we may not be able to adequately protect our intellectual property. Moreover, litigation may be necessary in the future to enforce our intellectual property rights. Future litigation could result in substantial costs and diversion of our management’s attention and resources, and could disrupt our business, as well as have a material adverse effect on our financial conditions and results of operations. Given the relative unpredictability of China’s legal system and potential difficulties in enforcing a court judgment in China, there is no guarantee that we would be able to halt the unauthorized use of our intellectual property through litigation.

We may be subject to intellectual property infringement claims, which may force us to incur substantial legal expenses and, if determined adversely against us, may materially disrupt our business.

We cannot ensure that our intellectual property does not or will not cause any infringement upon trademarks, valid copyrights or other intellectual property rights held by other parties. We may become subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business. If we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, and licensing fees may be incurred or we may be forced to develop alternatives. In addition, we may incur substantial expenses, and may be forced to divert management and other resources from our business operations, to defend against such infringement claims, regardless of their merit. Successful infringement or licensing claims against us may result in substantial monetary liabilities or may materially disrupt the conduct of our business by restricting or prohibiting our use of the intellectual property in question.

In order to comply with PRC laws limiting foreign ownership of Chinese companies, we conduct our natural gas business through Xi'an Xilan Natural Gas Co., Ltd. by means of contractual arrangements which may not be as effective as direct ownership or may be deemed in violation of PRC restrictions on foreign investment in our industry.

The government of the PRC restricts foreign investment in natural gas businesses in China. Accordingly, we operate our business in China through our VIE, XXNGC. XXNGC holds the licenses, approvals and assets necessary to operate our natural gas business in China. We have no equity ownership interest in XXNGC and rely on contractual arrangements with XXNGC and its shareholders that allow us to substantially control and operate XXNGC. These contractual arrangements may not be as effective in providing control over XXNGC as direct ownership would be. For example, XXNGC could fail to take actions required for our business despite its contractual obligation to do so. If XXNGC fails to perform under its agreements with us, we may have to spend substantial costs and resources to enforce such arrangements and may have to rely on legal remedies under the laws of the PRC, which may not be effective. In addition, we cannot assure you that XXNGC's shareholders and management would always act in our best interests.

Although we believe that we comply with current regulations of the PRC, we cannot assure you that the PRC government would agree that our structure or operating arrangements comply with the PRC's licensing, registration or other regulatory requirements under existing policies or with requirements or policies that may be adopted in the future. If the PRC government determines that our structure or operating arrangements do not comply with applicable laws, it could revoke our business and operating licenses, require us to discontinue or restrict our operations, restrict our right to collect revenues, require us to restructure our operations, impose additional conditions or requirements with which we may not be able to comply, impose restrictions on our business operations or on our customers, or take other regulatory or enforcement actions against us that could be harmful to our business. In addition, the equity pledge in the Equity Pledge Agreement between SXNGE and XXNGC and XXNGC's shareholders has not been registered and may be deemed to be unenforceable under PRC laws.

Other than the proxy agreement between SXNGE, XXNGC and XXNGC's chairman and shareholders, which does not contain a choice of law or jurisdictional clause, our contractual arrangements with XXNGC are governed by PRC laws and they provide for the resolution of disputes through arbitration in the PRC. Accordingly, these contracts would be interpreted in accordance with PRC laws and any disputes would be resolved in accordance with PRC legal procedures. If XXNGC or its shareholders fail to perform their respective obligations under these contractual arrangements, we may have to (i) spend substantial costs and resources to enforce such arrangements, and (ii) rely on legal remedies under PRC laws, including seeking specific performance or injunctive relief, and claiming damages, which we cannot be sure would be effective. However, the legal environment in the PRC is not as developed as in the United States and uncertainties in the Chinese legal system could limit our ability to enforce these contractual arrangements. In the event that we are unable to enforce these contractual arrangements, our business, financial condition and results of operations could be materially and adversely affected.

Our contractual arrangements with XXNGC may be subject to scrutiny by the Chinese tax authorities and create a potential double layer taxation for our revenue-generating services conducted by XXNGC.

We could face material and adverse tax consequences if the PRC tax authorities determine that our contractual arrangements with XXNGC were not priced at an arm’s length for the purpose of determining tax liabilities. If the PRC tax authorities determine that these contracts were not entered into on an arm’s-length basis, they may adjust our income and expenses for Chinese tax purposes in the form of a transfer pricing adjustment. A transfer pricing adjustment could result in a reduction, for Chinese tax purposes, of deductions recorded by XXNGC, which could adversely affect us by increasing the tax liabilities of XXNGC. This increased tax liability could further result in late payment penalties and other penalties to XXNGC for underpaid taxes. Any payments we make under these arrangements or adjustments in payments under these arrangements that we may decide to make in the future will be subject to the same risk. Prices for such services will be set prospectively and therefore we do not currently have a basis to believe that any of the payments to be made under the contracts will or will not be considered as an arm’s length for the purpose of determining tax liabilities.

Our agreement with the Port Committee and the town of Tangyu, China is currently being challenged by the Xi'an Municipal Administration Commission for violating an exclusive agreement between the municipal government and Qin Hua Gas Company, one of our major competitors in our pipeline natural gas business.

We have entered into agreements with the Port Committee and the town of Tangyu, China to provide natural gas to local residents and businesses. The international port project is estimated to involve the development of approximately 13.5 square miles of business district and the investment of up to $30 million over the next several years, based on the Port Committee’s planning schedule. The Tangyu project involves supplying natural gas to potentially 50,000 residential and commercial users at a tourist site undergoing development and expansion. Our agreement with the Port Committee is currently being challenged by the Xi'an Municipal Administration Commission for violating an exclusive agreement between the municipal government and Qin Hua Gas Company, one of our major competitors in our pipeline natural gas business. We are currently in negotiations with the Xi'an Municipal Administration Commission to resolve its assessment. Although we disagree with the Xi'an Municipal Administration Commission's assessment, there is no assurance that the negotiations will be settled to our satisfaction.

The shareholders of XXNGC may have potential conflicts of interests with us, which may materially and adversely affect our business and financial conditions.

The shareholders of XXNGC are also beneficial holders of our common shares. They are also directors of both XXNGC and our company. Conflicts of interests due to their dual roles as shareholders and directors of both XXNGC and our Company may arise. We cannot assure you that when conflicts of interests arise, any or all of these individuals will act in the best interests of our company, or that such conflicts of interests will be resolved in our favor. In addition, these individuals may breach or cause XXNGC to breach or refuse to renew the existing contractual arrangements that allow us to receive economic benefits from XXNGC. Currently, we do not have existing arrangements to address potential conflicts of interests between these individuals and us. We rely on these individuals to abide by the laws of Delaware, which provides that directors owe a fiduciary duty to us, that requires them to act in good faith and in our best interests and not to use their positions for personal gains. If we cannot resolve any conflict of interest or dispute between us and the shareholders of XXNGC, we would have to rely on legal proceedings, which could result in disruption of our business and substantial uncertainty as to the outcome of any such legal proceedings.

Certain shares in XXNGC, our VIE, may be subject to adverse claims.

Six individuals have previously claimed to own 1,200,000 shares of XXNGC's common stock, our main operating company and VIE. They have claimed that they acquired these shares from other shareholders of XXNGC. Based on XXNGC's registered capital of RMB69,000,000 when it became a joint stock limited company in 2004, we believe that the 1,200,000 shares represented 1.74% of XXNGC's outstanding common stock at the time when the six individuals claimed to have acquired the 1,200,000 shares of XXNGC. While we and XXNGC dispute their claim of ownership over the 1,200,000 shares, there is no assurance that XXNGC will prevail if these six individuals pursue their claim in legal proceedings. If these six individuals are found to have legitimate ownership over these shares, XXNGC's shareholding structure may change and our revenues from our contractual arrangements with XXNGC may be reduced.

We may lose the ability to use and enjoy assets held by XXNGC that are important to the operation of our business if XXNGC goes bankrupt or becomes subject to a dissolution or liquidation proceeding.

As part of our contractual arrangements with XXNGC, XXNGC holds certain assets that are important to the operation of our natural gas business. If XXNGC were to file for bankruptcy and all or part of its assets become subject to liens or rights of third-party creditors, we may be unable to continue some or all of our natural gas operations, which could materially and adversely affect our business, financial conditions and results of operations. If XXNGC undergoes a voluntary or involuntary liquidation proceeding, its shareholders or unrelated third-party creditors may claim rights to some or all of these assets, thereby hindering our ability to operate our natural gas business, which could materially and adversely affect our business, financial conditions and results of operations.

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The transfer of state-owned assets in China is subject to approval by authorities in charge of state-owned assets administration and supervision and any failure by us or prior owners of our projects to comply with PRC laws and regulations in respect of the transfer of state-owned assets may result in the imposition of fines or forfeiture of our projects.

As part of our business development, we have historically acquired and may continue to acquire assets which were previously state-owned. In particular, XXNGC, our main operating company and VIE, was previously a state-owned enterprise. XXNGC was acquired in 2004 by Xi'an Sunway Technology Industry Co., Ltd., or Sunway, a company in which our chairman of the Board, Mr. Ji, is a shareholder, and privatized after acquisition. Mr. Ji subsequently acquired XXNGC in October 2005. The acquisition of XXNGC by Sunway was approved by Xi'an Municipal Administration Committee. However, the acquisition price Sunway paid to acquire XXNGC was not evaluated by licensed appraisers. Under PRC laws, the transfer of state-owned assets is subject to strict procedures and approvals, including the requirement that the transfer price must be evaluated by licensed appraisers. If a previous transferor of state-owned assets failed to comply with relevant PRC laws, the transfer of the state-owned assets may be reversed by the government or fines may be levied. In such circumstances, we will have a legal right to recover our investment in the assets, but we may not be able to exercise this right and recover such investment from the relevant parties, that could result in a loss of revenues and a significant increase in operating costs. In addition, because XXNGC is our main operating company, any reversal of the transfer of XXNGC would have a material adverse effect on our business, financial conditions and result of operations.

Acquisition of state-owned assets involves a public bidding process and failure to win the bids for our state-owned target companies or equity interests therein may limit our future growth and the control of our existing projects.

Under PRC laws, we are required to bid for the acquisition of state-owned assets that we wish to acquire. We typically negotiate the terms of the sale with the state-owned seller prior to the bidding process. However, we may not be successful in the bid and may fail to obtain the project as a result. To the extent we seek in the future to acquire state-owned assets, we will need to follow this process, and may not be successful in obtaining the target business.

We may be required to vacate some of the land upon which our CNG fueling stations operate.

We entered into long term lease agreements with third parties to lease certain land upon which our CNG fueling stations operate. Some of the entities from which we leased the land may not possess valid title to their properties. In addition, we have leased land from individual villagers or villager committees and applicable PRC laws may be interpreted as prohibiting such land to be used for non-agricultural purposes or from being leased to parties other than local residents or their collective economic organizations. If there are disputes over the legal title to any of these leased properties, or if the relevant authorities determine that our use of such properties violate PRC laws and our leases are deemed to be invalid under PRC laws, we may be required to vacate such sites and our business, financial conditions and results of operations may be adversely affected.

We may be subject to fines in connection with the construction of our CNG fueling stations due to failure to comply with proper procedural requirements.

According to relevant PRC laws and regulations in Shaanxi and Henan Provinces, contracts exceeding certain specified amounts relating to the construction of natural gas stations, such as construction contracts and equipment purchase agreements, must be obtained through bidding. We, however, did not comply with such bidding procedures in connection with the construction of any of our CNG fueling stations. While we believe that this is an accepted local practice, it is not in compliance with national and local legal requirements, and as a result, we may be subject to administrative fines and other penalties as a result of our failure to comply with these requirements.

Our business operations are subject to extensive government regulation.

Our business activities are extensively regulated by policies and other laws and regulations enacted by the PRC government. Natural gas operations require approvals, licenses or permits from the relevant central and local government authorities, some of which may take longer to obtain than others. In addition, from time to time, the relevant government authorities may impose new regulations on these activities. The success of our strategy to increase our natural gas business is contingent upon, among other things, receipt of all required licenses, permits and authorizations, including, but not limited to, construction, safety and environmental permits. While we believe we have, or are in the process of obtaining, all the required licenses, permits and authorizations material to our business, it is possible that changes or concessions required by our regulatory authorities could also involve significant costs and delay or prevent the completion of our growth or could result in the loss of an existing license, permit or authorization, any of which could have a material adverse effect on our financial conditions and results of operations. Furthermore, to the extent we have failed to obtain any license, permit and authorization, the relevant government authorities may subject us to fines, penalties or require us to cease operations.

Because we may rely on dividends and other distributions on equity paid by our current and future Chinese subsidiaries for our cash requirements, restrictions under PRC laws on their ability to make such payments could materially and adversely affect our ability to maintain and grow our operations, make investments or acquisitions that could benefit our business, pay dividends to our shareholders , and fund our businesses in general.

We have adopted a holding company structure, and our holding companies may rely on dividends and other distributions on equity paid by our current and future Chinese subsidiaries for their cash requirements, including the funds necessary to service any debt we may incur or financing we may need for operations. PRC regulations permit payments of dividends by our Chinese subsidiaries only out of their accumulated after-tax profits, if any, determined in accordance with PRC GAAP. Our Chinese subsidiaries are also required under Chinese laws and regulations to allocate at least 10% of their after-tax profits determined in accordance with PRC GAAP to statutory reserves until such reserves reach 50% of the company’s registered capital. Allocations to these statutory reserves and funds can only be used for specific purposes and are not transferable to us in the form of loans, advances or cash dividends. Any limitations on the ability of our Chinese subsidiaries to transfer funds to us could materially and adversely limit our ability to maintain and grow our operations, make investments or acquisitions that could be beneficial to our business, pay dividends and fund and conduct our business.

Our failure to fully comply with PRC labor laws exposes us to potential liability.

Companies operating in China must comply with a variety of labor laws, including certain pension, housing and other welfare-oriented payment obligations. While we have made such payments beginning in July 2009, our failure to make previous payments may be in violation of applicable PRC labor laws and we cannot ensure that PRC governmental authorities will not impose penalties on us for failure to comply. In addition, in the event that any current or former employee files a complaint with the PRC government, we may be subject to making up the social insurance payment obligations as well as paying administrative fines.

Risks Related to the People's Republic of China

Adverse changes in PRC economic and political policies could have a material adverse effect on the overall economic growth of China, which could reduce the demand for natural gas and materially and adversely affect our business.

Substantially all of our assets are located in PRC and substantially all of our revenue is derived from our operations in PRC. Accordingly, our results of operations and prospects are subject, to a significant extent, to the economic, political and legal developments in PRC. The PRC economy differs from the economies of most developed countries in many aspects, including the:

- level of government involvement;
- level of development;
- growth rate;
- level and control of capital investment;
- control of foreign exchange; and
- allocation of resources.

Any measures taken by the PRC government, even if they benefit the overall Chinese economy in the long-term, may have a negative effect on us. For example, our financial conditions and results of operations may be materially and adversely affected by government control over capital investments. Although the Chinese economy has been transitioning from a planned economy to a more market-oriented economy, a substantial portion of the productive assets in China is still owned by the PRC government. The continued control of these assets and other aspects of the national economy by the PRC government could materially and adversely affect our business. The PRC government also exercises significant control over Chinese economic growth through allocating resources, controlling payment of foreign currency denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Any adverse change in the economic conditions or government policies in China could have a material adverse effect on the overall economic growth and the level of investments and expenditures in China, which in turn could lead to a reduction in demand for natural gas and consequently have a material adverse effect on our businesses.

The PRC legal system embodies uncertainties that could limit the legal protections available to you and us.

Unlike common law systems, the PRC legal system is based on written statutes and decided legal cases have little precedential value. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. The overall effect of legislation since then has been to significantly enhance the protections afforded to various forms of foreign investment in China. Our PRC operating subsidiaries are subject to laws and regulations applicable to foreign investment in China. Our PRC affiliated entities are subject to laws and regulations governing the formation and conduct of domestic PRC companies. Relevant PRC laws, regulations and legal requirements may change frequently, and their interpretation and enforcement involve uncertainties. For example, we may have to resort to administrative and court proceedings to enforce the legal protection that we enjoy either by law or contract. However, since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we enjoy than under more developed legal systems. Such uncertainties, including the inability to enforce our contracts and intellectual property rights, could materially and adversely affect our business and operations. Accordingly, we cannot predict the effect of future developments in the PRC legal system, particularly with respect to the natural gas sector, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. These uncertainties could limit the legal protections available to us and other foreign investors.

The PRC currency is not a freely convertible currency, which could limit our ability to obtain sufficient foreign currency to support our business operations in the future.

The PRC currency, the “Renminbi” or “RMB,” is not a freely convertible currency. We are regulated by the PRC government’s foreign currency conversion policies, which may change at any time, in regard to our currency exchange needs. We receive substantially all of our revenues in Renminbi, which is not freely convertible into other foreign currencies. In PRC, the government has control over Renminbi reserves through, among other things, direct regulation of the conversion of Renminbi into other foreign currencies and restrictions on foreign imports. Although foreign currencies that are required for current account transactions can be bought freely at authorized PRC banks, the proper procedural requirements prescribed by PRC law must be met. At the same time, PRC companies are also required to sell their foreign exchange earnings to authorized PRC banks and the purchase of foreign currencies for capital account transactions still requires prior approval by the PRC government. This substantial regulation by the PRC government of foreign currency exchange may restrict our ability to conduct business operations and a change in any of these government policies could negatively impact our operations, which could result in a loss of profits.

In order for our PRC subsidiaries to pay dividends to us, a conversion of Renminbi into U.S. dollars is required. Under current PRC laws, the conversion of Renminbi into foreign currency for capital account transactions generally requires approval from the PRC State Administration of Foreign Exchange, or SAFE, and, in some cases, other government agencies. Government authorities may impose restrictions that could have a negative impact in the future on the conversion process and upon our ability to meet our cash needs and to pay dividends to our shareholders. Although our subsidiaries classified as wholly foreign-owned enterprises, or WFOEs, under PRC laws, are permitted to declare dividends and repatriate their funds to us in the United States, any change in this status or the regulations permitting such repatriation could prevent them from doing so. Any inability to repatriate funds to us would in turn prevent payments of dividends to our shareholders.

Fluctuations in exchange rates could result in foreign currency exchange losses.

Because substantially all of our revenues and expenditures are denominated in Renminbi and the net proceeds from our capital raising were denominated in U.S. dollars, fluctuations in the exchange rate between the U.S. dollar and Renminbi affect the relative purchasing power of these proceeds and our balance sheet and earnings per share in U.S. dollars. In addition, we report our financial results in U.S. dollars, and appreciation or depreciation in the value of the Renminbi relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business or results of operations. Fluctuations in the exchange rate will also affect the relative value of any dividend we issue that will be exchanged into U.S. dollars and earnings from and the value of any U.S. dollar-denominated investments we make in the future.

Since July 2005, the Renminbi has no longer been pegged to the U.S. dollar. Although currently the Renminbi exchange rate versus the U.S. dollar is restricted to a rise or fall of no more than 0.5% per day and the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the Renminbi may appreciate or depreciate significantly in value against the U.S. dollar in the medium- to long-term. Moreover, it is possible that in the future, PRC authorities may lift restrictions on fluctuations in the Renminbi exchange rate and lessen intervention in the foreign exchange market.

Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedging transactions may be limited and we may not be able to successfully hedge our exposure at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into foreign currency.

SAFE regulations relating to offshore investment activities by PRC residents may increase our administrative burden and restrict our overseas and cross-border investment activities. If our shareholders and beneficial owners who are

PRC residents fail to make any required applications and filings under such regulations, we may be unable to distribute profits and may become subject to liability under PRC laws.

SAFE has promulgated several regulations, including Circular No. 75 issued in November 2005 and implementation rules issued in May 2007, requiring registrations with, and approvals from, PRC government authorities in connection with direct or indirect offshore investment activities by PRC residents. These regulations apply to our shareholders and beneficial owners who are PRC residents.

The SAFE regulations require registration of direct or indirect investments made by PRC residents in offshore companies. In the event that a PRC shareholder with a direct or indirect stake in an offshore parent company fails to make the required SAFE registration, the PRC subsidiaries of that offshore parent company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries. Further, failure to comply with the various SAFE registration requirements described above could result in liability under PRC laws for foreign exchange evasion.

We have requested our shareholders and beneficial owners who are PRC residents to make the necessary applications and filings as required under these regulations and under any implementation rules or approval practices that may be established under these regulations. We believe our PRC resident shareholders, including Mr. Ji, our chairman of the Board, have already completed the registration process. However, as a result of the recent enactment of the regulations, lack of implementation rules and uncertainty concerning the reconciliation of the new regulations with other approval requirements, it remains unclear how these regulations, and any future legislation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant government authorities. There is a risk that not all of our shareholders and beneficial owners who are PRC residents will in the future comply with our request to make or obtain any applicable registration or approvals required by these regulations or other related legislation. The failure or inability of our PRC resident shareholders and beneficial owners to receive any required approvals or make any required registrations may subject us to fines and legal sanctions, restrict our overseas or cross-border investment activities, limit our PRC subsidiaries' ability to make distributions or pay dividends or affect our ownership structure, as a result of which our acquisition strategies and business operations and our ability to distribute profits to you could be materially and adversely affected.

We may have difficulty establishing adequate management, legal and financial controls in the People's Republic of China.

The PRC historically has been deficient in Western style management and financial reporting concepts and practices, as well as in modern banking, computer and other control systems. We may have difficulty in hiring and retaining a sufficient number of qualified employees to work in the PRC. As a result of these factors, we may experience difficulty in establishing management, legal and financial controls, collecting financial data and preparing financial statements, books of accounts and corporate records and instituting business practices that meet Western standards.

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Because our assets and operations are located in PRC, you may have difficulty enforcing any civil liabilities against us under the securities and other laws of the United States or any other state.

We are a holding company, and all of our assets are located in the PRC. In addition, most of our directors and officers are non-residents of the United States, and all or a substantial portion of the assets of these non-residents are located outside the United States. As a result, it may be difficult for investors to effect service of process within the United States upon these non-residents, or to enforce against them judgments obtained in United States courts, including judgments based upon the civil liability provisions of the securities laws of the United States or any state.

There is uncertainty as to whether courts of the PRC would enforce:

Ÿ Judgments of United States courts obtained against us or these non-residents based on the civil liability provisions of the securities laws of the United States or any state; or

Ÿ In original actions brought in the PRC, liabilities against us or non-residents predicated upon the securities laws of the United States or any other state. Enforcement of a foreign judgment in the PRC also may be limited or otherwise affected by applicable bankruptcy, insolvency, liquidation, arrangement, moratorium or similar laws relating to or affecting creditors' rights generally and will be subject to a statutory limitation of time within which proceedings may be brought.

PRC laws and regulations governing our businesses and the validity of certain of our contractual arrangements are uncertain. If we are found to be in violation, we could be subject to sanctions. In addition, changes in such PRC laws and regulations may materially and adversely affect our business.

There are substantial uncertainties regarding the interpretation and application of PRC laws and regulations, including, but not limited to, the laws and regulations governing our business, or the enforcement and performance of our contractual arrangements with our variable interest entity, XXNGC, and its shareholders. We are considered a foreign person or foreign invested enterprise under PRC laws. As a result, we are subject to PRC legal limitations on foreign ownership of Chinese companies. These laws and regulations are relatively new and may be subject to change, and their official interpretation and enforcement may involve substantial uncertainties. The effectiveness of newly enacted laws, regulations or amendments may be delayed, resulting in detrimental reliance by foreign investors. New laws and regulations that affect existing and proposed future businesses may also be applied retroactively.

The PRC government has broad discretion in dealing with violations of laws and regulations, including levying fines, revoking business and other licenses and requiring actions necessary for compliance. In particular, licenses and permits issued or granted to us by relevant governmental bodies may be revoked at a later time by higher regulatory bodies. We cannot predict the effect of the interpretation of existing or new PRC laws or regulations on our businesses. We cannot assure you that our current ownership and operating structure would not be found to be in violation of any current or future PRC laws or regulations. As a result, we may be subject to sanctions, including fines, and could be required to restructure our operations or cease to provide certain services. Any of these or similar actions could significantly disrupt our business operations or restrict us from conducting a substantial portion of our business operations, which could materially and adversely affect our business, financial conditions and results of operations.

The new Antimonopoly Law, or AML, may subject our future acquisitions to increased scrutiny, which could affect our ability to consummate acquisitions on terms favorable to us or at all.

On August 8, 2006, six PRC government authorities, including the PRC Ministry of Commerce, the State Administration for Industry and Commerce, and the China Securities Regulatory Commission, promulgated a rule entitled “Provisions regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors,” or the M&A Rule, which became effective on September 8, 2006. The M&A Rule, among other things, requires that certain acquisitions of Chinese domestic enterprises by foreign investors be subject to anti-trust scrutiny by the Ministry of Commerce and the State Administration for Industry and Commerce. The AML was adopted by the Standing Committee of the National People’s Congress on August 30, 2007 and became effective on August 1, 2008. The AML was enacted in part to guard against and cease monopolistic activities, and to safeguard and promote orderly market competition. In accordance with the AML, monopolistic acts shall include monopolistic agreements among business operators, abuse of dominant market positions by business operators and concentration of business operators that eliminates or restricts competition or might be eliminating or restricting competition. On August 3, 2008, the State Council promulgated the Regulations on the Thresholds for Reporting of Concentration of Business Operators, or the Reporting Threshold Regulations, which provide specific thresholds for reporting of concentration of business operators. Under the AML and the Reporting Threshold Regulations, the parties to an acquisition must report to the Ministry of Commerce in advance if in the preceding accounting year the turnover in the aggregate achieved by all the parties to the transaction exceeds RMB10.0 billion worldwide or RMB2.0 billion within China, and the turnover achieved by at least two of them respectively exceeds RMB400.0 million within China. However, the Ministry of Commerce has the right to initiate investigation of a transaction not reaching the above-mentioned reporting thresholds if the Ministry of Commerce has evidence that the transaction has or may have the effect of excluding or restricting competition. The anti-trust scrutiny procedures and requirements set forth in the AML and the Reporting Threshold Regulations grant the government extensive authority of evaluation and control over the terms of acquisitions in China by foreign investors, and their implementation involves significant uncertainties and risks. To the extent our future acquisitions meet the threshold requirements set forth in the AML and the Reporting Threshold Regulations, or are deemed by the Ministry of Commerce to meet the thresholds, we will be subject to anti-monopoly review. The consummation of our future acquisitions could therefore be much more time-consuming and complex, and any required approval processes, including obtaining approval from the Ministry of Commerce, may delay or prevent the consummation of such acquisitions, and prevent us from attaining our business objectives.

We may be deemed a PRC "resident enterprise" under the Enterprise Income Tax Law ("EIT Law") and be subject to PRC taxation on our worldwide income.

The EIT Law also provides that enterprises established outside of China whose "de facto management bodies" are located in China are considered "resident enterprises" and are generally subject to the uniform 25% enterprise income tax rate as to their worldwide income. Under the implementation regulations to the EIT Law issued by the State Council, "de facto management body" is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and treasury, and acquisition and disposition of properties and other assets of an enterprise. It remains unclear how the PRC tax authorities will interpret this term. A substantial number of our management personnel are located in the PRC, and all of our revenues arise from our operations in China. However, we do recognize some interest income and other gains from our financing activities outside China. If the PRC tax authorities determine that we are a PRC resident enterprise, we will be subject to PRC tax on our worldwide income at the 25% uniform tax rate, which may have a material adverse effect on our financial condition and results of operations. Notwithstanding the foregoing provision, the new EIT Law also provides that, if a resident enterprise already invests in another resident enterprise, the dividends received by the investing resident enterprise from the invested resident enterprise are exempt from income tax, subject to certain qualifications. Therefore, if we are classified as a resident enterprise, the dividends received from our PRC subsidiaries and investee companies may be exempt from income tax. However, due to the short history of the EIT Law, it is unclear as to (i) the detailed qualification requirements for such exemption and (ii) whether dividend payments by our PRC subsidiaries and investee companies to us will meet such qualification requirements, even if we are considered a PRC resident enterprise for tax purposes.

Dividends we receive from our operating subsidiaries located in the PRC may be subject to PRC withholding tax.

The EIT Law provides that a withholding income tax rate of 20% will be applicable to dividends payable to foreign investors that are "non-resident enterprises" to the extent such dividends have their source within China unless the jurisdiction of such foreign investor has a tax treaty with China that provides a different withholding arrangement. The implementing regulations to the EIT Law subsequently reduced this withholding income tax rate from 20% to 10%.

We are a Delaware company and substantially all of our income may be derived from dividends we receive from our operating subsidiaries located in the PRC. Thus, dividends paid to us by our subsidiaries in China may be subject to the 10% withholding income tax if we are considered as a "non-resident enterprise" under the EIT Law. If we are required under the EIT Law to pay income tax for any dividends we receive from our subsidiaries, it will materially and adversely affect the amount of dividends, if any, we may pay to our shareholders.

PRC regulation of direct investment and loans by offshore holding companies to PRC entities may delay or limit our ability to use the proceeds of this offering to make additional capital contributions or loans to our PRC operating businesses.

Any capital contributions or loans that we, as an offshore company, make to our PRC operating businesses, including from the proceeds of this offering, are subject to PRC regulations. For example, any of our loans to our PRC operating businesses cannot exceed the difference between the total amount of investment our PRC operating businesses are approved to make under relevant PRC laws and their respective registered capital, and must be registered with the local branch of the State Administration of Foreign Exchange as a procedural matter. In addition, our capital contributions to our PRC operating businesses must be approved by the NDRC and the Ministry of Commerce or their local counterpart and registered with the State Administration for Industry and Commerce or its local counterpart. We cannot assure you that we will be able to obtain these approvals on a timely basis, or at all. If we fail to obtain such approvals, our ability to make equity contributions or provide loans to our PRC operating businesses or to fund their operations may be negatively affected, which could adversely affect their liquidity and their ability to fund their working capital and expansion projects and meet their obligations and commitments. Furthermore, the State Administration of Foreign Exchange promulgated a new circular in August 2008 with respect to the administration of conversion of foreign exchange capital contribution of foreign invested enterprises into RMB. Pursuant to this new circular, RMB converted from foreign exchange capital contribution can only be used for the activities within the approved business scope of such foreign invested enterprise and cannot be used for domestic equity investment or acquisition unless otherwise allowed by PRC laws or regulations. As a result, we may not be able to increase the capital contribution of our operating subsidiaries or equity investees and subsequently convert such capital contribution into RMB for equity investment or acquisition in China.

We may be adversely affected by the complexity, uncertainties and changes in PRC regulations of natural gas business and companies, including limitations on our ability to own key assets.

The PRC government regulates the natural gas industry including foreign ownership of, and the licensing and permit requirements pertaining to, companies in the natural gas industry. These laws and regulations are relatively new and evolving, and their interpretation and enforcement involve significant uncertainties. As a result, in certain circumstances it may be difficult to determine what actions or omissions may be deemed to be a violation of applicable laws and regulations. Issues, risks and uncertainties relating to PRC government regulations of the natural gas industry include the following:

Ÿ we only have contractual control over XXNGC. We do not own the equity of XXNGC due to the restriction of foreign investment in Chinese businesses; and

Ÿ uncertainties relating to the regulation of the natural gas business in China, including evolving licensing practices, mean that permits, licenses or operations of our company may be subject to challenge. This may disrupt our business, or subject us to sanctions, requirements to increase capital or other conditions or enforcement, or compromise enforceability of related contractual arrangements, or have other harmful effects on us.

The interpretation and application of existing PRC laws, regulations and policies and possible new laws, regulations or policies have created substantial uncertainties regarding the legality of existing and future foreign investments in, and the businesses and activities of, natural gas businesses in China, including our business.

If China Securities Regulatory Commission, or CSRC, or another PRC regulatory agency determines that its approval was required in connection with our prior offering in 2009, we may become subject to penalties.

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated the M&A Rule, which became effective on September 8, 2006. The M&A Rule, among other things, has certain provisions that require offshore special purpose vehicles, or SPVs, formed for the purpose of acquiring PRC domestic companies and controlled by PRC individuals, to obtain the approval of the CSRC prior to listing their securities on an overseas stock exchange. We believe, based on the opinion of our PRC legal counsel, Shaanxi Jiarui Law Firm, that while the CSRC generally has jurisdiction over overseas listings of SPVs like us, CSRC's approval is not required for our overseas listing and any future offerings given the fact that our current corporate structure was established before the new regulation became effective. However, there remains some uncertainty as to how this regulation will be interpreted or implemented in the context of an overseas offering. If the CSRC or another PRC regulatory agency subsequently determines that its approval was required for our overseas listing and any future offerings, we may face sanctions by the CSRC or another PRC regulatory agency. If this happens, these regulatory agencies may impose fines and penalties on our operations in the PRC, limit our operating privileges in the PRC, delay or restrict the injection of proceeds from an offering into our PRC subsidiaries, restrict or prohibit payment or remittance of dividends by our PRC subsidiaries to us or take other actions that could have a material adverse effect on our business, financial conditions, results of operations, reputation and prospects, as well as the trading price of our common stock.

We may be subject to fines and legal sanctions imposed by SAFE or other Chinese government authorities if we or our Chinese employees fail to comply with Chinese regulations governing the employee share options granted by offshore listed companies to Chinese citizens.

On March 28, 2007, SAFE issued the Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Share Holding Plan or Share Option Plan of Overseas Listed Companies, or the Share Option Rule. Under the Share Option Rule, Chinese citizens who are granted share options by an offshore listed company are required, through a Chinese agent or Chinese subsidiary of the offshore listed company, to register with SAFE and complete certain other procedures, including applications for foreign exchange purchase quotas and opening special bank accounts. We and our Chinese employees who have been granted share options are subject to the Share Option Rule. If we or our Chinese employees fail to comply with these regulations, we or our Chinese employees may be subject to fines and legal sanctions imposed by SAFE or other Chinese government authorities and we may be prevented from further granting options under our share incentive plans to our employees. Such events could adversely affect our business operations.

Recent changes in the PRC labor law restrict our ability to reduce our workforce in the PRC in the event of an economic downturn and may increase our labor costs.

In June 2007, the National People's Congress of the PRC enacted the Labor Contract Law, which became effective on January 1, 2008. To clarify certain details in connection with the implementation of the Labor Contract Law, the State Council promulgated the Implementing Rules for the Labor Contract Law, or the Implementing Rules, on September 18, 2008 that came into effect immediately. The Labor Contract Law provides various rules regarding employment contracts that will likely have a substantial impact on employment practices in China. The Labor Contract Law imposes severe penalties on employers that fail to timely enter into employment contracts with employees.

The employer is required to pay a double salary to the employee if it does not enter into a written contract with the employee within one month of the employment, and a non-fixed-term contract is assumed if a written contract is not executed after one year of the employment. Additionally, the Labor Contract Law sets a limit of two fixed-term contracts regardless of the length of each term, after which the contract must be renewed on a non-fixed-term basis should the parties agree to a further renewal unless otherwise required by the respective employee. This requirement curtails the common practice of continuously renewing short-term employment contracts. The Implementing Rules appear to further tighten this rule by suggesting that an employee has the right to demand a non-fixed-term contract upon the completion of the second fixed term regardless of whether the employer agrees to a contract renewal. A non-fixed-term contract does not have a termination date and it is generally difficult to terminate such a contract because termination must be based on limited statutory grounds. The employer can no longer supplement such statutory grounds through an agreement with the employee. In addition, the Labor Contract Law requires the payment of statutory severance upon the termination of an employment contract in most circumstances, including the expiration of a fixed-term employment contract.

Under the Labor Contract Law, employers can only impose a post-termination non-competition provision on employees who have access to their confidential information for a maximum period of two years. If an employer intends to maintain the enforceability of a post-termination non-competition provision, it has to pay the employee compensation on a monthly basis post-termination of the employment. Under the Labor Contract Law, a “mass layoff” is defined as termination of more than 20 employees or more than 10% of the workforce. The Labor Contract Law expands the circumstances under which a mass layoff can be conducted, such as when the company undertakes a restructuring pursuant to the PRC Enterprise Bankruptcy Law, suffers serious difficulties in business operations, changes its line of business, performs significant technological improvements, changes operating methods, or where there has been a material change in the objective economic circumstances relied upon by the parties at the time of the conclusion of the employment contract, thereby making the performance of such employment contract impractical. The employer must follow specific procedures in conducting a mass layoff. There is little guidance on what penalties an employer will suffer if it fails to follow the procedural requirements in conducting the mass layoff. Finally, the Labor Contract Law requires that the employer discuss the company’s internal rules and regulations that directly affect the employees’ material interests (such as employees’ salary, work hours, leave, benefits, and training, etc.) with all employees or employee representative assemblies and consult with the trade union or employee representatives on such matters before making a final decision.

All of our employees based exclusively within the PRC are covered by the Labor Contract Law. As there are uncertainties as to how the Labor Contract Law and its Implementing Rules will be enforced by the relevant PRC authorities, we cannot assess their potential impact on our business and results of operations at the moment. The implementation of the Labor Contract Law and its Implementing Rules may increase our operating expenses, in particular our personnel expenses and labor service expenses. If we want to maintain the enforceability of any of our employees’ post-termination non-competition provisions, the compensation and procedures required under the Labor Contract Law may add substantial costs and cause financial burdens to us. Prior to the new law such compensation was often structured as part of the employee’s salary during employment, and was not an additional compensation cost. In the event that we decide to dismiss employees or otherwise change our employment or labor practices, the Labor Contract Law and its Implementing Rules may also limit our ability to effect these changes in a manner that we believe to be cost-effective or desirable, which could adversely affect our business and results of operations. In particular, our ability to adjust the size of our operations when necessary in periods of recession or less severe economic downturns such as the recent financial turmoil may be affected. In addition, during periods of economic decline when mass layoffs become more common, local regulations may tighten the procedures by, among other things, requiring the employer to obtain approval from the relevant local authority before conducting any mass layoff. Such regulations can be expected to exacerbate the adverse effect of the economic environment on our results of operations and financial condition.

Risks Related to Corporate and Stock Matters

We have made errors in the preparation of certain of our historical financial statements and our internal control over financial reporting and disclosure controls and procedures have not been effective.

Because of the material weaknesses in our internal control over financial reporting and the ineffectiveness of our disclosure controls and procedures, we could be subject to sanctions or investigations by the exchange on which we list our shares, the SEC or other regulatory authorities. The SEC has commenced an investigation into the matters surrounding the Wang Loan and the acquisition of Lingbao Yuxi Natural Gas Co., Ltd. The Company has been cooperating with the investigation. The Company has restated quarterly reports on Form 10-Q/A for the three months ended March 31, 2010, six months ended June 30, 2010 and the nine months ended September 30, 2010 and the annual report on Form 10-K/A for the year ended December 31, 2010, and quarterly reports on Form 10-Q/A for the three months ended March 31, 2011, six months ended June 30, 2011 and the nine months ended September 30, 2011, regarding the above matters. In addition, NASDAQ has delisted the Company's common stock and, as a result, the Company's common stock is now quoted on the OTC Markets. The SEC may take enforcement action against the Company. The market price of our common stock has declined and because of these events, investor perceptions of the Company may suffer, and this could cause a further decline in the market price of our stock. If we are unable to remediate the material deficiencies in our internal control effectively or efficiently, it could harm our operations, financial reporting or financial results and could result in an adverse opinion on internal controls from our independent registered public accounting firm. In addition, we may identify additional material weaknesses in the future. Any additional failures of internal controls could have a material adverse effect on our results of operations and harm our reputation.

Qinan Ji, our chairman of the Board, beneficially owns a significant percentage of our outstanding common stock and, as a result, he has significantly greater influence over us and our corporate actions related to our public shareholders and his interests may not be aligned with the interests of other shareholders.

As of December 31, 2011, our co-founder and chairman of the Board, Mr. Ji, beneficially owned 3,002,299 shares of common stock or approximately14.0% of our outstanding shares of common stock. Mr. Ji is an affiliate as defined in Rule 144 under the Securities Act of 1933, as amended, or the Securities Act, due to the large size of his shareholding in us and his positions with us as our chairman. Rule 144 defines an affiliate of a company as a person that, directly or indirectly, through one or more intermediaries, controls or is controlled by, or is under common control with, our company. Mr. Ji has, and may continue to have, significant influence in determining the outcome of any corporate transactions or other matters submitted to our shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. He may not act in the best interests of our other shareholders. In addition, without the consent of Mr. Ji, we could be prevented from entering into transactions that could be beneficial to us. This concentration of ownership may also discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our common stock. These actions may be taken even if they are opposed by our other shareholders.

The market price of our common stock may be adversely affected by market volatility.

The market price of our common stock may be highly volatile due to general market conditions or conditions specific to us (including limited trading volume in our common stock as discussed below). A number of factors may have significant impact on the market price of our stock, including announcements of technological innovations by us or other companies, regulatory matters, new or existing products or procedures, concerns about our financial position, operating results, litigation, government regulation, developments or disputes relating to agreements, patents or proprietary rights. In addition, potential dilutive effects of future sales of shares of common stock by stockholders and by us could have an adverse effect on the market price of our shares of common stock.

NASD sales practice requirements may also limit a stockholder’s ability to buy and sell our stock.

Section 15(g) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and Rule 15g-2 promulgated thereunder by the SEC require broker-dealers dealing in penny stocks to provide potential investors with a document disclosing the risks of penny stocks and to obtain a manually signed and dated written receipt of the document before effecting any transaction in a penny stock for the investor’s account.

Potential investors in our common stock are urged to obtain and read such disclosure carefully before purchasing any shares that are deemed to be "penny stock." Moreover, Rule 15g-9 requires broker-dealers in penny stocks to approve the account of any investor for transactions in such stocks before selling any penny stock to that investor. This procedure requires the broker-dealer to (i) obtain from the investor information concerning his or her financial situation, investment experience and investment objectives; (ii)reasonably determine, based on that information, that transactions in penny stocks are suitable for the investor and that the investor has sufficient knowledge and experience as to be reasonably capable of evaluating the risks of penny stock transactions; (iii) provide the investor with a written statement setting forth the basis on which the broker-dealer made the determination in (ii) above; and (iv) receive a signed and dated copy of such statement from the investor, confirming that it accurately reflects the investor's financial situation, investment experience and investment objectives. Compliance with these requirements may make it more difficult for holders of our common stock to resell their shares to third parties or to otherwise dispose of them in the market or otherwise.

Shares eligible for future sale may adversely affect the market price of our common stock, as the future sale of a substantial amount of our restricted stock in the public marketplace could reduce the price of our common stock.

From time to time, certain of our stockholders may be eligible to sell all or some of their shares of common stock by means of ordinary brokerage transactions in the open market pursuant to Rule 144, promulgated under the Securities Act ("Rule 144"), subject to certain limitations. In general, pursuant to Rule 144, a stockholder (or stockholders whose shares are aggregated) who has satisfied a six-month holding period may, under certain circumstances, sell within any three-month period a number of securities which does not exceed the greater of 1% of the then outstanding shares of common stock or the average weekly trading-volume of the class during the four calendar weeks prior to such sale. Rule 144 also permits, under certain circumstances, the sale of securities, without any limitations, by a non-affiliate of our company that has satisfied a one-year holding period. Any substantial sale of common stock pursuant to Rule 144 or pursuant to any resale prospectus may have an adverse effect on the market price of our securities.

Stockholders should have no expectation of any dividends.

The holders of our common stock are entitled to receive dividends when declared by the Board of Directors out of funds available. To date, we have not declared nor paid any cash dividends. The Board of Directors does not intend to declare any dividends in the near future, but instead intends to retain all earnings, if any, for use in our business operations. Furthermore, if we decide to pay dividends, foreign exchange and other regulations in China may restrict our ability to distribute retained earnings from China or convert those payments from Renminbi into foreign currencies.

Item 1B. Unresolved Staff Comments

We have received certain comment letters from the SEC Staff with respect to our Annual Report on Form 10-K for the year ended December 31, 2009 (the "2009 Form 10-K"), to which we have responded. The last comment letter from the SEC Staff, with our follow-up response, relates to Part III of the 2009 Form 10-K. We have prepared a proposed Amendment No. 3 to the 2009 Form 10-K that amends and restates Part III ("Proposed Amendment No. 3"), and filed it on Form 10-K/A on June 14, 2011.

ITEM 2. PROPERTIES

Our principal executive offices are located at 19th Floor, Building B, Van Metropolis, No. 35 Tangyan Road, Hi-Tech Zone, Xi'an, 710065, Shaanxi Province, PRC. Our property consists of approximately 1,621 square meters of office space, the annual rent for which is $128,374.

We have additional properties located in Lantian County, the districts of Baqiao, Lintong and Gaoxin in the city of Xi'an, and the cities of Jiyuan, Kaifung and Pindingshan, in Henan Province. We own a 120km high-pressure underground pipeline network and two citygate stations (terminals) with accompanying buildings and equipment. We lease the main office building where we are headquartered and all of our CNG fueling station sites. In order to secure sufficient CNG supply, our VIE also own three mother stations in Shaanxi and Hubei Province to support our stations. As of December 31, 2011, our VIE owned and operated 25 CNG fueling stations in Shaanxi province and 12 CNG fueling stations in Henan Province.

As of December 31, 2011, our VIE owned 6 trucks and 15 tankers that were used to transport natural gas.

In December, 2009, XXNGC formed a wholly owned subsidiary, Hubei Xilan Natural Gas, Co., that maintains an office in the No. 478 of Hongneng Mansion, Jianshe Avenue, Jianghan District, Wuhan City, Hubei Province, China. The office is approximately 900 square meters in area, with annual rental payment of $39,060.

In October 2008, we acquired Lingbao Yuxi Natural Gas, Co., Ltd. through Xi'an Xilan Natural Gas Co., Ltd. Lingbao Yuxi Natural Gas maintains an office located at Changan Rd. W, Lingbao, Henan Province, with annual rent of approximately $6,200.

In August 2008, we purchased a 531.72-square-meter property in Beijing as office space for local operations in Beijing.

In May 27, 2008, we purchased a 412.10-square-meter property in Zhengzhou, Henan Province as office space for the local operations in Henan Province.

On February 29, 2008, we entered into a 62-month lease agreement in connection with an office located on the 22nd Floor, 370 Lexington Avenue, New York, New York. The monthly rent of this office in 2011 was $7,028.

On October 24, 2006, XXNGC formed a wholly owned subsidiary, Shaanxi Jingbian Liquefied Natural Gas Co., Ltd., that maintains an office in the Tongwang Road, Zhangjiapan Town, Jingbian County, China. We moved into our own office building upon completion in December 2010. The office building consists of approximately 6,600 square meters and is used by us conclusively.

We consider the properties to be adequate and sufficient for the requirements of each location. The extent of utilization of such properties varies from property to property and from time to time during the year.

ITEM 3. LEGAL PROCEEDINGS

a) We and certain of our officers and directors have been named as defendants in a putative class action lawsuit alleging violations of the federal securities laws. That action, captioned *Vandevelde v. China Natural Gas, Inc., et al.* , C.A. No. 10-728, was filed on August 26, 2010 in the United States District Court for the District of Delaware. The plaintiff in *Vandevelde* asserts that we, Qinan Ji, Zhiqiang Wang, Donald Yang, David She, Carl Yeung and Lawrence Leighton violated Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder, when we failed to disclose and properly account for the Loan in our Annual Report on Form 10-K for the year ended December 31, 2009 and Quarterly Report on Form 10-Q for the quarter ended March 31, 2010. The complaint alleges that the Pledge to secure the Loan violated the Indenture for the Senior Notes and the warrant agreement relating to the warrants issued to Abax, giving the holder of those notes and warrants the right to declare a default under the Indenture. The complaint further alleges that, on August 20, 2010, the Company amended its Annual Report on Form 10-K for the year ended December 31, 2009 and Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 to disclose the Loan and restate its financial statements in light of the note and warrant holder's right to declare a default under the Indenture, and that the announcement of this news caused the price of our stock to drop by twenty percent. The plaintiff seeks damages in an unspecified amount to recover the losses purportedly suffered by the putative class as a result of that decline. The complaint also asserts claims against the individual defendants as controlling persons of the Company for violations of Section 20(a) of the Securities Exchange Act of 1934.

On August 12, 2011, the Court entered an order appointing Robert Skeway, an individual investor, as lead plaintiff and approving his selection of lead counsel. Lead plaintiff and Raimundo Jo-Fung, another individual investor, who together seek to represent a class of all purchasers and acquirers of the Company's common stock between March 10, 2010 and September 21, 2011, filed an amended complaint on October 11, 2011. On December 12, 2011, we filed a motion to dismiss. Plaintiff's counsel filed its opposition to the motion to dismiss on March 2, 2012. We have until April 16, 2012 to file our reply brief with the court.

b) On December 5, 2011, plaintiff Haitham J. Kousa filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, Yang Xiang Dong, China Natural Gas, Inc. and The Nasdaq Stock Market, LLC, as defendants (C.A. No. 11-1202-SLR), and on January 17, 2012, plaintiff Robert Mallano also filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, Yang Xiang Dong, China Natural Gas, Inc., as defendants (C.A. No. 12-0048-SLR) (the "Constituent Actions"). The Constituent Actions allege, inter alia, breach of fiduciary duties, self-dealing, and misconduct by management for related-party loans to management and the failure to disclose such loans. The Constituent Actions were consolidated on February 14, 2012 and bear the following caption, In re China Natural Gas, Inc. Shareholder and Derivative Litigation (Consol. C.A. No. 11-1202-SLR). On March 19, 2012 the court granted Nasdaq's motion to dismiss, denied plaintiff's motion for appointment of a receiver and dismissed plaintiff's motion for expedited discovery.

c) On February 8, 2012, plaintiff Rick Steinmetz, filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, David She, Carl Yeung, Yang Xiang Dong, China Natural Gas, Inc., alleging the same or similar claims as in the Constituent Actions. This case has not yet been consolidated with the Constituent Actions, although we believe consolidation will occur soon.

We intend to defend these cases vigorously. We currently cannot estimate the outcome of these matters as of the date of this Report.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II

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

Prior to June 5, 2009, our common stock was quoted on the Over-the-Count Bulletin Board ("OTCBB") under the symbol "CHNG." On June 5, 2009, we terminated our listing on OTCBB and listed our common stock on NASDAQ Global Market also under the symbol "CHNG." On November 9, 2011, we received a delisting notice from The NASDAQ Stock Market LLC ("Nasdaq") in which the Nasdaq Staff stated that it has determined to exercise its discretionary authority under Listing Rule 5101 and delist the Company's securities. We then filed an appeal of Nasdaq's decision to delist us to a Nasdaq Hearing Panel. On March 6, 2012, we received a letter from Nasdaq indicating that the Nasdaq Hearings Panel has determined to deny the Company's appeal for continued listing on Nasdaq. As a result, trading of the Company's common stock was suspended at the open of business on March 8, 2012, and our common stock was quoted on the OTC Markets as of that date.

The following table sets forth, for the indicated periods, the high and low sales prices for our common stock, as reported on NASDAQ and OTC Markets, for the years ended December 31, 2011 and 2010, respectively. The quotations represent inter-dealer prices without retail markup, markdown or commission, and may not necessarily represent actual transactions.

	COMMON STOCK MARKET PRICE	
	HIGH	LOW
FISCAL YEAR ENDED DECEMBER 31, 2011:		
Fourth Quarter	$ 1.93	$ 1.93
Third Quarter (trading was halted on September 21, 2011)	$ 3.95	$ 1.90
Second Quarter	$ 6.10	$ 2.44
First Quarter	$ 6.27	$ 5.00
FISCAL YEAR ENDED DECEMBER 31, 2010:		
Fourth Quarter	$ 7.13	$ 4.9
Third Quarter	$ 8.38	$ 4.63
Second Quarter	$ 10.19	$ 6.45
First Quarter	$ 12.57	$ 8.8

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among China Natural Gas, Inc., the S&P Smallcap 600 Index

and the S&P Gas Utilities Index

*$100 invested on 12/31/06 in stock or index, including reinvestment of dividends.

Fiscal year ending December 31.

	12/06	12/07	12/08	12/09	12/10	12/11
China Natural Gas, Inc.	100.00	219.05	95.24	176.51	87.46	30.63
S&P Smallcap 600	100.00	98.78	67.18	83.15	103.93	103.76
S&P Gas Utilities	100.00	124.92	82.64	108.02	129.79	180.71

Shareholders' return on the common stock for the past five years are shown as follows

	2011	2010	2009	2008	2007
Return on equity	8.5 %	11.0%	17.5%	24.7%	23.7%

Holders

As of March 23, 2012, there were approximately 24 holders of record of our common stock.

Dividends

There are no restrictions in our articles of incorporation or bylaws that prevent us from declaring dividends. The Delaware General Corporation Law, however, does prohibit us from declaring dividends where, after giving effect to the distribution of the dividend:

1. We would not be able to pay our debts as they become due in the usual course of business; or

2. Our total assets would be less than the sum of our total liabilities plus the amount that would be needed to satisfy the rights of stockholders who have preferential rights superior to those receiving the distribution.

We have never paid any cash dividends on our common stock. We currently anticipate that we will retain any future earnings for use in our business. Consequently, we do not anticipate paying any cash dividends in the foreseeable future.

The payment of dividends in the future will depend upon our results of operations, as well as our short-term and long-term cash availability, working capital, working capital needs and other factors, as determined by our board of directors. Currently, except as may be provided by applicable laws, there are no contractual or other restrictions on our ability to pay dividends if we were to decide to declare and pay them.

Securities Authorized for Issuance under Equity Compensation Plan

There has been no common stock authorized for issuance with respect to any equity compensation plan as of the fiscal year ended December 31, 2011.

Recent Sales of Unregistered Securities

We did not sell any equity securities that were not registered under the Securities Act of 1933, as amended, during the year ended December 31, 2011.

ITEM 6. SELECTED FINANCIAL DATA

The following Selected Consolidated Financial Data should be read in conjunction with our Consolidated Financial Statements and the related Notes thereto, Management's Discussion and Analysis of Financial Condition and Results of Operations and other financial information included elsewhere in this Annual Report on Form 10-K. The data set forth below with respect to our Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009 and the Consolidated Balance Sheet Data as of December 31, 2011 and 2010 are derived from our Consolidated Financial Statements which are included elsewhere in this Annual Report on Form 10-K and are qualified by reference to such Consolidated Financial Statements and related Notes thereto. The data set forth below with respect to our Consolidated Statements of Operations for the years ended December 31, 2008 and 2007 and the Consolidated Balance Sheet Data as of December 31, 2009, 2008 and 2007 are derived from our Consolidated Financial Statements, that are not included elsewhere in this Annual Report on Form 10-K.

	Year ended December 31				
	2011	2010	2009	2008	2007
STATEMENT OF OPERATIONS:					
Revenues					
Natural gas	$106,178,398	$71,367,502	$ 62,236,342	$55,746,893	$28,278,033
Gasoline	5,998,022	7,522,412	6,384,172	4,616,052	38,486
Installation and others	12,045,106	11,063,709	12,445,604	7,357,714	7,075,534
	124,221,526	89,953,623	81,066,118	67,720,659	35,392,053
Cost of revenues					
Natural gas	65,062,505	38,651,298	29,478,854	27,234,508	14,838,997
Gasoline	5,756,960	7,050,003	5,993,207	4,277,458	34,747
Installation and others	5,183,985	4,838,858	5,432,978	3,469,671	3,151,331
	76,003,450	50,540,159	40,905,039	34,981,637	18,025,075
Gross profit	48,218,076	39,413,464	40,161,079	32,739,022	17,366,978
Operating expenses					
Selling	17,377,703	13,254,923	10,607,596	7,651,948	3,451,161
General and administrative	9,984,565	7,131,543	4,500,676	4,024,882	2,837,768
	27,362,268	20,386,466	15,108,272	11,676,830	6,288,929
Income from operations	20,855,808	19,026,998	25,052,807	21,062,192	11,078,049
Interest income	42,290	418,763	125,287	209,502	70,697
Interest expense	(771,916)	-	(747,172)	(2,228,244)	-
Other income (expense), net	126,100	(134,817)	(186,805)	111,859	31,976
Change in fair value of warrants	252,062	1,793,572	(1,031,330)		
Foreign currency exchange loss	(430,723)	(88,613)	(69,077)	(397,299)	(150,729)
	(782,187)	1,985,905	(1,909,097)	(2,304,182)	(48,056)

Income before income tax	20,073,621	21,012,903	23,143,710	18,758,010	11,029,993
Provision for income tax	4,811,689	3,792,531	4,312,923	3,567,642	1,913,923
Net income	15,261,932	17,220,372	18,830,787	15,190,368	9,116,070
Other comprehensive income					
Foreign currency translation gain	4,150,348	6,953,126	52,959	5,184,035	2,637,573
Comprehensive income	$19,412,280	$24,173,498	$18,883,746	$20,374,403	$11,753,643
Weighted average shares outstanding					
Basic	21,418,389	21,268,972	16,624,294	14,600,154	13,100,340
Diluted	21,418,389	21,430,867	16,830,907	14,645,070	13,150,901
Earnings per share					
Basic	$0.71	$0.81	$1.13	$1.04	$0.70
Diluted	$0.71	$0.80	$1.12	$1.04	$0.69
BALANCE SHEETS DATA (at end of year):					
PROPERTY AND EQUIPMENT, net	$174,097,754	$82,769,171	$72,713,012	$76,028,272	$32,291,995
Working capital	$(7,775,122)	$12,478,142	$46,661,041	$4,989,448	$13,581,900
TOTAL ASSETS	$276,983,808	$247,448,555	$197,614,516	$118,262,291	$53,289,998
Long-term liabilities	$54,055,151	$64,020,429	$46,837,925	$42,021,605	$-
Stockholders ’ equity	$190,757,311,	$170,047,296	$144,113,272	$71,648,421	$51,207,314

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This Annual Report contains statements that are forward-looking and, as such, are not historical facts. Rather, these statements constitute projections, forecasts and forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, as amended by Public Law 104-67. These statements are not guarantees of performance. They involve known and unknown risks, uncertainties, assumptions and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these statements. Such statements can be identified by the fact that they do not relate strictly to historical or current facts. These statements use words such as “believe,” “expect,” “should,” “strive,” “plan,” “intend,” “estimate,” “anticipate” or similar expressions. When we discuss our strategies or plans, we are making projections, forecasts or forward-looking statements. Actual results and stockholders’ value will be affected by a variety of risks and factors, including, without limitation, the recent crisis in worldwide financial markets, international, national and local economic conditions, merger, acquisition and business combination risks, financing risks, geo-political risks and acts of terror or war. Many of the risks and factors that will determine these results and stockholder values are beyond our ability to control or predict. These statements are necessarily based upon various assumptions involving judgment with respect to the future. You should carefully read the risk factor disclosure contained in “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2011, where we discuss many of the important factors currently known to management that could cause actual results to differ materially from those in our forward-looking statements.

All such forward-looking statements speak only as of the date of this Annual Report. We are under no obligation to, nor do we intend to, release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Overview

We are an integrated natural gas operator in the People’s Republic of China (referred to herein as China or the PRC), primarily involved in distribution of compressed natural gas, or CNG, through the CNG fueling stations owned by our variable interest entity, or VIE, Xi’an Xilan Natural Gas Co., Ltd. (referred to as XXNGC). As of December 31, 2011, our VIE owned and operated 37 CNG fueling stations, including 25 CNG fueling stations in Shaanxi Province and 12 CNG fueling stations in Henan Province. Our VIE owns our CNG fueling stations while we lease the land upon which our VIE-owned CNG fueling stations operate. For the year ended December 31, 2011, we sold 162,752,780 cubic meters of CNG through our fueling stations, compared to 169,441,928 cubic meters for the year ended December 31, 2010. Our VIE and its subsidiary, Lingbao Yuxi Natural Gas Co. Ltd. (“LYNG”), also install natural gas pipelines for, and distribute and sell piped natural gas to, residential and commercial customers in the city of Xi'an in Shaanxi Province, including Lantian County, and the districts of Lintong and Baqiao, and in the city of Lingbao in Henan Province, through a high pressure pipeline network of approximately 120 kilometers.

In addition, we have expanded into liquefied natural gas ("LNG") business and anticipate generating significant revenue from the LNG business. Our first LNG production facility, Shaanxi Jingbian Liquefied Natural Gas Co. Ltd. ("JBLNG"), located in Jingbian County, Shaanxi Province, commenced commercial production and sales on July 16, 2011. As of December 31, 2011, we had begun construction of ten LNG fueling stations in Shaanxi and Henan Provinces.

We are pursuing multiple, synergistic paths of growth through our VIE, XXNGC, and XXNGC's subsidiaries, all of which are based in the PRC. We intend to:

- continue to grow our LNG business through the ongoing construction of JBLNG and through the construction of LNG fueling stations in Shaanxi, Henan and Hubei Provinces;

- capitalize on the opportunities arising from the busy shipping activities on the Yangtze River by expanding into Hubei Province through the construction of LNG fueling stations located in harbors along the Yangtze River, inland LNG fueling stations and reserve LNG stations along the course of the Yangtze River, as well as continued development of conversion technologies and operations to modify river vessels to run on a mixture of LNG and diesel; and

- continue to expand our CNG business into Hubei Province by acquiring existing stations. We are currently evaluating additional sites for CNG fueling stations in Hubei Province.

For additional information regarding these growth initiatives, please see "*Recent Developments*" below.

Current Operations

We currently operate five main business lines:

- distribution and sales of CNG through our VIE-owned CNG fueling stations serving hybrid (natural gas/gasoline) powered vehicles. As of December 31, 2011, our VIE owned and operated 37 fueling stations in total;
- installation, distribution and sales of piped natural gas to residential and commercial customers through our VIE-owned pipelines. We distributed and sold piped natural gas to approximately 116,790 residential customers as of December 31, 2011;
- production and sales of LNG through our LNG production facility in Jingbian County, Shaanxi Province. Revenues from commercial production and sales of LNG started on July 16, 2011.
- distribution and sales of gasoline through our VIE-owned CNG fueling stations for gasoline and hybrid (natural gas/gasoline) powered vehicles (two of our VIE-owned CNG fueling stations were selling gasoline as of December 31, 2011); and
- conversion of gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles at our automobile conversion workshops.

We purchase all of the natural gas that we sell and distribute to our customers from our suppliers, and we are not directly involved in the mining or production of natural gas. We currently sell our natural gas in three forms: (i) we compress natural gas into CNG and sell it to our customers through CNG fueling stations, (ii) we distribute natural gas through pipelines to commercial and residential customers and (iii) we liquefy natural gas into LNG and sell and distribute to our customers.

We had total revenues of $124,221,526, $89,953,623 and $81,066,118 for the years ended December 31, 2011, 2010 and 2009, respectively. We had net income of $15,261,932, $17,220,372 and $18,830,787 for the years ended December 31, 2011, 2010 and 2009, respectively.

Recent Developments

LNG Business

As of December 31, 2011, we had invested $68.6 million in Phase I of the LNG project located in Jingbian Country, Shaanxi Province and expected to invest approximately an additional $0.38 million to satisfy installment payments to contractors. We commenced test runs of Phase I of the LNG plant during 2010 and, in December 2010, we conducted and completed further test runs, including testing the operation of various components and equipments of the plant. We completed production preparation and trial production in June 2011. On July 16, 2011, we completed most of the construction of Phase I of the LNG plant and began commercial production and sale of LNG. Phase I of the LNG plant has a processing capacity of 500,000 cubic meters of LNG per day, or approximately 150 million cubic meters of LNG per year. Customers of our LNG business mainly include city gas companies supplying industrial, commercial and residential pipeline end users, such as ENN Energy Holdings Ltd., Shaanxi Sanxin Energy & Chemical Ltd. and Changsha Ruihua Energy Equipment Ltd. The launch of the LNG plant is an important part of our integration strategies, which include strategic plans to develop our own network of LNG fueling stations in Shaanxi, Henan and Hubei Provinces.

The total expected cost of $68.7 million for the construction of Phase I of the LNG project is higher than what we originally anticipated. The increased costs were attributable to unforeseen cost overruns and escalations, including increased material and labor costs incurred to reinforce pilings based upon modified engineering analysis, and increased prices for land use rights, which we believe resulted from the energy resource exploration activities in nearby areas. Construction of Phase I of the LNG plant experienced delays due to policy changes with respect to tariff exemptions for core equipment imported by the Company and the increased international shipment time for ordered equipment.

In addition, as of December 31, 2011, we had invested $43.58 million for the construction of phases II and III of Jingbian LNG plant. We estimate that a further aggregate investment of $198.6 million will need to be made through December 2015 to finance the construction of Phase II and III of the LNG plant, which, upon completion, will have a processing capacity of 3,000,000 cubic meters of LNG per day, or approximately 900 million cubic meters of LNG per year. The expected completion date of Phase II and III of the LNG plant is December 2015.

On September 2, 2010, we announced the completion of our first LNG fueling station. The station is located in Hongqing District, Xi'an, and we believe it is the first LNG fueling station in Shaanxi Province. The LNG fueling station initially serves as a working model to showcase the market potential of LNG to future users rather than to generate revenues. As of December 31, 2011, ten LNG fueling stations were under construction in various locations in Shaanxi and Henan Provinces.

Hubei Province and Yangtze River

As of December 31, 2011, we had made certain progress in the expansion of both our CNG and LNG businesses into Hubei Province. In April 2010, we received the approval from local government authorities in Hubei Province to build LNG fueling stations, both inland and in harbors, and reserve LNG stations, along the Yangtze River. We are currently going through necessary procedures to prepare for the building of these LNG stations.

During the third quarter of 2010, we completed the acquisition of Hanchun Makou Yuntong Compressed Natural Gas Co., Ltd., or Makou, for a purchase price of $3,648,080. Makou owns and operates a CNG compressor station in Hanchuan City, Hubei Province, and purchases natural gas through pipelines, conducts compressing and sells natural gas on a wholesale basis through tankers to fueling stations in Hubei Province. Makou's compressor station currently has sufficient capacity to process 80,000 to 100,000 cubic meters of natural gas daily and is advantageously located near railways and arterial highways. We believe that the Makou acquisition laid the foundation for expanding our CNG business into Hubei Province.

On June 28, 2011, our VIE, XXNGC, entered into an Equity Transfer Agreement (the "Transfer Agreement") with five individual shareholders of Xiantao City Jinhua Gas and Oil Co., Ltd. ("XTJH"). Pursuant to the Transfer Agreement, XXNGC will acquire a 58.5284% ownership of XTJH for a total purchase price of approximately $1,905,099 (RMB 12,290,964). The effectiveness of the Transfer Agreement is subject to the satisfaction of certain conditions. During the fourth quarter of 2011, the Company paid $976,500 (RMB 6,300,000), and made a payment of $310,000 (RMB 2,000,000) in January 2012, and then on February 29, 2012, the Company paid an additional payment of approximately $337,000(RMB 2,142,857), for the purchase of the equity interest in XTJH. Through the acquisition of XTJH, we will have our own fueling station available locally, which will increase our revenue and share in the local market. As of December 31, 2011, the transfer of the assets was under progress and the company had not exercised full control over its operations, therefore, the accounts of XTJH are not included in our consolidated financial statements.

As of December 31, 2011, we also engaged in developing market demand for our natural gas products along the Yangtze River. By leveraging our automobile conversion know-how, we are developing conversion technologies and operations to modify river vessels so that they can be powered by a mixture of LNG and diesel. In August 2010, a tugboat, modified by us to operate on a mixture consisting of 70% LNG and 30% diesel, completed its maiden voyage on the Yangtze River. We believe it was the first time that an LNG-powered ship navigated China's domestic waterways.

Shaanxi and Henan Provinces

During the first quarter of 2011, we closed one CNG fueling station in Shaanxi Province due to changes in market conditions, and in October, 2011, we closed another CNG fueling station in Shaanxi Province because the district will be demolished for urban redevelopment. As a result, as of December 31, 2011, XXNGC operated 25 CNG fueling stations in Shaanxi Province and 12 CNG fueling stations in Henan Province. Four gasoline fueling stations were closed in November and December 2010, due to changes in market conditions in their respective local areas. During the first quarter of 2011, we reopened one of the previously closed gasoline fueling stations and during the second quarter of 2011, we closed another station. During the fourth quarter of 2011, we closed another two of our gasoline fueling stations due to changes in market situations. As of December 31, 2011, we operated two gasoline fueling stations.

Factors Affecting Our Results of Operations

Significant factors affecting our results of operations are:

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Successful expansion of our CNG business. As of December 31, 2011, we operated 37 CNG fueling stations in total, with 25 CNG fueling stations in Shaanxi Province alone, therefore maintaining a stable and significant presence in these vital market regions. Upon the successful completion of the acquisition of XTJH, we will have our own fueling station available locally in Hubei Province, which will enhance our presence in the region and increase our revenue and share in the local market. We plan to expand the network of our VIE-owned CNG fueling stations through constructing new stations as well as acquiring existing stations, when we consider the market conditions to be favorable. We are currently evaluating sites for additional CNG fueling stations in Hubei Province.

Successful launch and development of our LNG business. On July 16, 2011, we completed most of the construction of Phase I of our LNG plant in Jingbian County, Shaanxi Province and began commercial production and sale of LNG. Phase I of the LNG plant has a processing capacity of 500,000 cubic meters of LNG per day, or approximately 150 million cubic meters of LNG per year. Revenues from the completed Phase I of the LNG plant have been realized during the third quarter of 2011. In addition, Phases II and III of the LNG plant are planned to be completed by December 2015, adding processing capacity of 3,000,000 cubic meters of LNG per day, or approximately 900 million cubic meters of LNG per year. We anticipate significant revenues from the LNG business in the future.

Regulation of natural gas prices in the PRC. The prices at which we purchase our natural gas supplies and sell CNG and pipeline natural gas products are strictly regulated by the PRC central government, including the National Development and Reform Commission, or the NDRC. Local pricing administrations have the discretion to set natural gas prices within the price range set by the PRC central government. Our revenue increased by 38.1% during the year ended December 31, 2011, compared to the year ended December 31, 2010, largely due to the increase in the sales prices of our natural gas in Shaanxi and Henan Provinces based on regulatory changes implemented by the PRC government during the fourth quarter of 2010. In addition, natural gas procurement and sales prices are not uniform across China and may vary from province to province. For example, the prices at which we procure and sell CNG and piped natural gas are usually lower in Shaanxi Province than in Henan Province. Accordingly, our results of operations and, in particular, our revenue, cost of revenue and gross profit and gross margin are affected significantly by factors that are outside of our control, including the regulation of natural gas products both on the national and local levels. As we expand our natural gas business into other provinces, we expect our results of operations to continue to be affected significantly by the regulations over natural gas prices in the PRC.

Government policies encouraging the adoption of cleaner burning fuels. Our results of operations for the periods covered by this report have benefited from environmental regulations and programs in the PRC that promote the use of cleaner burning fuels, including natural gas, for vehicles. As an enterprise engaged in the natural gas industry, our VIE, XXNGC, benefits from a reduced income tax rate of 15% compared to the standard 25% enterprise income tax rate in the PRC. In addition, the PRC government has encouraged companies to invest in and build the necessary transportation, distribution and sales infrastructure for natural gas in various policy pronouncements, such as by officially including CNG/gasoline hybrid vehicles in the PRC's "encouraged development" category. These policies have benefitted our results of operations by encouraging the demand for our natural gas products and also by lowering our expenses. As we intend to continue to expand into the LNG business, and our LNG plant in Jingbian has commenced commercial production and sale, we anticipate that our results of operations will continue to be affected by government policies encouraging the adoption of cleaner burning fuels and the increased adoption of CNG and LNG technologies.

The overall economic growth of China. We do not export our products and our results of operations are thus substantially affected by various economic factors, including the growth of the natural gas industry in the PRC, the increase in domestic residential, commercial and vehicular consumption, the overall growth of the economy of the PRC and related developments. While the PRC economy has experienced significant growth in the past 30 years, growth has been uneven across different regions and economic sectors. The PRC government has implemented various economic and political policies and laws and regulations to encourage economic development and to guide the allocation of resources. Some of these measures may benefit the overall PRC economy but may also have a negative effect on us. For example, our financial results may be adversely affected by government control over capital investments or changes in tax regulations that apply to us. The PRC government has also implemented certain measures recently, including interest rate increases, to control the rate of economic growth to prevent the aggravation of inflation. These measures may suppress the level of economic activities in the PRC, possibly including slowing the growth of the PRC's domestic commodity markets. Any adverse changes to the policies of the PRC government or the laws and regulations of the PRC could have a material adverse effect on the overall economic growth of the PRC, which could adversely affect our business in turn.

Taxation

United States

We are incorporated in the State of Delaware and are subject to the tax laws of the United States. We incurred a net operating loss for income tax purposes for the years ended December 31, 2011, 2010 and 2009, and the estimated net operating loss carry-forwards for United States income tax purposes amounted to $10,259,949 and $4,934,195 as of December 31, 2011 and 2010, respectively, which may be available to reduce future years' taxable income. These carry-forwards will expire, if not utilized, through 2031. Our management believes that the realization of the benefits arising from these net operating loss carry-forwards appears to be uncertain due to our limited operating history and continuing losses for United States income tax purposes. Accordingly, we have provided a 100% valuation allowance at December 31, 2011, 2010 and 2009, respectively.

We paid franchise taxes of $188,102, $107,350 and $6,888 for the years ended December 31, 2011, 2010 and 2009, respectively, to the State of Delaware.

The PRC

Our subsidiary, VIE and its subsidiaries operate in the PRC. Starting January 1, 2008, pursuant to the tax laws of the PRC, general enterprises are subject to income tax at an effective rate of 25%. Based on certain income tax regulations adopted in 2001 to encourage the development of certain industries, including the natural gas industry, in the western regions of the PRC such as Shaanxi Province, XXNGC is subject to a reduced tax rate of 15%. Accordingly, except for income from XXNGC, which is subject to the reduced tax rate of 15%, income from Shaanxi Xilan Natural Gas Equipment Co., Ltd. (referred to as SXNGE, a wholly foreign owned enterprise), Jingbian Xilan LNG Co., Ltd (referred to as SJLNG, a wholly owned subsidiary of XXNGC), Xi'an Xilan Auto Body Shop Co., Ltd. (referred to as XXABC, a wholly owned subsidiary of XXNGC), Henan Xilan Natural Gas Co., Ltd. (referred to as HXNGC, a wholly owned subsidiary of XXNGC), Lingbao Yuxi Natural Gas Co., Ltd (referred to as Lingbao Yuxi, a wholly owned subsidiary of XXNGC), Hubei Xilan Natural Gas Co., Ltd. (referred to as HBXNGC, a wholly owned subsidiary of XXNGC) and Hanchuan Makou Yuntong Compressed Natural Gas Co., Ltd. (referred to as Makou, a wholly owned subsidiary of HBXNGC) are subject to the 25% PRC income tax rate. Our effective income tax rate for the year ended December 31, 2011, 2010 and 2009 were approximately 24%, 18% and 19%, respectively.

Value-Added Tax. Sales revenue represents the invoiced value of goods, net of a value-added tax, or VAT. The products of our VIE, XXNGC, and two of XXNGC's subsidiaries, Lingbao Yuxi Natural Gas co., Ltd. (or "Lingbao Yuxi"), and Makou, that are sold in the PRC are subject to a PRC VAT at a rate of 13% of the gross sales price. Under PRC tax laws, the VAT may be offset by VAT paid by XXNGC or Lingbao Yuxi or Makou, as applicable, on purchased raw materials and other materials included in the cost of producing their finished products. XXNGC recorded VAT payable and VAT receivable net of payments in our financial statements. The VAT tax return is filed offsetting the payables against the receivables. When output tax of VAT is greater than input tax of VAT, the tax difference will be paid to the tax bureaus at different government levels.

All revenues from XXNGC's wholly owned subsidiary, XXABC, are subject to a PRC VAT at a rate of 6%. This VAT cannot be offset with VAT paid for purchased materials included in the cost of revenues.

Results of Operations

The following table sets forth certain information regarding our results of operations for the years ended December 31, 2011, 2010 and 2009.

	Years Ended December 31,		
	2011	2010	2009
Revenue			
Natural gas	$106,178,398	$71,367,502	$62,236,342
Gasoline	5,998,022	7,522,412	6,384,172
Installation and other	12,045,106	11,063,709	12,445,604
	124,221,526	89,953,623	81,066,118
Cost of revenue			
Natural gas	65,062,505	38,651,298	29,478,854
Gasoline	5,756,960	7,050,003	5,993,207
Installation and other	5,183,985	4,838,858	5,432,978
	76,003,450	50,540,159	40,905,039
Gross profit	48,218,076	39,413,464	40,161,079
Operating expenses			
Selling	17,377,703	13,254,923	10,607,596
General and administrative	9,984,565	7,131,543	4,500,676
	27,362,268	20,386,466	15,108,272
Income from operations	20,855,808	19,026,998	25,052,807
Non-operating income (expense):			
Interest income	42,290	418,763	125,287
Interest expense	(771,916)	-	(747,172)
Other income (expense), net	126,100	(137,817)	(186,805)
Change in fair value of warrants	252,062	1,793,572	(1,031,330)
Foreign currency exchange loss	(430,723)	(88,613)	(69,077)
	(782,187)	1,985,905	(1,909,097)
Income before income tax	20,073,621	21,012,903	23,143,710
Provision for income tax	4,811,689	3,792,531	4,312,923
Net income	15,261,932	17,220,372	18,830,787
Other comprehensive income			

Foreign currency translation gain	4,150,348	6,953,126	52,959
Comprehensive income	$19,412,280	$24,173,498	18,883,746

Year Ended December 31, 2011 compared to Year Ended December 31, 2010

The following table represents the consolidated operating results for the years ended December 31, 2011 and 2010:

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Sales Revenues

The following table sets forth a breakdown of our revenues for the years indicated:

	December 31, 2011	December 31, 2010	Increase (decrease) in dollar amount		Increase (decrease) in percentage	
Natural gas from fueling stations	$77,996,838	$65,285,236	$ 12,711,602		19.5	%
Natural gas from pipelines	7,852,525	6,082,266	1,770,259		29.1	%
Liquefied natural gas	20,329,035	-	20,329,035		-	
Gasoline	5,998,022	7,522,412	(1,524,390	)	(20.3	)%
Installation	10,061,088	9,458,242	602,846		6.4	%
Automobile conversion	1,984,018	1,605,467	378,551		23.6	%
Total	$124,221,526	$89,953,623	$ 34,267,903		38.1	%

Overall. Total revenue for the year ended December 31, 2011 increased to $124,221,526 from $89,953,623 for the year ended December 31, 2010, an increase of $34,267,903 or 38.1%, due to the reasons discussed below. We sold 246,729,831 cubic meters of natural gas, including 188,850,630 cubic meters of CNG and 57,879,201 cubic meters (35,519.9 tons) of LNG, during the year ended December 31, 2011 compared to 190,481,315 cubic meters during the year ended December 31, 2010. For the year ended December 31, 2011, 90.3% of our revenue was generated from the sale of natural gas and gasoline, and the remaining 9.7% was generated from our installation and automobile conversion services.

Natural Gas from Fueling Stations. Natural gas revenue from our fueling stations increased by 19.5%, or $12,711,602, to $77,996,838 during the year ended December 31, 2011, from $65,285,236 during the year ended December 31, 2010, and contributed 62.8% of our total revenue for the year ended December 31, 2011, which was the largest contributor to revenue among our major business lines. During the year ended December 31, 2011, we sold 162,752,780 cubic meters of CNG, compared to 169,441,928 cubic meters during the year ended December 31, 2010, through our fueling stations. Though sales volume decreased over the period, sales revenue actually increased, because the average unit selling price per cubic meter of CNG increased to $0.49 (RMB 3.13) during the year ended December 31, 2011from $0.39 (RMB 2.64) during the year ended December 31, 2010, net of VAT, due to the increase in the sales prices of our natural gas in Shaanxi and Henan Provinces caused by regulatory changes implemented by the PRC government during the fourth quarter of 2010. With respect to average sales revenue and volume per station, in the year ended December 31, 2011, we sold approximately $2,066,141 and 4,311,332 cubic meters of CNG per station, respectively, compared to approximately $1,695,720 and 4,401,089 cubic meters, respectively, in the year ended December 31, 2010.

Natural Gas from Pipelines. Natural gas revenue from our pipelines increased by 29.1%, or $1,770,259, to $7,852,525 during the year ended December 31, 2011, from $6,082,266 during the year ended December 31, 2010, and contributed 6.3% of our total revenue for the year ended December 31, 2011. As of December 31, 2011, we had 116,790 pipeline customers, an increase of 1,311 customers from 115,479 customers as of December 31, 2010. We sold 26,097,850 cubic meters of natural gas through our pipelines during the year ended December 31, 2011, compared to 21,039,387 cubic meters during the year ended December 31, 2010, an increase of 24.0%, primarily due to the increase of customers in Xi'an.

Liquefied Natural Gas. Our LNG production facility in Jingbian County, Shaanxi Province started operations in July 2011. Revenue from LNG was $20,329,035 during the year ended December 31, 2011, and contributed 16.4% of our total revenues for the year ended December 31, 2011. We sold 57,879,201 cubic meters of LNG, and the average unit selling price per cubic meter was $0.35 (RMB 2.27), net of VAT, during the year ended December 31, 2011

Gasoline. Revenue from gasoline sales decreased by 20.3%, or $1,524,390, to $5,998,022 during the year ended December 31, 2011 from $7,522,412 during the year ended December 31, 2010, and contributed 4.8% of our total revenue for the year ended December 31, 2011. The decrease was primarily attributable to the sales volume decrease of 33.8% from 9,624,555 liters to 6,368,498 liters, because of the closure of six of our eight gasoline fueling stations during the fourth quarter of 2010 and the fourth quarter of 2011. The average unit sales price of gasoline increased by 20.5%, from $0.78 (RMB 5.28) per liter, net of VAT, in the year ended December 31, 2010 to $0.94 (RMB 6.08) per liter in the year ended December 31, 2011, compensating for the significant decrease in sales volume to a certain degree.

Installation Services. Revenue from installation services increased by 6.4%, or $602,846, to $10,061,088 during the year ended December 31, 2011, from $9,458,242 during the year ended December 31, 2010, mainly due to the increase of pipeline customers, and contributed 8.1% of our total revenue for the year ended December 31, 2011. Revenue from our four largest customers accounted for 5.8%, 5.4%, 5.2% and 5.1%, respectively, of our total installation revenue for the year ended December 31, 2011.

Automobile Conversion Services. Revenue from our automobile conversion division increased by 23.6%, or $378,551, to $1,984,018 during the year ended December 31, 2011, from $1,605,467 during the year ended December 31, 2010, mainly due to the increase of customers, and contributed 1.6% of our total revenue for the year ended December 31, 2011.

Cost of Revenue

The following table sets forth a breakdown of our cost of revenue for the years indicated:

	December 31, 2011	December 31, 2010	Increase / (decrease) in dollar amount	Increase / (decrease) in percentage	
Natural gas from fueling stations	$ 43,784,390	$ 34,256,983	$ 9,527,407	27.8	%
Natural gas from pipelines	6,014,860	4,394,315	1,620,545	36.9	%
Liquefied natural gas	15,263,255	-	15,263,255	-	
Gasoline	5,756,960	7,050,003	(1,293,043)	(18.3	)%
Installation	3,955,852	3,859,961	95,891	2.5	%
Automobile conversion	1,228,133	978,897	249,236	25.5	%
Total	$ 76,003,450	$ 50,540,159	$ 25,463,291	50.4	%

Overall. Our cost of revenue consists of the cost of natural gas and gasoline sold, installation costs and other costs. Costs of natural gas sold from fueling stations and pipelines as well as costs of gasoline sold consist mainly of procurement costs from our suppliers. Costs of LNG consist mainly of procurement costs of natural gas and processing costs. Costs of installation and others include the expenditures that were incurred to connect customers to our pipeline system, and the cost for converting gasoline-fueled vehicles into natural gas-fueled hybrid vehicles.

Our cost of revenue for the year ended December 31, 2011 was $76,003,450, an increase of $25,463,291, or 50.4%, from $50,540,159 for the year ended December 31, 2010, mainly attributable to the addition of costs of revenue of LNG, which started in July 2011, and the increase in average procurement costs of natural gas. Our average costs of revenue of all natural gas sold per cubic meter of natural gas increased to $0.26 (RMB1.70) for the year ended December 31, 2011 from $0.20 (RMB 1.37) for the comparable period in 2010. As a comparison, our total revenues increased by 38.1% for the year ended December 31, 2011 from the year ended December 31, 2010.

Natural Gas from Fueling Stations. Cost of revenue of our natural gas for our fueling stations increased by 27.8%, or $9,527,407, to $43,784,390 during the year ended December 31, 2011 from $34,256,983 for the year ended December 31, 2010. The increase was primarily due to the increase in average procurement costs per cubic meter of our natural gas for our fueling stations from $0.20 (RMB 1.37), net of VAT, for the year ended December 31, 2010, to $0.27 (RMB 1.74), net of VAT, during the year ended December 31, 2011. However, the average procurement cost remained materially below the natural gas retail price of $0.49 (RMB 3.13) per cubic meter, net of VAT, during the year ended December 31, 2011.

Natural Gas from Pipelines. Cost of revenue of our natural gas sold through our pipelines increased by 36.9%, or $1,620,545, to $6,014,860 during the year ended December 31, 2011 from $4,394,315 during the year ended December 31, 2010. The increase was primarily due to the increase in sales volume.

Liquefied Natural Gas. Cost of revenue from LNG was $15,263,255 during the year ended December 31, 2011, and the average cost of revenue per cubic meter was $0.26 (RMB 1.70), net of VAT, during the year ended December 31, 2011.

Gasoline. Cost of gasoline revenue decreased by 18.3% or $1,293,043, to $5,756,960 during the year ended December 31, 2011 from $7,050,003 for the year ended December 31, 2010. The decrease of cost of gasoline revenue was primarily due to the closure of four and two out of eight gasoline fueling stations of ours during the fourth quarter of 2010 and the fourth quarter of 2011, respectively. The average procurement cost per liter increased from $0.73 (RMB 4.95), net of VAT, during the year ended December 31, 2010 to $0.90 (RMB 5.82), net of VAT, during the year ended December 31, 2011.

Installation Services. Cost of revenue from our installation services increased by 2.5%, or $95,891, to $3,955,852 during the year ended December 31, 2011 from $3,859,961 during the year ended December 31, 2010, primarily as a result of the increase in the number of our pipeline customers.

Automobile Conversion Services. Cost of our automobile conversion revenue increased by 25.5%, or $249,236, to $1,288,133 during the year ended December 31, 2011 from $978,897 during the year ended December 31, 2010, which is consistent with the increase in sales revenue.

Gross Profit

The following table sets forth a breakdown of our gross profit for the years indicated:

	December 31, 2011	December 31, 2010	Increase (decrease) in dollar amount	Increase (decrease) in percentage	
Natural gas from fueling stations	$ 34,212,448	$ 31,028,253	$ 3,184,195	10.3	%
Natural gas from pipelines	1,837,665	1,687,951	149,714	8.9	%

Liquefied natural gas	5,065,780	-	5,065,780		-	
Gasoline	241,062	472,409	(231,347	)	(49.0	)%
Installation	6,105,236	5,598,281	506,955		9.1	%
Automobile conversion	755,885	626,570	129,315		20.6	%
Total	$ 48,218,076	$ 39,413,464	$ 8,804,612		22.3	%

We earned a gross profit of $48,218,076 for the year ended December 31, 2011, an increase of $8,804,612, or 22.3%, from $39,413,464 for the year ended December 31, 2010. The increase in gross profit was primarily attributable to the increase in sales revenues, although our gross profit margin decreased, as discussed below.

Gross Margin

Gross margin for natural gas sold through our fueling stations decreased from 47.5% in the year ended December 31, 2010 to 43.9% in the year ended December 31, 2011, primarily due to our average purchasing cost of natural gas increasing at a greater rate than that of our average sales price of natural gas.

Gross margin for natural gas sold through pipelines was 23.4% during the year ended December 31, 2011, decreased from 27.8% during the year ended December 31, 2010, primarily because our average purchasing costs of natural gas had increased at a greater rate than that of our average sales price of natural gas.

Gross margin for our LNG business was 24.9% in the year ended December 31, 2011. This gross margin is lower than that of CNG sold through fueling stations, because till the end of the year 2011, we had been selling LNG only to industrial customers at wholesale price. We expect that the gross margin of LNG sales may be improved after our own LNG fueling stations start operations and sell LNG at retail price.

Gross margin for gasoline sales decreased from 6.3% during the year ended December 31, 2010 to 4.0% during the year ended December 31, 2011, primarily due to a larger portion of the gasoline sales being made to industrial customers at wholesale prices, which were usually lower than the retail prices we offered to individual customers and therefore with a lower gross margin.

Gross margin for our installation business increased slightly to 60.7% in the year ended December 31, 2011, from 59.2% in the year ended December 31, 2010.

Gross margin for our automobile conversion business decreased from 39.0% in the year ended December 31, 2010 to 38.1% in the year ended December 31, 2011, mainly due to intensified competition in the market.

Our total gross margin decreased from 43.8% for the year ended December 31, 2010 to 38.8% for the year ended December 31, 2011, primarily due to the current lower gross margin level of our LNG business, as compared to the gross margins of those business lines making greatest contribution to revenues, and the growth rate of sales price of natural gas products being lower than that of the purchase costs of natural gas.

Operating Expenses

We incurred operating expenses of $27,362,268 for the year ended December 31, 2011, an increase of $6,975,802, or 34.2%, compared to $20,386,466 for the year ended December 31, 2010.

Selling expenses increased by $4,122,780, or 31.1%, to $17,377,703 for the year ended December 31, 2011, from $13,254,923 for the year ended December 31, 2010, primarily due to the increase of $1,490,410 in depreciation mainly associated with the operations of our LNG plant, which started in July 2011, and $1,415,105 in salaries of the staff as a result of the growth in the number of staff and the increase in general salary levels. Transportation cost during the year ended December 31, 2011 was approximately $3,605 per million cubic meters of natural gas, compared to $4,903 per million cubic meters of natural gas for the year ended December 31, 2010. The decrease was mainly attributable to the lower average transportation cost of LNG due to the decrease in its unit volume as a result of liquification.

General and administrative expenses increased by $2,853,022, or 40.0%, from $7,131,543 for the year ended December 31, 2010 to $9,984,565 for the year ended December 31, 2011, primarily attributable to the increase of $2,216,345 in legal fees incurred in connection with a class action lawsuit brought against us and an investigation by the SEC on the Wang Loan, a related party transaction, and the increase of $686,916 in salaries and benefits for the staff, offset mainly by the decrease of $390,643 in stock-based compensation. An analysis by region or entity demonstrates that the general and administrative expenses for our operations in Hubei and Shaanxi Provinces, and the management expenses of SJLNG, a wholly owned subsidiary of XXNGC, increased, primarily due to the rapid growth and expansion of these entities.

Income from Operations and Operating Margin

Income from operations increased by $1,828,810, or 9.6%, to $20,855,808 for the year ended December 31, 2011 from $19,026,998 for the year ended December 31, 2010, primarily attributable to the realization of revenue and gross profit of LNG, which started in July 2011. Our operating margin for the year ended December 31, 2011 was 16.8%, as compared to 21.2% for the year ended December 31, 2010.

Non-Operating Income (Expense)

Non-operating expense was $782,187 for the year ended December 31, 2011, as compared to non-operating income of $1,985,905 for the year ended December 31, 2010, primarily due to the foreign currency exchange loss of $430,723 during the year ended December 31, 2011, mainly attributable to the loss on the Abax Senior Notes caused by material appreciation of the RMB against USD in recent years because such notes were denominated in RMB, while the repayment of the principals as well as interest should be made in USD equivalent, as compared to a loss of $88,613 for the year ended December 31, 2010.

Provision for Income Tax

Income tax was $4,811,689 for the year ended December 31, 2011, as compared to $3,792,531 for the year ended December 31, 2010, primarily due to the realization of revenue from our LNG plant, which started operations and sales in July 2011, and increased revenue of XXNGC. The effective income tax rate increased from 18.0% to 24.0% over this period, primarily attributable to the increase of general and administrative expenses in CHNG and certain subsidiaries of the VIE being in a start-up, non-operational stage (such as HBXNGC) and were not generating any revenue or profit during the year ended December 31, 2011. These subsidiaries of the VIE, however, incurred considerable amounts of selling expenses and general and administrative expenses for the period, materially reducing the amount of income before tax, the denominator in the calculation of the effective income tax rate. As a result, the effective income tax rate for the year ended December 31, 2011 rose materially.

Net income

Net income decreased to $15,261,932 for the year ended December 31, 2011, by $1,958,440, or 11.4%, from $17,220,372 for the year ended December 31, 2010. Net margin decreased to 12.3% in the year ended December 31, 2011 from 19.1% in the year ended December 31, 2010, primarily due to the increase in the average unit purchasing costs of natural gas at a higher rate than that of our sales prices, a lower gross margin generated from the LNG sales, and increased operating expenses.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009

The following table represents the consolidated operating results for the years ended December 31, 2010 and 2009:

Sales Revenues

The following table sets forth a breakdown of our revenues for the years indicated:

	December 31, 2010	December 31, 2009	Increase in dollar Amount	Increase in percentage
Natural gas from fueling stations	$ 65,285,236	$ 59,257,975	$ 6,027,261	10.2 %

Natural gas from pipelines	6,082,266	2,978,367	3,103,899	104.2 %
Gasoline	7,522,412	6,384,172	1,138,240	17.8 %
Installation	9,458,242	9,838,812	(380,570)	(3.9)%
Automobile conversion	1,605,467	2,606,792	(1,001,325)	(38.4)%
Total	$ 89,953,623	$ 81,066,118	$ 8,887,505	11.0 %

Overall. Total revenue for the year ended December 31, 2010 increased to $89,953,623 from $81,066,118 for the year ended December 31, 2009, an increase of $8,887,505 or 11.0%, due to the reasons discussed below. We sold 190,481,315 cubic meters of natural gas during the year ended December 31, 2010 compared to 176,424,700 cubic meters during the year ended December 31, 2009. For the year ended December 31, 2010, 87.7% of our revenue was generated from the sale of natural gas and gasoline, and the remaining 12.3% was generated from our installation and automobile conversion services.

Natural Gas from Fueling Stations. Natural gas revenue from our fueling stations increased by 10.2%, or $6,027,261, to $65,285,236 during the year ended December 31, 2010, from $59,257,975 during the year ended December 31, 2009, and contributed 72.6% of our total revenue, the largest of our four major business lines. The increase in natural gas revenue was primarily due to the addition of four new fueling stations during the second quarter of 2010 and one new fueling station in the third quarter of 2009, offset by the one fueling station closed during the third quarter of 2010. During the year ended December 31, 2010, we sold 169,441,928 cubic meters of compressed natural gas through our fueling stations compared to 164,343,895 cubic meters during the year ended December 31, 2009. In the year ended December 31, 2010, the average revenue of our fuel stations was $1,695,720 and the average sales volume was 4,401,089 cubic meters of compressed natural gas per station, compared to approximately $1,677,271 and 4,651,681 cubic meters, respectively, in the year ended December 31, 2009. The reason for the decline in per station sales was primarily due to the construction of main subway lines in Xi'an, which caused certain bus routes to deviate from our stations and resulted in decreased sales. During the year ended December 31, 2010, unit selling price was $0.37 (RMB 2.48) and $0.44 (RMB 2.98) net of VAT in Shaanxi and Henan Provinces, respectively, or $0.39 (RMB 2.64) on an average basis, compared to $0.34 (RMB 2.33) and $0.41 (RMB 2.83) net of VAT in Shaanxi Province and Henan Province, respectively, or $0.37 (RMB 2.5) on an average basis during the year ended December 31, 2009.

Natural Gas from Pipelines. Natural gas revenue from our pipelines increased by 104.2%, or $3,103,899, to $6,082,266 during the year ended December 31, 2010 from $2,978,367 during the year ended December 31, 2009, and contributed 6.8% of our total revenue. As of December 31, 2010, we had 115,479 pipeline customers, an increase of 7,056 customers from 108,423 customers as of December 31, 2009. We sold 21,039,387 cubic meters of natural gas through our pipelines during the year ended December 31, 2010, compared to 12,080,805 cubic meters during the year ended December 31, 2009. The increase was primarily due to the addition of 4,749,409 cubic meters of natural gas sold through Makou, which started to contribute revenue in August 2010.

Gasoline. Revenue from gasoline sales increased by 17.8%, or $1,138,240, to $7,522,412 during the year ended December 31, 2010 from $6,384,172 during the year ended December 31, 2009, and contributed 8.3% of our total revenue. The increase in gasoline revenue was primarily due to an increase of 21.4% in the average unit sales price of gasoline from $0.64 (RMB 4.39) per liter, net of VAT, in the year ended December 31, 2009 to $0.78 (RMB 5.28) per liter in the year ended December 31, 2010, mainly attributable to the increase in international oil prices, partially offset by the sales volume decrease of 2.6% from 9,885,482 liters to 9,624,555 liters, because two of our oil stations were closed in November, 2010 and another two stations were closed in December, 2010.

Installation Services. Revenue from installation services decreased by 3.9%, or $380,570, to $9,458,242 during the year ended December 31, 2010 from $9,838,812 during the year ended December 31, 2009, and contributed 10.5% of our total revenue. We believe that the decrease was primarily due to a slowdown in the property market, which led to a decrease in demand for installation services.

Automobile Conversion Services. Revenue from our automobile conversion division decreased by 38.4%, or $1,001,325, to $1,605,467 during the year ended December 31, 2010 from $2,606,792 during the year ended December 31, 2009, and contributed 1.8% of our total revenue. We believe that the decrease was primarily due to an increasing percentage of CNG vehicles having already undergone conversion, as well as increased market competition.

Cost of Revenue

The following table sets forth a breakdown of our cost of revenue for the years indicated:

	December 31, 2010	December 31, 2009	Increase in dollar amount	Increase in percentage
Natural gas from fueling stations	$ 34,256,983	$ 27,395,962	$ 6,861,021	25.0 %
Natural gas from pipelines	4,394,315	2,082,892	2,311,423	111.0 %
Gasoline	7,050,003	5,993,207	1,056,796	17.6 %
Installation	3,859,961	3,888,996	(29,035)	(0.7)%
Automobile conversion	978,897	1,543,982	(565,085)	(36.6)%
Total	$ 50,540,159	$ 40,905,039	$ 9,635,120	23.6 %

Overall. Our cost of revenue consists of the cost of natural gas and gasoline sold, installation costs and other costs. Cost of natural gas and gasoline sold consists mainly of the cost for purchases from our suppliers. Cost of installation and other costs include certain expenditures for connecting our customers to our pipeline network system, and the cost for converting gasoline-fueled vehicles into natural gas hybrid vehicles.

Our cost of revenue for the year ended December 31, 2010 was $50,540,159, an increase of $9,635,120, or 23.6%, from $40,905,039 for the year ended December 31, 2009. The increase was mainly attributable to an increase in procurement cost in Henan Province. Our revenue increased by 11.0% during the same period.

Natural Gas from Fueling Stations. Cost of revenue of our natural gas for our fueling stations increased by 25.0%, or $6,861,021, to $34,256,983 during the year ended December 31, 2010 from $27,395,962 for the year ended December 31, 2009. The increase in the cost of natural gas for our fueling stations was primarily due to the increase in average procurement prices in Henan Province from $0.17 (RMB 1.19, net of VAT, during the year ended December 31, 2009 to $0.25 (RMB 1.69), net of VAT, during the year ended December 31, 2010. However, the average procurement cost remained significantly below the natural gas retail price of $0.44 (RMB 2.98) net of VAT in Henan Province for both the year ended December 31, 2009 and the year ended December 31, 2010.

Natural Gas from Pipelines. Cost of revenue of our natural gas sold through our pipelines increased by 111.0%, or $2,311,423, to $4,394,315 during the year ended December 31, 2010 from $2,082,892 during the year ended December 31, 2009, which was basically in line with the growth in sales revenue.

Gasoline. Cost of gasoline revenue increased by 17.6% or $1,056,796, to $7,050,003 during the year ended December 31, 2010 from $5,993,207 for the year ended December 31, 2009. The increase of cost of gasoline revenue was primarily due to the increase in average procurement cost per liter from $0.61 (RMB 4.13), net of VAT, during the year ended December 31, 2009 to $0.73 (RMB 4.95), net of VAT, during the year ended December 31, 2010, which we believe was mainly attributable to the increase in international oil prices. The increase in the cost of gasoline revenue was partly offset by the decrease in sales volume.

Installation Services. Cost of revenue from our installation services decreased by 0.7%, or $29,035, to $3,859,961 during the year ended December 31, 2010 from $3,888,996 during the year ended December 31, 2009, mainly due to the decreased cost of labor and materials.

Automobile Conversion Services. Cost of our automobile conversion revenue decreased by 36.6%, or $565,085, to $978,897 during the year ended December 31, 2010 from $1,543,982 during the year ended December 31, 2009, which was basically in line with the decrease in revenue from automobile conversion services.

Gross Profit

The following table sets forth a breakdown of our gross profit for the periods indicated:

	December 31, 2010	December 31, 2009	Increase in dollar amount	Increase in percentage
Natural gas from fueling stations	$ 31,028,253	$ 31,862,013	$ (833,760)	(2.6)%
Natural gas from pipelines	1,687,951	895,475	792,475	88.5 %
Gasoline	472,409	390,965	81,444	20.8 %
Installation	5,598,281	5,949,816	(351,535)	(5.9)%
Automobile conversion	626,570	1,062,810	(436,240	(41.0)%
Total	$ 39,413,464	$ 40,161,079	$ (747,615)	(1.9)%

We earned a gross profit of $39,413,464 for the year ended December 31, 2010, a decrease of $747,615, or 1.9%, from $40,161,079 for the year ended December 31, 2009. The decrease in gross profit was primarily due to the increased cost of fueling station revenue in Henan Province.

Gross Margin

Gross margin for natural gas sold through our fueling stations decreased from 53.8% in the year ended December 31, 2009 to 47.5% in the year ended December 31, 2010, mainly due to increased procurement costs for natural gas for fueling stations in Henan Province.

Gross margin for natural gas sold through pipelines was 27.8% during the year ended December 31, 2010, a slight decrease as compared to 30.1% during the year ended December 31, 2009. The decline was mainly due to the increase in the sales price, as denominator, while the amount of gross profit, as numerator, remained stable, as sales price and procurement cost increased in approximately the same proportion.

Gross margin for gasoline sales increased from 6.1% during the year ended December 31, 2009 to 6.3% during the year ended December 31, 2010, primarily due to a greater increase in gasoline retail price compared with the increase in procurement prices for gasoline.

Gross margin for our installation business decreased to 59.2% in the year ended December 31, 2010 from 60.5% in the year ended December 31, 2009, mainly due to increased cost of labor and materials used in installation.

Gross margin for our automobile conversion business decreased from 40.8% in the year ended December 31, 2009 to 39.0% in the year ended December 31, 2010, mainly due to intensifying competition and the resulted decrease in conversion prices.

Our total gross margin decreased from 49.5% for the year ended December 31, 2009 to 43.8% for the year ended December 31, 2010, mainly caused by higher procurement costs for natural gas for fueling stations in Henan Province,

Operating Expenses

We incurred operating expenses of $20,386,466 for the year ended December 31, 2010, an increase of $5,278,194, or 34.9%, compared to $15,108,272 for the year ended December 31, 2009.

Sales and marketing costs increased 25.0%, or $2,647,327, from $10,607,596 for the year ended December 31, 2009 to $13,254,923 for the year ended December 31, 2010, primarily due to an increase of $976,177 in depreciation expense, an increase of $406,372 in rental expense, an increase of $357,115 in transportation expense, an increase of $333,347 in salary, an increase of $365,008 in transportation expense, as well as an increase of $312,334 in electricity costs, primarily related to the addition of four new fueling stations in the second quarter of 2010 and one new fueling station in the third quarter of 2009, offset by the disposal of one fueling station during the third quarter of 2010. Transportation cost during the year ended December 31, 2010 was approximately $4,903 per million cubic meters of natural gas, compared to $2,834 per million cubic meters of natural gas for the year ended December 31, 2009.

General and administrative expenses increased by $2,630,867, or 58.5%, from $4,500,676 for the year ended December 31, 2009 to $7,131,543 for the year ended December 31, 2010, primarily reflecting the increase of $1,084,327 in non-cash expense of stock options granted to employees according to our employee stock option plan, $689,988 in legal fees, $240,505 in salaries, as well as increased Delaware franchise tax due to our increased outstanding share and asset base. In addition, the G&A expenses were also increased in Hubei and Shaanxi Provinces, as well as management cost in Jinbian Liquefied Natural Gas Co., Ltd., a subsidiary of XXNGC, due to a rapid expansion stage during 2010.

Income from Operations and Operating Margin

Income from operations decreased by $6,025,809, or 24.1%, to $19,026,998 for the year ended December 31, 2010 from $25,052,807 for the year ended December 31, 2009, primarily due to the increase in procurement costs and operating expenses, as explained in the above sections. Our operating margin for the year ended December 31, 2010 was 21.2%, as compared to 30.9% for the year ended December 31, 2009.

Other income (expense)

Other income was $1,985,905 for the year ended December 31, 2010, as compared to other expense of $1,909,097 for the year ended December 31, 2009, primarily due to the $1,793,572 gain associated with a change in the fair value of our outstanding warrants, as compared to a loss of $1,031,330 from the change in the fair value of warrants for the year ended December 31, 2009. In addition, we capitalized $6,498,995 of interest expense for the year ended December 31, 2010, as compared to $4,597,544 of capitalized interest expense for the year ended December 31, 2009.

Provision for Income Tax

Income tax was $3,792,531 for the year ended December 31, 2010, as compared to $4,312,923 for the year ended December 31, 2009. The decrease was primarily due to lower operating income for the year ended December 31, 2010 as compared to the year ended December 31, 2009. The non-operating income from the change in fair value of warrants was not subject to income tax because we had incurred a net operating loss for income tax purpose for the year ended December 31, 2010.

Net income

For the reasons described in the above sections, net income decreased to $17,220,372 for the year ended December 31, 2010, by $1,610,415, or 8.6%, from $18,830,787 for the year ended December 31, 2009. Net margin decreased to 19.1% in the year ended December 31, 2010 from 23.2% in the year ended December 31, 2009.

Liquidity and Capital Resources

Historically, our primary sources of liquidity consisted of cash generated from our operations, debt financing and proceeds from equity offerings. Our principal uses of cash have been, and are expected to continue to be, working capital for operational purposes, as well as for satisfying capital investment, such as constructing our LNG plant in Jingbian County, Shaanxi Province and other projects. Due to the required repayment of 25% of the principal of the Abax Senior Notes, 25% of the principal of the loan from Shanghai Pudong Development Bank, and the short-term loans from Mr. Hao Qu, all of which are payable within one year from December 31, 2011, our current liabilities were larger than current assets as of December 31, 2011, resulting in negative working capital. We expect that the net cash generated from operations in the year 2012 will be sufficient to compensate for this negative working capital, based on our forecast of cash flows. On March 22, 2012, we entered into an agreement with Mr. Qu to extend the maturity dates of certain borrowing totaling $1.32 million to 2013. We will continue to obtain new short-term bank loans to finance our working capital, and long term loans to fund our capital expenditure projects, if necessary.

As of December 31, 2011, 2010 and 2009, we had $9,622,883, $10,046,249 and $48,177,794 of cash and cash equivalents on hand, respectively. The decrease was primarily attributable to the construction of the LNG plant and other projects, and the repayment of the loans from Shanghai Pudong Development Bank and of the principal of the Abax Senior Notes.

Net cash provided by operating activities was $24,479,256 for the year ended December 31, 2011, compared to net cash provided by operating activities of $16,702,003 for the year ended December 31, 2010, primarily due to the increase in accounts payable and accrued liabilities, and increase in unearned revenue, and adjustments for non-cash expense items, including depreciation and amortization expenses, offset mainly by the increase in accounts receivable and in advances to suppliers. Net cash provided by operating activities was $16,702,003 for the year ended December 31, 2010, compared to net cash provided by operating activities of $25,433,922 for the year ended December 31, 2009, primarily due to an increase in the advance payment to suppliers for purchase of raw materials and prepayment for constructions, and the increase in prepaid VAT for equipment purchased for the LNG plant, during the year ended December 31, 2010.

Net cash used in investing activities decreased from $73,171,441 during the year ended December 31, 2010 to $21,403,058 for the year ended December 31, 2011, primarily due to the significant decrease in the amount of additions to construction in progress, as the investments for phase I of JBLNG project had been mostly completed by the end of 2010. The decrease in other items, including prepayment for long-term assets, payment for acquisition of business, for intangible assets and for land use rights, also helped to reduce the amount of net cash used in investing activities over the period. Net cash used in investing activities increased from $37,537,257 during the year ended December 31, 2009 to $73,171,441 for the year ended December 31, 2010, mainly due to prepayments of $10,274,357 to equipment suppliers, and prepayments of $4,283,789 for land use rights, additions of $44,830,638 to construction in progress primarily related to the LNG plant, $10,548,122 related to the acquisition of four fueling stations and $3,582,256 related to the acquisition of Makou and loans receivable to related and non-related parties during the year ended December 31, 2010.

Net cash used in financing activities was $3,858,314 for the year ended December 31, 2011, primarily due to the repayment of the principals of the Abax Senior Notes and of the long term loan from Shanghai Pudong Development Bank (or “SPDB”), offset by the proceeds from the related party borrowings, including the short-term borrowings from Mr. Hao Qu, a former senior management member and a shareholder of the Company, and the short-term borrowings from our joint venture company, Henan CNPC Kunlun Xilan Compressed Natural Gas Co., Ltd,. On a comparable basis, net cash provided by financing activities was $18,429,000 for the year ended December 31, 2010, the primary source of which was the proceeds from a bank loan in the amount of $17,752,800 from SPDB as compared to net cash provided by financing activities of $54,370,359 for the year ended December 31, 2009,.

Based on our past performance and current expectations, we believe our cash and cash equivalents, as well as cash generated from operations, will satisfy most of our working capital needs. We will try to obtain new short-term bank loans to finance our working capital and to satisfy other liquidity requirements associated with our operations. As for capital expenditures, we will evaluate the necessity and availability of long-term bank loans or other long-term financing options.

The majority of our revenues and expenses were denominated primarily in RMB, the currency of the PRC. There is no assurance that exchange rates between the RMB and United States dollars will remain stable. Historically, inflation has not had a material impact on our business.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial conditions, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our investors.

Capital Expenditures

Our planned capital expenditures as of December 31, 2011 were approximately $221.4 million through December 2015, the majority of which were to be incurred in connection with Phase II and III of the LNG facility in Jingbian County, Shaanxi Province, the construction or acquisition of additional fueling stations and compressor stations, and the expansion of our operations in Hubei Province. We expect to fund the planned capital expenditures mainly through cash flows from operations as well as through potential bank loans or other forms of borrowing.

Outstanding Indebtedness

On December 30, 2007, we entered into a securities purchase agreement with Abax Lotus Ltd. ("Abax") and, on January 29, 2008, we entered into an amendment to such agreement with Abax (the "Purchase Agreement", as amended). Under the Purchase Agreement, on January 29, 2008, we sold to Abax $20,000,000 in principal amount of our 5.0% Guaranteed Senior Notes due 2014 (the "Senior Notes") and warrants to purchase 1,450,000 shares of our common stock and, on March 3, 2008, we issued to Abax an additional $20,000,000 in principal amount of Senior Notes.

We are required to make mandatory prepayments on the Senior Notes on certain dates and we are subject to customary covenants for financings of this type, including restrictions on the incurrence of liens, payment of dividends and disposition of properties as well as being obligated to maintain certain financial ratios. On August 5, 2011, the Company paid the first balance due equal to 8.3333% of the principal amount outstanding. The second repayment for 8.3333% of the principal of the Senior Notes was due on January 30, 2012. After negotiations with Abax, the note-holders agreed that the Company could make the payment on or before March 9, 2012. On March 7, 2012, the Company paid the principal due on January 30, 2011 in full plus accrued interest, as well as penalty interest of $7,393. Abax issued a waiver to exempt the Company from any other consequences of the late payment.

Long-Term Loan

On February 26, 2010, JBLNG entered into a fixed assets loan contract with Shanghai Pudong Development Bank Xi'an Branch ("SPDB"), pursuant to which the SPDB agreed to lend $18,564,000 to JBLNG. SPDB transferred $13,923,000 and $4,641,000 to JBLNG on March 17 and May 28, 2010, respectively. The applicable interest rate of this loan is the standard three- to five-year rate issued by the People's Bank of China's, 5.76% for the first year and subject to adjustment commencing the second year. As the People's Bank of China adjusted the standard interest rate two times on October and December 2010 respectively, since January 1, 2011 the interest rate of these loans had been adjusted to 6.22%. Later the People's Bank of China adjusted the standard interest rate in February, April and July 2011, so beginning January 1, 2012 the interest rate of these loans had been adjusted to 6.90%.The repayment term was amended in October 2011. According to the amended contract, the loan period is 58 months from the date of effectiveness of the contract, and will be repaid twice a year, with the last repayment no later than December 5, 2014. The loan is guaranteed by XXNGC and secured by XXNGC's equipment and vehicles located within PRC. Pursuant to the long-term loan agreement with Pudong Development Bank Xi'an Branch, the Company repaid the principal of $775,000 (RMB 5,000,000), $3,875,000 (RMB 25,000,000) and $775,000 (RMB 5,000,000) to the SPDB on October 10, 2011, December 31, 2011 and March 5, 2012, respectively.

Contractual Obligations

Our contractual obligations are as follows:

	Payments due by period				
Contractual obligations	Total	Less than 1 year	1-3 Years	3-5 years	More than 5 years
			(in thousands)		
Long-term debt obligations(1)	$35,463	$9,672	$ 25,791	$-	$ -
Operating lease obligations(2)	39,748	2,027	4,141	3,747	29,833
Purchase obligations (3)	7,569	7,569	-	-	-
Other long-term liabilities reflected on balance sheet (4)	17,500	-	-	17,500	-
Related party debt (5)	2,680	1,360	1,320	-	-
Long-term loan	14,166	4,722	9,444	-	-
Total	$117,126	$25,350	$ 40,696	$21,247	$ 29,833

(1) Please refer to Note 4 to our consolidated financial statements for the year ended December 31, 2011.

(2) The Company entered into a series of long-term lease agreements with outside parties to lease land use rights for the Company's CNG fueling stations located in the PRC. The agreements have terms ranging from 10 to 30 years. The Company makes annual prepayments for most of these lease agreements. The Company also entered into five office leases in Xi'an, PRC, one office lease in Wuhan, PRC, one office lease in Yichang, PRC, one office lease in Huangshi, PRCand one office lease in New York, United States of America ("USA").

(3) We have purchase commitments for materials, supplies, services and property and equipment for constructing the LNG plant and other construction in progress projects.

(4) The $17,500,000 reflects derivative liability related to the embedded put option in the 1,450,000 warrants we issued to Abax in January 2008. Abax is entitled to require us to purchase back the portion of warrants not exercised upon expiration.

(5) The $2,680,000 reflects related party debt to Mr. Hao Qu, a former employee of XXNGC and shareholder of the Company.

Natural Gas Purchase Commitments

We have existing long-term natural gas purchase agreements with our major suppliers. As of December 31, 2011, we maintained long-term natural gas purchase agreements with one of our vendors, Qinshui Lanyan Coal Bed Methane Co., Ltd. ("Qinshui Lanyan"). We do not expect any issues or difficulties in renewing our supply contracts with the vendor going forward.

We continued to seek lower-cost sources of supply and did not have commitments for the purchasing volume of natural gas to any suppliers except Qinshui Lanyan. Pursuant to the agreement with Qinshui Lanyan, we should purchase from Qinshui Lanyan a daily volume of approximately 200,000 cubic meters of coal bed gas. Prices of natural gas are strictly controlled by the PRC government.

The sales prices of both pipeline natural gas in Shaanxi Province and vehicular fuel in the city of Xi'an were raised on October 20, 2010. The sales price of pipeline natural gas in Shaanxi Province increased by $0.03 (RMB 0.23) per cubic meter for residential use. The sales prices for commercial and industrial use was increased by $0.05 and $0.08 (RMB 0.35 and RMB 0.55) per cubic meter, respectively. Additionally, the sales price of CNG for vehicular fuel in Xi'an was adjusted based on the target ratio of 0.6:1 to the retail price of Grade 90 gasoline. The retail price of CNG increased by $0.14 (RMB 0.9) per cubic meter. The adjusted prices took effect on October 20, 2010.

The sales prices of vehicular fuel in the cities of Kaifeng and Xuchang, Henan Province were raised on July 20, 2010 and August 1, 2010, respectively. The sales price of vehicular fuel in Kaifeng increased from $0.42 (RMB 3.30) to $0.46 (RMB 3.60) per cubic meter. The sales price of vehicular fuel in Xuchang increased from $0.41 (RMB 3.20) to $0.47 (RMB 3.65) per cubic meter. Additionally, the sale prices of CNG for vehicular fuel in Kaifeng was adjusted based on the target ratio of no less than 0.6:1 to the retail price of Grade 90 gasoline. The sale prices of CNG for vehicular fuel in Xuchang was adjusted to no less than 0.6:1 to the retail price of Grade 90 gasoline and would gradually be raised to the target ratio of no less than 0.75:1.

Foreign Currency Translations

Our reporting currency is the U.S. dollar ("USD"). The functional currency of XXNGC and XXNGC's PRC subsidiaries and, therefore, our functional currency, is the RMB. The results of operations and financial position of XXNGC and XXNGC's PRC subsidiaries are translated to USD using the period 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.

The balance sheet amounts, with the exception of equity, were translated at the December 31, 2011 exchange rate of RMB 6.35 to $1.00 as compared to RMB 6.59 to $1.00 at December 31, 2010. The equity accounts were stated at their historical rate. The average translation rates applied to income and cash flow statement amounts for the years ended December 31, 2011, 2010 and 2009, were 6.45 RMB, 6.76 RMB and 6.82 RMB to $1.00, respectively.

Critical Accounting Policies

Our discussion and analysis of our financial position and results of operations contained in this Annual Report on Form 10-K is based on our consolidated financial statements, contained elsewhere herein. The preparation of these financial statements in conformity with generally accepted accounting principles requires that we 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. There have been no material changes in the development of our accounting estimates or the assumptions underlying those estimates, or the accounting policies that we disclosed as our Critical Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2010.

Use of Estimates and assumptions

The preparation of the consolidated financial statements in conformity with U.S. GAAP 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. Significant accounting estimates reflected in the Company's consolidated financial statements include revenue recognition, allowance for doubtful accounts, inventory obsolescence, warrants liability and useful lives of property and equipment. Actual results could differ from those estimates.

Consolidation of Variable Interest Entity

In accordance with the accounting standard regarding consolidations, VIEs are 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. Any VIE with which the Company is involved must be evaluated to determine the primary beneficiary of the risks and rewards of the VIE. Management makes ongoing reassessments of whether the Company is the primary beneficiary of XXNGC.

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 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

Construction in Progress

Construction in progress consists of (1) the costs for constructing CNG fueling stations, the liquefied natural gas, or LNG, project in Jingbian County, and the natural gas infrastructure project in Xi'an International Port District and (2) other construction in progress costs, including 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.

Revenue Recognition

Revenue is recognized when services are rendered to customers and when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of ours 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. 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.

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 provide 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.

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 our notes payable and derivative liabilities were modeled using a series of techniques, including closed-form analytic formula, such as the Black-Scholes option-pricing model, which does not entail material subjectivity because the methodology employed does not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets.

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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 balance sheet would not be considered a derivative financial instrument. There is a 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. Changes in the fair value of warrants are recognized in the income statement.

Income Taxes

Deferred tax assets and liabilities are recognized 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 December 31, 2011 and 2010, there were no significant book to tax differences except for warrants liability and stock based compensation. An uncertain 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. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the year incurred. No significant penalties or interest relating to income taxes have been incurred during the years ended December 31, 2011, 2010 and 2009.

Long-Lived Assets

We evaluate the carrying value of long-lived assets to be held and used whenever events or changes in circumstances indicate that the assets might be impaired. Impairment losses are 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.

RECENT ACCOUNTING PRONOUNCEMENTS

See *"Note 2. Summary of Significant Accounting Policies"* in *"Item 1. Financial Statements"* herein for a discussion of the new accounting pronouncements adopted in this Annual Report on Form 10-K.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Natural Gas Price Risk

Our major market risk exposure continues to be the pricing applicable to our purchases and value-added reselling of CNG. Our revenues and profitability depend substantially upon the applicable prices of natural gas, which in China are regulated and fixed by central and local governments and do not fluctuate significantly. Such price stability is expected to continue for operations in China. We currently do not have any hedge positions in place to reduce our exposure to changes in natural gas wholesale and retail prices.

Interest Rate Risk

We are subject to interest rate risk on our long-term fixed-interest rate debt. Fixed rate debt, where the interest rate is fixed over the life of the instrument, exposes us to changes in market interest rates reflected in the fair value of the debt and to the risk that we may need to refinance maturing debt with new debt at a higher rate. All other things being equal, the fair value of our fixed rate debt will increase or decrease as interest rates change. We had interest-bearing long-term and short-term debts outstanding in an aggregate of $49,628,833 at December 31, 2011. The fixed-rate long-term debt, or the notes payable to Abax of $36,666,666, is due in installments beginning in January 2012 through January 2014. The most recent repayment of 8.3333% of the principal of the notes payable was due on January 30, 2012. After negotiations with Abax, the note-holders agreed that the Company could make the payment before March 9, 2012. On March 7, 2012, the Company paid the portion of the principal due on January 30, 2012 in full plus accrued interest for the period from July 30, 2011 to January 29, 2012, as well as a penalty interest of $7,393 for the period from February 6, 2012 to March 7, 2012. Abax issued a waiver to exempt the Company from any other consequences of the late payment. The fixed-rate loan from a related party of $2,679,945 is due during 2012. The remaining balance in the amount of $14,166,000, or the loan from Pudong Development Bank, bears interest at floating rates, and is due between 2012 and 2014. We repaid principal of $775,000 (RMB 5,000,000) due on March 5, 2012.We currently have no interest rate hedge positions in place to reduce our exposure to changes in interest rates.

Foreign Currency Exchange Rates Risk

We operate using China's local currency and the effects of foreign currency fluctuations are largely mitigated because local expenses in China are also denominated in the same currency.

Our assets and liabilities, of which the functional currency is the RMB, are translated into USD using the exchange rates in effect at the balance sheet date, resulting in translation adjustments that are reflected as cumulative translation adjustment in the stockholders' equity section on our consolidated balance sheets. A portion of our net assets are impacted by changes in foreign currencies translation rates in relation to the U.S. dollar. We recorded a foreign currency translation gain of $4,150,348 for the year ended December 31, 2011, to reflect the impact of the fluctuation of RMB against USD.

Legal Proceedings Risk

The Company and certain of its officers and directors have been named as defendants in a putative class action lawsuit alleging violations of the federal securities laws. Two motions for appointment of lead plaintiff and approval of selection of lead counsel were filed. On June 29, 2011, the court denied without prejudice both motions and ordered supplemental briefs from the motion filers on or before July 12, 2011.

On August 12, 2011, the Court entered an order appointing Robert Skeway, an individual investor, as lead plaintiff and approving his selection of lead counsel. Lead plaintiff and Raimundo Jo-Fung, another individual investor, who together seek to represent a class of all purchasers and acquirers of the Company's common stock between March 10, 2010 and September 21, 2011, filed an amended complaint on October 11, 2011. On December 12, 2011, we filed a motion to dismiss. Plaintiff's counsel filed its opposition to the motion to dismiss on March 2, 2012. We have until April 16, 2012 to file our reply brief with the court.

On June 16, 2008, James A. Garner, a former independent member of the Company's board filed a lawsuit against the Company and two other board members in New York State Supreme Court, Nassau County. The plaintiff alleges violations of Labor Law § 740, defamation, breach of contract, and fraud. The court ordered the Company to issue 20,000 options to the plaintiff subject to any restrictions required by applicable securities laws and dismissed all of plaintiff's remaining claims. On June 29, 2010, the Court of Appeals of New York denied plaintiff's motion for leave to appeal.

On December 5, 2011, plaintiff Haitham J. Kousa filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, Yang Xiang Dong, China Natural Gas, Inc. and The Nasdaq Stock Market, LLC, as defendants (C.A. No. 11-1202-SLR), and on January 17, 2012, plaintiff Robert Mallano also filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, Yang Xiang Dong, China Natural Gas, Inc., as defendants (C.A. No. 12-0048-SLR) (the "Constituent Actions"). The Constituent Actions allege, inter alia, breach of fiduciary duties, self-dealing, and misconduct by management for related-party loans to management and the failure to disclose such loans. The Constituent Actions were consolidated on February 14, 2012 and bear the following caption, In re China Natural Gas, Inc. Shareholder and Derivative Litigation (Consol. C.A. No. 11-1202-SLR). On March 19, 2012 the court granted Nasdaq's motion to dismiss, denied plaintiff's motion for appointment of a receiver and dismissed plaintiff's motion for expedited discovery.

On February 8, 2012, plaintiff Rick Steinmetz, filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, David She, Carl Yeung, Yang Xiang Dong, China Natural Gas, Inc., alleging the same or similar claims as in the Constituent Actions. This case has not yet been consolidated with the Constituent Actions, although we believe consolidation will occur soon.

We intend to defend these cases vigorously. We currently cannot estimate the outcome of these matters as of the date of this Report.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements and notes thereto are included herein beginning at page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There are no reportable disagreements with our current independent auditors, Friedman LLP.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this Report, and under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we conducted an evaluation of our disclosure controls and procedures that were in effect at the end of the period covered by this report. Disclosure controls and procedures is defined under Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as those controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Based on their evaluation and considering the material weaknesses previously identified in our internal control over financial reporting, as disclosed in the latest amendments to our quarterly financial statements for the periods ended March 31, 2010, June 30, 2010, September 30, 2010, March 31, 2011, June 30, 2011, and September 30, 2011, respectively, and to our annual financial statements for the year ended December 31, 2010 and as discussed below, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures that were in effect on December 31, 2011 were not effective.

Management’s Report on Internal Control over Financial Reporting

The Company’s management is responsible for establishing and maintaining an adequate system of internal control over financial reporting. Internal control over financial reporting is defined under Rule 13a-15(f) as a process designed by, or under the supervision of, an issuer's principal executive officer and principal financial officer, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and include those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statements.

In connection with this annual report, management has conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Evaluation Framework* developed by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on its evaluation under the *Internal Control - Evaluation Framework* and due to the material weaknesses evidenced by the events described below, management concluded that our internal control over financial reporting was not effective as of December 31, 2011. A material weakness is a control deficiency, or combination of control deficiencies, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented or detected on a timely basis by employees in the normal course of their work.

As part of management's evaluation of the effectiveness of internal control over financial reporting, management reviewed certain transactions entered into by the Company in 2010. As disclosed in the latest amendments to our quarterly financial statements for the periods ended March 31, 2010, June 30, 2010, September 30, 2010, March 31, 2011, June 30, 2011, and September 30, 2011, respectively, and to our annual financial statements for the year ended December 31, 2010, as of March 31, 2010, the Company had outstanding balances of $9,858,240 and $4,401,000 of loan receivables, extended to Ms. Taoxiang Wang (the "Wang Loan") and Shanxi JunTai Housing Purchase Ltd. Respectively (the "Juntai Loan") (together with the Wang Loan, the "Loans"). The Company's Board of Directors has concluded that the Wang Loan was made to parties related to the Company's former Chief Executive Officer and current Chairman of the Company's Board of Directors, Mr. Qinan Ji, for the benefit of those related parties, and that the nature of the Wang Loan had not been properly disclosed to the Company's Board of Directors and Audit Committee, its Independent Registered Public Accounting Firm, Frazer Frost, LLP at the time the Wang Loan was made, or its current Independent Registered Public Accounting Firm, Friedman LLP at the time they were engaged as the Company's new Independent Registered Public Accounting Firm in December 2010. Furthermore, neither of the Loans were reported to or approved by the Company's Board of Directors.

During management's evaluation of the effectiveness of internal control over financial reporting in connection with this annual report for the year ended December 31, 2011, management concluded that the Company had the following material weaknesses in its internal control over financial reporting during the year ended December 31, 2011:

- The Company does not maintain personnel with a sufficient level of accounting knowledge, experience and training in the application of the accounting principles generally accepted in the United States of America ("U.S. GAAP") and SEC requirements in the application thereof.

- The Company entered into a related party transaction without appropriate authorization and failed to correctly disclose the Wang Loan as a related party transaction.

- The Company failed to communicate to the Board of Directors the Wang Loan and the Juntai Loan and had entered into the Loans without approval of the Board of Directors.

- The Company did not have a formal process to analyze the Company's goodwill for possible impairment.

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The Company did not initially translate the proceeds from the Senior Notes in USD into RMB, the functional currency of the Company, and failed to recognize the foreign currency change gain or loss at the end of each reporting period, when the Company should translate its amount back into USD, the reporting currency of the Company.

- The Company failed to have a written policy that documents the internal control procedures over its revenue and purchase cycles relating to its liquefied natural gas business.

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Management concluded that these events indicated that the Company's policies and procedures in place as of December 31, 2011 were not sufficient to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act was being recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, nor were such policies and procedures sufficient to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act was being accumulated and communicated to the Company’s management to allow timely decisions regarding required disclosure.

Management’s Remediation Initiatives

In response to the above identified material weaknesses in general and to strengthen our internal control over financial reporting, we have taken or will take the following remediation initiatives:

1) Developing a comprehensive training and development plan for our accounting personnel, including our Chief Financial Officer, Financial Controller and others, in the knowledge of the principles and rules of U.S. GAAP and the SEC requirements in the application thereof.

2) Replacement of Mr. Qinan Ji as Chief Executive Officer of the Company. The Company has found a competent CEO, Mr. Shuwen Kang;

3) Resignation in August 2011 of certain employees involved in concealing the related party nature of the Wang Loan;

4) Appointment of an Independent Controller reporting to the Audit Committee of the Board of Directors;

5) Re-engagement of Ernst & Young Advisory to further improve procedures required to comply with the internal control over financial reporting and disclosure control provisions of the Sarbanes Oxley Act and to provide training to employees regarding U.S. GAAP, internal controls over financial reporting and disclosure controls and procedures;

6) Adopting a policy that restricts the signing authority of the Chairman and other executives. The policy mandates two signing parties for any obligation outside the normal scope of operations set forth in the Company’s business plan, as reviewed and approved from time to time by the Company’s Board of Directors; and

7) Engagement of Grant Thornton in 2011, and then Crowe Horwath in 2012, as U.S. GAAP consultant to the Company for purposes of preparing its quarterly and annual periodic reports.

8) Formulation of a formal process of analyzing goodwill and testing it for impairment.

9) Formulation of a formal process of identifying items for which foreign exchange gain or loss may occur specifically and recognizing such gain or loss in our financial statements.

10) Development of a formal policy that documents the internal control procedures over the revenue and purchase cycles relating to the liquefied natural gas business.

Of the above items, Item 1 through to Item 7 have been completed.

In addition, the Company continues to reassess its internal controls and procedures in light of these recent events and is in the process of determining additional appropriate actions to take to remediate these material weaknesses.

Changes in Internal Control over Financial Reporting

Other than the remediation measures described above, there was no change in our internal control over financial reporting during the year ended December 31, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Friedman, LLP, the independent registered public accounting firm that audited the consolidated financial statements, has issued an attestation report on our internal control over financial reporting which is included in Item 8.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE.

Pursuant to Paragraph G(3) of the General Instructions to Form 10-K, the information required by Part III (Items 10, 11, 12, 13 and 14) is being incorporated by reference herein from our definitive proxy statement (or an amendment to our Annual Report on Form 10-K) to be filed with the SEC within 120 days of the end of the year ended December 31, 2011 in connection with our 2012 Annual Meeting of Stockholders.

ITEM 11. EXECUTIVE COMPENSATION

See Item 10.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

See Item 10.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

See Item 10.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

See Item 10.

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PART V

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Exhibits:

Number	Description of Exhibit
1.1	Underwriting Agreement, dated September 2, 2009 (incorporated by reference to same Exhibit 1.1 filed with the Registrant's Form 8-K filed on September 3, 2009).
2.1	Form of Equity Ownership Transfer Agreement (incorporated by reference to same exhibit filed with the Registrant's Form 8-K filed on December 31, 2008).
3.1	Articles of Incorporation, dated March 31, 1999 (incorporated by reference to same exhibit filed with the Company's Form 10SB Registration Statement filed September 15, 2000, SEC file no. 000-31539); Certificate of Amendment to the Articles of Incorporation, dated May 25, 2000 (incorporated by reference to same exhibit filed with the Registrant's Form 10SB Registration Statement filed September 15, 2000, SEC file no. 000-31539); Certificate of Amendment to the Articles of Incorporation, dated October 26, 2007 (incorporated by reference to Exhibit 4 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File No. 001-34373); Certificate of Amendment to the Articles of Incorporation, dated April 20, 2009 (incorporated herein by reference to Exhibit 5 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File no. 001-34373).
3.2	Registrant's Amended and Restated By-Laws, dated June 14, 2006 (incorporated by reference to Exhibit 3.1 filed with the Registrant's Form 8-K filed June 16, 2006, SEC file no. 000-31539); Amended and Restated By-Laws, dated September 24, 2008 (incorporated by reference to Exhibit 7 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File No. 001-34373).
3.3	Certificate of Ownership and Merger, dated February 14, 2002 (incorporated by reference to Exhibit 2 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File No. 001-34373).
3.4	Certificate of Ownership, dated December 12, 2005 (incorporated by reference to Exhibit 3 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File No. 001-34373).
4.1	Registrant's 2009 Employee Stock Option and Stock Award Plan (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8 (333-166422) filed April 30, 2010); Registrant's 2009 Employee Stock Option and Stock Award Plan – Award Agreement (incorporated by reference to Exhibit 10.2 to the Registrant's Form 10-Q filed July 20, 2009).
10.1	Share Purchase Agreement made as of December 6, 2005 among Coventure International Inc., Xi'an Xilan Natural Gas Co., Ltd. and each of Xilan's shareholders (incorporated by reference to the exhibits to

Registrant's Form 8-K filed on December 9, 2005).

10.2	Return to Treasury Agreement between Coventure International Inc. and John Hromyk, dated December 6, 2005 (incorporated by reference to the exhibits to Registrant's Form 8-K filed on December 9, 2005).
10.3	Purchase Agreement made as of December 20, 2005 between China Natural Gas, Inc. and John Hromyk (incorporated by reference to the exhibit to Registrant's Form 8-K filed on December 23, 2005).
10.4	Form of Securities Purchase Agreement (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 12, 2006).
10.5	Form of Warrant (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 12, 2006).

10.6	Form of Registration Rights Agreement (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 12, 2006).
10.7	CNG Product Purchase and Sale Agreement between Xi'an Xilan Natural Gas Co., Ltd. and Zhengzhou Zhongyou Hengran Petroleum Gas Co., Ltd. made as of July 20, 2006, (translated from the original Mandarin) (incorporated by reference to the exhibits to Registrant's Form 10-KSB filed on April 17, 2007).
10.8	Securities Purchase Agreement, dated August 2, 2007, between the Company and the Investors named therein (incorporated by reference to the exhibits to Registrant's Form 8-K filed on August 8, 2007).
10.9	Registration Rights Agreement, dated August 2, 2007, between the Company and the Investors named therein (incorporated by reference to the exhibits to Registrant's Form 8-K filed on August 8, 2007).
10.10	Consulting Services Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi'an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant's Form 10-QSB filed on August 20, 2007).
10.11	Operating Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi'an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant's Form 10-QSB filed on August 20, 2007).
10.12	Equity Pledge Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi'an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant's Form 10-QSB filed on August 20, 2007).
10.13	Option Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi'an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant's Form 10-QSB filed on August 20, 2007).
10.14	Proxy Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi'an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant's Form 10-QSB filed on August 20, 2007).
10.15	Securities Purchase Agreement, dated December 30, 2007, between the Company and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.16	Amendment to Securities Purchase Agreement, dated January 29, 2008, between the Company and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.17	Indenture, dated January 29, 2008, by and among the Company and DB Trustees (Hong Kong) Limited, as trustee, relating to the 5.00% Guaranteed Senior Notes due 2014 (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.18	Warrant Agreement, dated January 29, 2008, by and among the Company, Mr. Qinan Ji, Deutsche Bank AG, Hong Kong Branch as Warrant Agent and Deutsche Bank Luxembourg S.A. as Warrant Agent (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).

10.19	Equity Registration Rights Agreement, dated January 29, 2008, by and between the Company and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).

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10.20	Investor Rights Agreement, dated January 29, 2008, by and among the Company, its subsidiaries, Mr. Qinan Ji, and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.21	Information Rights Agreement, dated January 29, 2008, between the Company and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.22	Onshore Share Pledge Agreement, dated January 29, 2008, between the Company and DB Trustees (Hong Kong) Limited, as security agent (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.23	Account Pledge and Security Agreement, dated January 29, 2008, by and between the Company and DB Trustees (Hong Kong) Limited as Security Agent (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.24	Natural Gas Purchase Agreement entered by and between Xi' An Xilan Natural Gas Co., Ltd. and China Petroleum Co., Ltd., Changqing Branch, dated July 30, 2006 (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.25	Natural Gas Purchase Agreement entered by and between Jiyuan Yuhai Natural Gas Co., Ltd. and Xi' An Xilan Natural Gas Co., Ltd. dated, February 28, 2008 (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.26	Natural Gas Supply Agreement between Jincheng Ming Shi Natural Gas Co., Ltd., Jinan Branch and Xi' An Xilan Natural Gas Co., Ltd. dated March 20, 2008 (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.27	Natural Gas Purchase Agreement entered by and between Shaanxi Natural Gas Co., Ltd. and Xi' An Xilan Natural Gas Co., Ltd., dated July 17, 2008 (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.28	Independent Director Agreement dated January 1, 2008, by and between China Natural Gas., Inc. and Zhiqiang Wang (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.29	Independent Director Agreement dated July 1, 2008, by and between China Natural Gas., Inc. and Carl Yeung (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.30	Independent Director Agreement dated August 5, 2008, by and between China Natural Gas., Inc. and Lawrence W. Leighton (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.31	Employment Agreement, dated October 10, 2008, by and between China Natural Gas., Inc. and Richard Peidong Wu (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.32	Employment Agreement, dated May 10, 2005, by and between China Natural Gas., Inc. and Qinan Ji (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009); Employment Agreement, dated January 1, 2009, by and between China Natural Gas., Inc. and Qinan Ji

	(incorporated herein by reference to the Exhibit 10.4 to the Registrant's Form 10-Q/A filed on July 20, 2009); Employment Agreement dated January 1, 2010, by and between the Company and Qinan Ji (incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K filed on November 9, 2010).
10.33	Equity Ownership Transfer Agreement, dated October 2, 2008, by and between Xi'an Xilan Natural Gas Co., Ltd., Zhihe Zhang and Lingjun Hu (incorporated by reference to the Registrant's Form 8-K filed on December 31, 2008).
10.34	Joint Venture Agreement dated July 22, 2009 by and between Xi'an Xilan Natural Gas Co., Ltd. and China National Petroleum Corporation Kunlun Natural Gas Co., Ltd. (incorporated by reference to the Registrant's Form 8-K filed on July 28, 2009).

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10.35	Strategic Cooperation Framework Agreement dated as of July 6, 2009 by and between Xi'an Xilan Natural Gas Co., Ltd. and China National Petroleum Corporation Kunlun Natural Gas Co., Ltd. (incorporated by reference to the Registrant's Form 8-K filed on July 8, 2009).
10.36	Employment Agreement dated December 20, 2010 between the Company and Shaocheng Xu (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on December 23, 2010).
10.37	Independent Director Agreement dated November 25, 2010 between the Company and Frank Waung (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on November 26, 2010).
10.38	Waiver dated February 4, 2009, executed by DB Trustees (Hong Kong) Limited, as trustee under the Indenture governing the Company's 5.0% Guaranteed Senior Notes due 2014 (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on November 9, 2010).
10.39	Waiver dated August 14, 2009, by and among the Company and the holders of the Company's 5.0% Guaranteed Senior Notes due 2014 signatory thereto (incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed on November 9, 2010).
10.40	Loan Contract of Fixed Asset dated February 26, 2010, by the between Jingbian Xi'an Xilan Liquefied Natural Gas Co. Ltd. and Xi'an Branch Shanghai Pudong Development Bank (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on August 13, 2010).
10.41	Mortgage Contract of Movables dated February 26, 2010, by and between Xi'an Xilan Natural Gas Co. Ltd. and Xi'an Branch Shanghai Pudong Development Bank (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed on August 13, 2010).
10.42	Contract of Guarantee dated February 26, 2010, by and between Xi'an Xilan Natural Gas Co. Ltd. and Xi'an Branch Shanghai Pudong Development Bank (incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed on August 13, 2010).
10.43	Employment Agreement of Veronica Chen dated May 1, 2009 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on July 20, 2009).
10.44	Supply Agreement between CNP Changqing Oil Field Branch Company dated November 25, 2010 and Jingbian LNG Company (incorporated by reference to Exhibit 99.1 to the Registrant's Form 8-K filed on December 1, 2010).
10.45	Coal Bed Methane Purchase Agreement entered by and between Henan Xilan Natural Gas Co., Ltd. and Qinshui Lanyan Coal Bed Methane Co., Ltd. dated January 12, 2009 (Incorporated by reference to the Company's Form 10-K filed March 14, 2011)
10.46	Natural Gas Supply Agreement between Huojia Hualong Petrochemical Co., Ltd., and Xi' An Xilan Natural Gas Co., Ltd. dated November 16, 2009 (Incorporated by reference to the Company's Form 10-K filed March 14, 2011)
14.1	Code of Ethics adopted by the Company on June 14, 2006 (incorporated by reference to the exhibits to Registrant's Form 8-K filed on June 16, 2006).

21.1	List of Subsidiaries (incorporated by reference to the exhibits to Registrant's Form 10-K/A filed on December 28, 2011)
23.1*	Written consent of Frazer Frost, LLP.
31.1*	Certification of Principal Executive Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended.
31.2*	Certification of Principal Financial Officer pursuant to Rule 13a-14 and Rule 15d 14(a), promulgated under the Securities and Exchange Act of 1934, as amended.
32.1*	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer).
32.2*	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer).
101**	Interactive Data File

* Filed herewith.

** IN ACCORDANCE WITH THE TEMPORARY HARDSHIP EXEMPTION PROVIDED BY RULE 201 OF REGULATION S-T, THE DATE BY WHICH THE INTERACTIVE DATA FILE IS REQUIRED TO BE SUBMITTED HAS BEEN EXTENDED BY SIX BUSINESS DAYS.

SIGNATURES

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

Date: April 2, 2012

CHINA NATURAL GAS, INC.

/s/ Shuwen Kang	/s/ Bode Xu
Name: Shuwen Kang	Name: Bode Xu
Title: Chief Executive Officer	Title: Chief Financial Officer
(Principal Executive Officer)	(Principal Financial and Accounting Officer)

Pursuant to the requirements of Section 13 or 15(d) of the Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf of the registrant and in the capacities and on the dates indicated.

/s/ Shuwen Kang Shuwen Kang	President and Chief Executive Officer (Principal Executive Officer)	April 2, 2012
/s/ Qinan Ji Qinan Ji	Chairman of the Board of Directors	April 2, 2012
/s/ Zhiqiang Wang Zhiqiang Wang	Director	April 2, 2012
/s/ Donald Yang Donald Yang	Director	April 2, 2012
/s/ Bode Xu	Chief Financial Officer (Principal Financial and Accounting Officer)	April 2, 2012

Bode Xu

/s/ Frank Waung Frank Waung	Director	April 2, 2012
/s/ Lawrence Leighton Lawrence Leighton	Director	April 2, 2012

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CHINA NATURAL GAS, INC.

AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

China Natural Gas, Inc.

We have audited the accompanying consolidated balance sheets of China Natural Gas, Inc. and Subsidiaries (the "Company" or "China Natural Gas, Inc.") as of December 31, 2011 and 2010, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for the years then ended. We also have audited China Natural Gas, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). China Natural Gas, Inc.'s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audits of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management's assessment as of December 31, 2011:

- As previously disclosed in the amended Company's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2010, June 30, 2010 and September 30, 2010, and also in 2010 Form 10-K/A, the Company had outstanding balances of $9,858,240 and $4,401,000 of loan receivables, extended to Ms. Taoxiang Wang (the "Wang Loan") and Shanxi JunTai Housing Purchase Ltd., respectively (the "Juntai Loan") (together with the Wang Loan, the "Loans"). As of December 31, 2010, the Loans were repaid in full, so there was no effect on the overall financial position or results of operations of the company as of and for the year then ended. However, the aforementioned periodic reports required amendments to disclose the fact that such receivables were related party loans.

Management failed to disclose the Wang Loan made to parties related to the Company's former Chief Executive Officer and current Chairman of the Company's Board of Directors, Mr. Qinan Ji, for the benefit of those related parties, and that the nature of the Wang Loan had not been properly disclosed to the Company's Board of Directors and Audit Committee, its Independent Registered Public Accounting Firm, Frazer Frost, LLP at the time the Wang Loan was made, or its current Independent Registered Public Accounting Firm, Friedman LLP at the time they were engaged as the Company's new Independent Registered Public Accounting Firm in December 2010. Furthermore, neither of the Loans were reported to or approved by the Company's Board of Directors.

- Management did not have a formal process to analyze the Company's goodwill for possible impairment.

- Management received proceeds from a note in US dollars, which it failed to initially translate into RMB, the functional currency of the Company when it recorded the obligation. At each reporting period, the note payable should then be reported in US dollars at the exchange rate in effect at the balance sheet date.

- The Company failed to have a written policy that documents the internal control procedures over its revenue and purchase cycles relating to its liquefied natural gas business.

- The Company did not maintain personnel with a sufficient level of accounting knowledge, experience and training in the application of U.S. GAAP and SEC requirements in the application thereof.

These material weaknesses were considered in determining the nature, timing and extent of audit tests applied in our audits of the 2011 consolidated financial statements, and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements.

In our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, China Natural Gas, Inc. has not maintained effective internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Natural Gas, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Friedman LLP

New York, New York

April 2, 2012

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

China Natural Gas, Inc.

We have audited the accompanying consolidated balance sheets of China Natural Gas, Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income and other comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2009. China Natural Gas, Inc.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Natural Gas, Inc. and subsidiaries as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), China Natural Gas, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 10, except for the effects of the material weaknesses described in the six paragraph of that report, as to which the date is September 30, 2010, expressed an adverse opinion on the effectiveness of internal control over financial reporting.

/s/ Frazer Frost, LLP (Successor Entity of Moore Stephens Wurth Frazer and Torbet, LLP, see Form 8-K filed on January 7, 2010)

Brea, California

March 10, 2010, except for the effects on the consolidated financial statements of the restatement described in Note 2 and 15, as to which the date is September, 30, 2010

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CHINA NATURAL GAS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$9,622,883	$10,046,249
Accounts receivable, net	2,997,845	1,821,595
Other receivables	540,646	188,364
Employee advances	285,270	302,532
Inventories	1,938,754	815,884
Advances to suppliers	4,540,139	8,434,995
Prepaid expense and other current assets	4,470,687	4,249,353
Total current assets	24,396,224	25,858,972
Investment in unconsolidated joint ventures	1,574,000	1,517,000
Property and equipment, net	174,097,754	82,769,171
Construction in progress	45,882,320	116,569,871
Deferred financing cost, net	517,334	927,166
Goodwill	629,729	606,924
Other intangible assets	18,910,244	7,046,954
Prepaid expenses and other assets	10,976,203	12,152,497
TOTAL ASSETS	$276,983,808	$247,448,555
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Senior notes- current maturities	$9,671,682	$2,551,306
Current portion of bank loan payable	4,722,000	-
Accounts payable and accrued liabilities	7,694,423	5,428,669
Other payable - related party	787,000	-
Short-term borrowing - related party	1,359,945	-
Unearned revenue	4,280,594	2,376,563
Accrued interest	1,029,431	646,527
Taxes payable	2,626,271	2,377,765
Total current liabilities	32,171,346	13,380,830
LONG-TERM LIABILITIES:		
Senior notes, net of current portion	25,791,151	28,064,363
Bank loan payable, net of current portion	9,444,000	18,204,000
Borrowings - related party	1,320,000	-
Warrants liability	17,500,000	17,752,066
Total long-term liabilities	54,055,151	64,020,429

Total liabilities	86,226,497	77,401,259
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, par value $0.0001 per share, 5,000,000 authorized, none issued and outstanding	-	-
Common stock, par value $0.0001 per share, 45,000,000 authorized, 21,458,654 and 21,321,904 issued and outstanding at December 31, 2011 and 2010, respectively	2,145	2,132
Additional paid-in capital	82,909,485	81,611,763
Accumulated other comprehensive income	19,817,493	15,667,145
Statutory reserves	10,124,710	7,918,634
Retained earnings	77,903,478	64,847,622
Total stockholders' equity	190,757,311	170,047,296
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$276,983,808	$247,448,555

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

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CHINA NATURAL GAS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Years Ended December 31,		
	2011	2010	2009
Revenue			
Natural gas	$106,178,398	$71,367,502	$62,236,342
Gasoline	5,998,022	7,522,412	6,384,172
Installation and other	12,045,106	11,063,709	12,445,604
	124,221,526	89,953,623	81,066,118
Cost of revenue			
Natural gas	65,062,505	38,651,298	29,478,854
Gasoline	5,756,960	7,050,003	5,993,207
Installation and other	5,183,985	4,838,858	5,432,978
	76,003,450	50,540,159	40,905,039
Gross profit	48,218,076	39,413,464	40,161,079
Operating expenses			
Selling	17,377,703	13,254,923	10,607,596
General and administrative	9,984,565	7,131,543	4,500,676
	27,362,268	20,386,466	15,108,272
Income from operations	20,855,808	19,026,998	25,052,807
Non-operating income (expense):			
Interest income	42,290	418,763	125,287
Interest expense	(771,916)	-	(747,172)
Other income (expense), net	126,100	(137,817)	(186,805)
Change in fair value of warrants	252,062	1,793,572	(1,031,330)
Foreign currency exchange loss	(430,723)	(88,613)	(69,077)
	(782,187)	1,985,905	(1,909,097)
Income before income tax	20,073,621	21,012,903	23,143,710
Provision for income tax	4,811,689	3,792,531	4,312,923
Net income	15,261,932	17,220,372	18,830,787
Other comprehensive income			
Foreign currency translation gain	4,150,348	6,953,126	52,959
Comprehensive income	$19,412,280	$24,173,498	18,883,746

Weighted average shares outstanding			
Basic	21,418,389	21,268,972	16,624,294
Diluted	21,418,389	21,430,867	16,830,907
Earnings per share			
Basic	$0.71	$0.81	$1.13
Diluted	$0.71	$0.80	$1.12

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

CHINA NATURAL GAS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock Shares	Amount	Additional Paid-in Capital	Accumulative Other Comprehensive Income	Retained Earnings Statutory Reserve	Unrestricted	Total Stockholders' Equity
Balance December 31, 2008	14,600,154	$1,460	$32,115,043	$8,661,060	$3,730,083	$27,140,775	$71,648,421
Reclassification of warrants from equity to derivative liabilities	-	-	(6,858,547)	-	-	5,844,239	(1,014,308)
Issuance of common stock	6,583,750	658	57,607,155	-	-	-	57,607,813
Offering costs	-	-	(3,237,452)	-	-	-	(3,237,452)
Options issued for services	-	-	66,535	-	-	-	66,535
Stock based compensation	-	-	158,517	-	-	-	158,517
Cumulative translation adjustment	-	-	-	52,959	-	-	52,959
Net income	-	-	-	-	-	18,830,787	18,830,787
Transfer to statutory reserve	-	-	-	-	2,232,612	(2,232,612)	-
Balance December 31, 2009	21,183,904	2,118	79,851,251	8,714,019	5,962,695	49,583,189	144,113,272
				-	-	-	
Exercise of stock options	138,000	14	676,186	-	-	-	676,200
Options issued for services	-	-	66,024	-	-	-	66,024
	-	-	1,018,302	-	-	-	1,018,302

Stock based compensation							
Cumulative translation adjustment	-	-	-	6,953,126	-	-	6,953,126
Net income	-	-	-	-	-	17,220,372	17,220,372
Transfer to statutory reserve	-	-	-	-	1,955,939	(1,955,939)	-
Balance December 31, 2010	21,321,904	2,132	81,611,763	15,667,145	7,918,634	64,847,622	170,047,296
Exercise of stock options	136,750	13	670,062	-	-	-	670,075
Stock based compensation	-	-	627,660	-	-	-	627,660
Cumulative translation adjustment	-	-	-	4,150,348	-	-	4,150,348
Net income	-	-	-	-	-	15,261,932	15,261,932
Transfer to statutory reserve	-	-	-	-	2,206,076	(2,206,076)	-
Balance December 31, 2011	21,458,654	$2,145	$82,909,485	$19,817,493	$10,124,710	$77,903,478	$190,757,311

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

CHINA NATURAL GAS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years ended December 31, 2011	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$15,261,932	$17,220,372	$18,830,787
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,600,518	6,644,843	5,571,772
Provision for (recovery of) doubtful accounts	110,166	(149,859)	-
(Gain) Loss on disposal of equipment	(3,385)	123,553	21,373
Amortization of discount on senior notes	-	-	280,250
Amortization of financing costs	-	-	63,940
Options issued for services	-	66,204	66,535
Stock-based compensation	627,660	1,018,123	158,517
Change in fair value of warrants	(252,062)	(1,793,572)	1,031,330
Change in assets and liabilities:			
Accounts receivable	(1,201,079)	(326,573)	(387,948)
Other receivables	(339,941)	531,970	(644,083)
Employee advances	27,679	46,174	(6,425)
Inventories	(860,723)	53,292	(322,099)
Advances to suppliers	(2,729,776)	(7,624,015)	240,724
Prepaid expense and other current assets	(133,968)	(2,973,865)	(306,445)
Accounts payable and accrued liabilities	2,064,383	3,144,057	2,526
Unearned revenue	1,787,063	488,687	869,239
Accrued interest	382,903	(139,524)	(75,062)
Taxes payable	137,886	372,136	38,991
Net cash provided by operating activities	24,479,256	16,702,003	25,433,922
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payment on investment in unconsolidated joint ventures	-	-	(1,467,000)
Payment for acquisition of property and equipment	(7,314,640)	(6,060,288)	(1,074,066)
Proceeds from sales of property and equipment	16,990	96,141	41,325
Loan to related party	-	(9,941,568)	-
Loans to third party	-	(4,438,200)	-
Proceeds from loans receivable – related party	-	9,941,568	-
Proceeds from loans receivable – third party	-	4,734,080	-
Additions to construction in progress	(11,769,752)	(44,830,638)	(28,020,498)
Return (payment) of acquisition deposit	-	1,627,340	(283,200)
Prepayment on long-term assets	(1,169,313)	(10,274,357)	(6,139,766)
Payment for acquisition of business	(976,500)	(3,077,031)	-

Payment for intangible assets	(189,843)	(6,159,474)	(161,486)
Payment for land use rights	-	(4,283,789)	(432,566)
Excess of cost over fair value of net assets acquired	-	(505,225)	-
Net cash used in investing activities	(21,403,058)	(73,171,441)	(37,537,257)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from the issuance of common stock	-	-	57,607,813
Proceeds from exercise of stock options	670,075	676,200	-
Proceeds from short-term borrowing and other payable, related parties	3,454,945	-	-
Proceeds from long-term debt	-	17,752,800	-
Repayment of long -term debt	(4,650,000)	-	-
Repayment of senior notes	(3,333,334)	-	-
Stock issuance costs	-	-	(3,237,454)
Net cash (used in) provided by financing activities	(3,858,314)	18,429,000	54,370,359
Effect of exchange rate changes on cash and cash equivalents	358,750	(91,107)	56,387
NET (DECREASE) INCREASE IN CASH & CASH EQUIVALENTS	(423,366)	(38,131,545)	42,323,411
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	10,046,249	48,177,794	5,854,383
CASH AND CASH EQUIVALENTS, END OF YEAR	$9,622,883	$10,046,249	$48,177,794
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Interest paid, net of capitalized interest	$742,224	$139,524	$503,845
Income taxes paid	$4,683,774	$3,863,788	$4,178,066
Non-cash transactions for investing and financing activities:			
Construction material transferred to construction in progress	$7,396,787	$-	$-
Construction in progress transferred to property and equipment	$94,607,146	$5,057,958	$-
Construction in progress transferred to intangible assets	$11,676,342	$-	$-
Advances to suppliers transferred to construction in progress	$7,652,350	$-	$-
Prepayment on long-term assets transferred to property and equipment	$-	$18,431,526	$-
Other assets transferred to construction in progress	3,070,647	-	-
Purchase of equipment through accounts payable	$-	$-	$1,234,603
Capitalized interest - amortization of discount of notes payable and issuance costs	$4,203,896	$3,733,214	$2,836,324

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

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China Natural Gas, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note 1 - Organization

Organization and Line of Business

China Natural Gas, Inc. (the “Company,” “our,” “us” or “we”) was incorporated in the State of Delaware on March 31, 1999. The Company through its wholly owned subsidiaries and variable interest entity (“VIE”), Xi’an Xilan Natural Gas Co., Ltd. (“XXNGC”) and subsidiaries of its VIE, which are located in Hong Kong, Shaanxi Province, Henan Province 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 through fueling stations, tankers and pipelines, construction of pipeline networks, installation of natural gas fittings and parts for end-users, and conversions of gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles at automobile conversion sites. Our subsidiaries are: Xilan Energy Co. Ltd. (“XEC”), Shaanxi Xilan Natural Gas Equipment Co. Ltd (“SXNGE”), Hubei Xian Natural Gas Co., Ltd (“HBXNG”), Lingbao Yuxi Natural Gas Co. Ltd. (“LYNG”), Shaanxi Jingbian Liquefied Natural Gas Co. Ltd (“JBLNG”), Henan Xilan Natural Gas Co. Ltd (“HXNGC”), Xi’an Xilan Auto Body Shop Co, Ltd. (“XXABC”), Henan CNPC Kunlun Xilan Compressed Natural Gas Co., Ltd (“JV”) and Hanchuan Makou Yuntong Compressed Natural Gas Co., Ltd (“Makou”).

On July 16, 2011, our JBLNG plant successfully completed trial operations and commenced commercial production and sales of liquefied natural gas ("LNG").

On June 28, 2011, XXNGC entered into an Equity Transfer Agreement (the “Transfer Agreement”) with five individual shareholders of Xiantao City Jinhua Gas And Oil Co., Ltd. (“XTJH”). XTJH is in the business of retail sale of natural gas and gasoline, and it owns and operates a station selling natural gas and gasoline in Xiantao, Hubei Province. Pursuant to the Transfer Agreement, XXNGC will acquire a 58.5284% equity interest in XTJH for a total purchase price of $1,905,099 (RMB 12,290,964). The effectiveness of the Transfer Agreement is subject to the satisfaction of all the following conditions:

- the transferor, or the shareholders of XTJH, as applicable, must satisfy each of the items provided for in Article 2 of the Transfer Agreement, which includes providing relevant corporate certificates and documents of XTJH to XXNGC and providing approvals from government authorities for the construction of a building of XTJH’s;
- the Transfer Agreement must be approved at a General Meeting of Shareholders of XTJH;

- the Transfer Agreement must be notarized by the Notary Public Office of the City of Xiantao.

All terms above must be satisfied in order to complete the transaction. During the fourth quarter of 2011, the Company paid $976,500 (RMB 6,300,000). In January 2012, the Company paid $310,000 (RMB 2,000,000), and then on February 29, 2012, the Company made an additional payment of approximately $337,000(RMB 2,142,857), for the purchase of the equity interest in XTJH. As of December 31, 2011, the transfer of assets was in progress and the Company had not exercised full control over its operations; therefore, the accounts of XTJH are not included in the accompanying consolidated financial statements.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("U.S. GAAP").

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP 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. Significant accounting estimates reflected in the Company's consolidated financial statements include revenue recognition, allowance for doubtful accounts, inventory obsolescence, construction in progress, warrants liability and useful lives of property and equipment. Actual results could differ from those estimates.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries and its 100% VIE, XXNGC, and XXNGC's wholly owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation.

Consolidation of Variable Interest Entity

VIEs are 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. Any VIE with which the Company is involved must be evaluated to determine the primary beneficiary of the risks and rewards of the VIE. Management makes ongoing reassessments of whether the Company is the primary beneficiary of XXNGC.

On February 21, 2006, the Company formed SXNGE as a wholly foreign owned enterprise (“WFOE”) under the laws of the PRC. 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 and appoint its senior executives. The Company is considered the primary beneficiary of XXNGC and it consolidates its accounts as a VIE. The Company’s arrangements with XXNGC consist of the following agreements:

· *Consulting Service Agreement, dated August 17, 2007*. Under this agreement entered into between SXNGE and XXNGC, SXNGE provides XXNGC exclusive consulting services with respect to XXNGC's general business operations, human resources and research and development. In return, XXNGC pays a quarterly service fee to SXNGE, which is equal to XXNGC's revenue for such quarter. The term of this agreement is indefinite unless SXNGE notifies XXNGC of its intention to terminate this agreement. XXNGC may not terminate this agreement during its term. This agreement is retroactive to March 8, 2006.

· *Operating Agreement, dated August 17, 2007*. Under this agreement entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand, SXNGE agrees to fully guarantee XXNGC's performance of all operations-related contracts, agreements or transactions with third parties and, in return, XXNGC agrees to pledge all of its assets, including accounts receivable, to SXNGE. The XXNGC shareholders party to this operating agreement agree to, among other things, appoint as XXNGC's directors, individuals recommended by XXNGC, and appoint SXNGE's senior officers as XXNGC's general manager, chief financial officer and other senior officers. The term of this agreement is indefinite unless SXNGE notifies XXNGC of its intention to terminate this agreement with 30 days prior notice. XXNGC may not terminate this agreement during its term. This agreement is retroactive to March 8, 2006.

· *Equity Pledge Agreement, dated August 17, 2007*. Under this agreement entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand, to secure the payment obligations of XXNGC under the consulting service agreement described above, the XXNGC shareholders party to this equity pledge agreement have pledged to SXNGE all of their equity ownership interests in XXNGC. Upon the occurrence of certain events of default specified in this agreement, SXNGE may exercise its rights and foreclose on the pledged equity interest. Under this agreement, the pledgors may not transfer the pledged equity interest without SXNGE's prior written consent. This agreement will also be binding upon successors of the pledgor and transferees of the pledged equity interest. The term of the pledge is two years after the obligations under the Consulting Service Agreement have been fulfilled. This agreement is retroactive to March 8, 2006.

· *Option Agreement, dated August 17, 2007*. Under this agreement entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand, the XXNGC shareholders party to this option agreement irrevocably granted to SXNGE, or any third party designated by SXNGE, the right to acquire, in whole or in part, the respective equity interests in XXNGC of these XXNGC shareholders. The option agreement can be terminated by SXNGE by notifying XXNGC of its intention to terminate this agreement with 30 days prior notice. The option agreement is retroactive to March 8, 2006.

· *Addendum to the Option Agreement, dated August 8, 2008*. Under this addendum to the option agreement entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand, the XXNGC shareholders irrevocably granted to SXNGE an option to purchase the XXNGC shareholders' additional equity interests in XXNGC (the "Additional Equity Interest") in connection with any increase in XXNGC's registered capital subsequent to the execution of the option agreement described above, at $1.00 or the lowest price permissible under applicable law at the time that SXNGE exercises the option to purchase the Additional Equity Interest. The option agreement can be terminated by SXNGE by notifying XXNGC of its intention to terminate this agreement with 30 days prior notice. This addendum is retroactive to June 30, 2008.

· *Proxy Agreement, dated August 17, 2007*. Under this agreement entered into between SXNGE, on the one hand, and XXNGC and certain shareholders of XXNGC, on the other hand, the XXNGC shareholders irrevocably granted to SXNGE the right to exercise their shareholder voting rights, including attendance at and voting of their shares at shareholders meetings in accordance with the applicable laws and XXNGC's articles of association. This agreement is retroactive to March 8, 2006.

Foreign Currency Translation

Our reporting currency is the U.S. dollar. The functional currency of XXNGC and the Company's and XXNGC's PRC subsidiaries is the Chinese Renminbi ("RMB"). The results of operations and financial position of XXNGC and the Company's and XXNGC's PRC subsidiaries are translated to U.S. dollars using the period 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.

The balance sheet amounts, with the exception of equity, were translated at the December 31, 2011 exchange rate of RMB 6.35 to $1.00 as compared to RMB 6.59 to $1.00 at December 31, 2010. The equity accounts were stated at their historical rate. The average translation rates applied to income and cash flow statement amounts for the years ended December 31, 2011, 2010 and 2009 were RMB 6.45, RMB 6.76 and RMB 6.82 to $1.00, respectively.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and demand deposits in accounts maintained with state-owned banks within the PRC, and private sector banks in 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.

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 December 31, 2011 and 2010, the Company had total deposits of $9,236,515 and $9,106,073, respectively, without insurance coverage or in excess of HKDPB or FDIC insured limits. The Company has not experienced any losses to date as a result of this policy.

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Accounts Receivable

Accounts receivable are presented net of an allowance for doubtful accounts. Management periodically 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 the allowance.

Management considers accounts past due after three months. Delinquent account balances are allowed for when management has determined that the likelihood of collection is not probable. Uncollectible receivables are written off against the allowance for doubtful accounts when identified. We recorded allowances for doubtful accounts of $127,619 and $15,177 as of December 31, 2011 and 2010, respectively.

Employee Advances

From time to time, the Company advances predetermined amounts based upon internal Company policy to certain employees and internal units. As of December 31, 2011 and 2010, the Company had employee advances in the amount of $285,270 and $302,532, respectively.

Inventories

Inventories are stated at the lower of cost or market, as determined on a first-in, first-out basis. Management compares the cost of inventories with the market value, and writes down the inventories to their market value, if lower than cost. Inventories consist of material used in the construction of pipelines, material used in repairing and modifying vehicles and material used in processing LNG. Inventory also consists of LNG and gasoline.

The following are the details of the inventories:

	December 31, 2011	December 31, 2010
Materials and supplies	$ 1,529,678	$ 524,934
Liquefied natural gas	298,016	-
Gasoline	111,060	290,950
	$ 1,938,754	$ 815,884

Investments in Unconsolidated Joint Ventures

Investee companies that are not required to be 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, the Company's share of the earnings or losses of the investee company is reflected in the caption "other income (expense), net" in the consolidated statements of income and comprehensive income.

The Company's investment in unconsolidated joint ventures that are accounted for on the equity method of accounting represents the Company's 49% interest in the JV. The investment in the JV amounted to $1,574,000 and $1,517,000 at December 31, 2011 and December 31, 2010, respectively. The JV has not had any operations to date.

The condensed financial information of the JV is summarized below:

	December 31, 2011	December 31, 2010
Current assets	$ 3,212,245	$ 3,095,918
Noncurrent assets	-	-
Total assets	$ 3,212,245	$ 3,095,918
Current liabilities	-	-
Noncurrent liabilities	-	-
Equity	$ 3,212,245	$ 3,095,918
Total liabilities and equity	$ 3,212,245	$ 3,095,918

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. Depreciation of property and equipment is provided using the straight-line method for 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:

	December 31, 2011	December 31, 2010
Office equipment	$ 823,822	$ 580,688
Operating equipment	158,183,281	71,163,466
Vehicles	3,540,962	3,308,624
Buildings and improvements	41,713,318	27,861,655
Total property and equipment	204,261,383	102,914,433

Less accumulated depreciation	(30,163,629)	(20,145,262)
Property and equipment, net	$ 174,097,754	$ 82,769,171

Depreciation expense for the years ended December 31, 2011, 2010 and 2009 was $9,286,221, $6,591,008 and $5,565,608, respectively.

Construction in Progress

Construction in progress consists of (1) the costs for constructing compressed natural gas (“CNG”) fueling stations, the liquefied natural gas (“LNG”) project in Jingbian County, and the natural gas infrastructure project in Xi’an Fangzhi District and International Port District, and (2) other costs related to construction in progress projects, including technology licensing fees, equipment purchases, land use rights acquisition costs, capitalized interests and other construction fees. No depreciation is provided for construction in progress until such time as the assets are completed and placed into service. To the extent that the borrowings could have been avoided, should the construction in progress projects not be implemented, interest incurred on such borrowings during construction period is capitalized into construction in progress. All other interest is expensed as incurred.

As of December 31, 2011 and 2010, the Company had construction in progress in the amount of $45,882,320 and $116,569,871, respectively. On August 31, 2011, $94,607,146 was transferred from construction in progress to property and equipment, and $11,676,342 was transferred from construction in progress to intangible assets, related to the investment in construction of Phase I of the LNG plant. Interest cost capitalized into construction in progress for the years ended December 31, 2011, 2010 and 2009 amounted to $7,286,405, $6,492,529 and $4,597,544, respectively.

Construction in progress at December 31, 2011 and 2010 is set forth in the table below. The column of “estimated additional cost to complete” reflects the amounts currently estimated by management to be necessary to complete the relevant project. As of December 31, 2011, the Company was not contractually or legally obligated to expend the estimated additional cost to complete these projects, except to the extent reflected in Note 13 to the consolidated financial statements.

Project Description	Location	December 31, 2011		Commencement date	Expected completion date	Estimated additional cost to complete	
Phase I of LNG Project	Jingbian County, Shaanxi Province, PRC	$ 6,531,004	(1)	December 2006	September 2012(2)	$ 385,359	(3)
Phases II and III of LNG Project	Jingbian County, Shaanxi Province, PRC	8,849,299	(4)	December 2006	December 2015	198,638,693	(5)
Fangzhi District		19,346,484		October 2010	June 2012	1,361,198	

	Fangzhi District, Xi'an, PRC				
Sa Pu Mother Station	Henan Province, PRC	1,090,627	July 2008	June 2013	6,300,000
International Port(6)	International Port District, Xi'an, PRC	5,715,443	May 2009	December 2020	299,400,000
LNG fueling stations	Shaanxi & Henan Province, PRC	899,653	Various	Various	11,692,347
Other Construction in Progress Costs	PRC	3,449,810	Various	Various	3,000,000
		$ 45,882,320			$ 520,777,597

Project Description	Location	December 31, 2010	Commencement date	Expected completion date	Estimated additional cost to complete
Phase I of LNG Project	Jingbian County, Shaanxi Province, PRC	$65,309,335	December 2006	July 2011	$ 1,760,278
Phases II and III of LNG Project	Jingbian County, Shaanxi Province, PRC	35,860,914	December 2006	December 2015	206,840,695
Sa Pu Mother Station	Henan Province, PRC	925,328	July 2008	Various	6,300,000
International port	International Port District, Xi'an, PRC	5,440,515	May 2009	December 2020	299,400,000
Other Construction in Progress Costs	PRC	9,033,779	Various	Various	9,447,266
		$116,569,871			$ 523,748,239

(1) Includes $4,566,850 of construction costs and $1,964,154 of capitalized interest for Phase I of the LNG project.

(2) The Company completed most of the construction of Phase I of the LNG plant and initiated commercial production and sale on July 16, 2011. Phase I of the LNG plant has a processing capacity of 500,000 cubic meters of LNG per day, or approximately 150 million cubic meters of LNG per year. Construction of Phase I of the LNG plant experienced delays due to policy changes with respect to tariff exemptions for core equipments imported by the Company and the increased international shipment time for ordered equipments. As certain facilities, including the staff dormitory building are still under construction, the project hasn't been completely transferred from construction in progress to property and equipment, though a substantial amount of construction in progress has been transferred to property and equipment.

(3) Includes costs the Company expected to expend to complete test runs and make installment payments to contractors. The total expected cost of $68.7million for the construction of Phase I of the LNG project exceeded the amount originally anticipated by the Company. The increased costs were attributable to unforeseen cost overruns and escalations, including increased material and labor costs incurred to reinforce pilings based upon modified engineering analysis, and increased prices for land use rights, which the Company believes resulted from the energy resource exploration activities in nearby areas.

(4) Includes $6,187,934 of construction costs and $2,661,365 of capitalized interest for Phases II and III of the LNG project.

(5) This amount reflects the estimated costs of Phases II and III of the LNG project from December 31, 2011 to December 31, 2015, including an estimated $181 million of construction costs and $17 million of capitalized interest. Such costs should be able to finance the construction of a facility capable of processing 3 million cubic meters of LNG per day, or approximately 900 million cubic meters of LNG per year.

(6) Xi'an International Port District Committee, a local government agency in the PRC, pursuant to a conditional non-binding agreement, has appointed XXNGC to be the developer of natural gas infrastructure for Xi'an International Port District, a former agricultural area that has been zoned for urbanization. If XXNGC chooses to proceed with the project, it will be responsible for the construction and all costs related thereof a natural gas pipeline network that will service residential, commercial and industrial buildings and users, as well as fueling stations and related infrastructure. The estimated cost of $299,400,000 was based on a third-party feasibility study and management's estimate. The Company is the only natural gas provider in the surrounding area and expects that it would supply natural gas to the International Port District once construction is completed. If the Company decides not to proceed with this project, it expects to be able to obtain a refund from subcontractors of the $7,256,676 invested as of December 31, 2011 or sell the construction-in-progress assets to third parties.

Goodwill

The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed is recognized as goodwill. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis in the fourth quarter or more frequently if indicators of impairment exist. The Company uses a two-step goodwill impairment test to identify the potential impairment and to measure the amount of goodwill impairment, if any. The first step is to compare the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is considered not impaired. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. Under step two, the impairment loss is measured by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

Long-Lived Assets

We evaluate the carrying value of long-lived assets to be held and used whenever events or changes in circumstances indicate that the assets might be impaired. Impairment losses are 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 our review, no impairment indicators were noted at December 31, 2011.

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 provide 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.

The 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 to stockholders’ equity in the statement of financial position would not be considered a derivative financial instrument. This Financial Accounting Standards Board’s (“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.

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

	December 31, 2011		December 31, 2010		December 31, 2009	
Annual dividend yield	-		-		-	
Expected life (years)	0.82		1.59		2.82	
Risk-free interest rate	0.10	%	0.48	%	1.49	%
Expected volatility	55	%	84	%	90	%

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The following tables set forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2011 and 2010.

	Carrying Value at December 31, 2011	Fair Value Measurement at December 31, 2011		
		Level 1	Level 2	Level 3
Redeemable liability – warrants	$ 17,500,000	$ -	$ 17,500,000	$ -
Derivative liability – warrants	4	-	4	-
Total liability measured at fair value	$ 17,500,004	$ -	$ 17,500,004	$ -

	Carrying Value at December 31, 2010	Fair Value Measurement at December 31, 2010		
		Level 1	Level 2	Level 3
Redeemable liability – warrants	17,500,000	-	17,500,000	-
Derivative liability – warrants	252,066	-	252,066	-
Total liability measured at fair value	$ 17,752,066	$ -	$ 17,752,066	$ -

Other than the assets and liabilities set forth in the table above, the Company did not identify any other assets or liabilities that are required to be accounted for at fair value on the balance sheet. The carrying value of long-term debt with variable interest rate approximates its fair value based on market rates available to the Company with similar terms (See Notes 5 and 6).

The following is a reconciliation of the beginning and ending balance of warrants liability measured at fair value on a recurring basis as of December 31, 2011and 2010:

	Fair Value Measurement at	
	December 31, 2011	December 31, 2010
Beginning balance	$ 252,066	$ 2,045,638
Change in fair value	(252,062)	(1,793,572)
Ending balance	$ 4	$ 252,066

The fair value of the warrants was $4 and $252,066 as of December 31, 2011 and 2010, respectively. The Company recognized a gain of $252,062, a gain of $1,793,572, and a loss of $1,031,330 for the years ended December 31, 2011, 2010 and 2009, respectively, to reflect the change in fair value of the warrants.

Revenue Recognition

Revenue is recognized when services are rendered to customers and 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. Construction contracts for installation of pipelines 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.

Stock-Based Compensations

The Company records and reports stock-based compensation based on 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. Compensation for stock granted to non-employees is determined as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

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. As at December 31, 2011 and 2010, there were no significant book to tax differences except for warrants liability and stock based compensation. An uncertain 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. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the year incurred. No significant penalties or interest relating to income taxes have been incurred during the years ended December 31, 2011, 2010 and 2009.

XXNGC, the Company's PRC VIE, and XXNGC's subsidiaries operate in the PRC. Pursuant to the tax laws of PRC, general enterprises are subject to income tax at an effective rate of 25%. However, under PRC income tax regulation, any company deemed to be engaged in the natural gas industry under such regulation enjoys a favorable income tax rate. Thus, XXNGC's income is subject to a reduced tax rate of 15%. All of XXNGC's subsidiaries are not deemed to be engaged in the natural gas industry under PRC income tax regulation and, accordingly, are subject to a 25% income tax rate.

The estimated tax savings as a result of the reduced tax rate enjoyed by XXNGC for the years ended December 31, 2011, 2010 and 2009 amounted to approximately $2,229,282, $2,095,808 and $2,410,928, respectively. The net effect on earnings per share, had the income tax been applied, would reduce basic earnings per share for the years ended December 31, 2011, 2010 and 2009, from $0.71 to $0.61, $0.81 to $0.71 and $1.13 to $0.99, respectively. The net effect on earnings per share, had the income tax been applied, would reduce diluted earnings per share for the years ended December 31, 2011, 2010 and 2009, from $0.71 to $0.61, $0.80 to $0.71 and $1.12 to $0.98, respectively.

China Natural Gas, Inc. was incorporated in the State of Delaware, United States and has incurred net operating losses for income tax purposes for the years ended December 31, 2011, 2010 and 2009. The estimated net operating loss carry-forwards for U.S. income tax purposes amounted to $10,259,949 as of December 31, 2011, which may be available to reduce future years' taxable income. These carry-forwards will expire, if not utilized through 2031. 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 U.S. income tax purposes. Accordingly, the Company has provided a 100% valuation allowance at December 31, 2011 and 2010 for net deferred tax assets resulting from net operating loss carry forwards, stock based compensation and warrants liability. Management reviews this valuation allowance periodically and makes adjustments as warranted. The valuation allowances were as follows:

	For the years ended December 31		
Valuation allowance	2011	2010	2009
Balance, beginning of period	$759,872	$917,754	563,541
Increase (decrease)	3,462,617	(157,882)	354,213
Balance, end of period	$4,222,489	$759,872	917,754

Provision for income tax is as follow:

	For the year ended December 31,	
	2011	2010
Current	$4,811,689	$3,792,531
Deferred	-	-
	$4,811,689	$3,792,531

The following is a reconciliation of the provision for income tax at the PRC tax rate, to the income tax reflected in the Consolidated Statement of Income and Comprehensive Income:

	December 31, 2011		December 31, 2010	December 31, 2009
Tax expense at statutory rate-US	35.0	%	34.0%	34.0%
Changes in valuation allowance-US	(35.0	)%	(34.0)%	(34.0)%
Foreign income tax rate-PRC	25.0	%	25.0%	25.0%
Effect of favorable tax rate	(8.3	)%	(9.0)%	(9.0)%
Other items (1)	7.3	%	2.0%	3.0%

Effective income tax rate	24.0 %	18.0%	19.0%

(1) The 7.3%, 2.0% and 3.0% represents $5,701,352, $1,525,674 and $3,444,173 in expenses incurred by the Company that are not deductible in the PRC for the years ended December 31, 2011, 2010 and 2009, respectively.

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The Company has cumulative undistributed earnings of foreign subsidiaries of approximately $62,572,536 as of December 31, 2011, 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 the Company concluded that such earnings will be remitted in the future.

Franchise Tax

According to the laws of the State of Delaware, we are required to pay annual franchise tax to the state government based on the number of the authorized shares. We paid $188,102, $107,350 and $6,888 for the year ended December 31, 2011, 2010 and 2009, respectively.

Basic and Diluted Earnings Per Share

Basic net earnings per share are based upon the weighted average number of common shares outstanding. Diluted net earnings per share are based on the assumption that all dilutive convertible shares and stock options were converted or exercised, unless this results in anti-dilution. 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.

Reclassification

Certain reclassifications have been made to the prior year financial statements to confirm with the current year presentation.

Recent Accounting Pronouncements

In May 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-04, *"Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs," ("ASU 2011-04").* ASU 2011-04 expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This new guidance is to be applied prospectively. This guidance will be effective for the Company beginning January 1, 2012. Management does not expect the adoption of this standard to have a significant effect on the Company's consolidated financial position or results of operations.

In June 2011, the FASB issued ASU No. 2011-05, *"Comprehensive Income (Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05").* ASU 2011-05 eliminates the option to report other comprehensive income and its components in the statement of changes in equity. ASU 2011-05 requires that all non-owner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This new guidance is to be applied retrospectively. This guidance will be effective for the Company beginning January 1, 2012. The Company anticipates that the adoption of this standard will not change the presentation of its consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, *“Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment” (“ASU 2011-08”).* Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. This amendment is effective for the years beginning after December 15, 2011. Management adopted this update early, as permitted, and it did not have a significant effect on the Company’s consolidated financial position or results of operations.

In December 2011, the FASB issued ASU No. 2011-11, *“Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities” (“ASU 2011-11”).* The amendments in this Update require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This guidance will be effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. Management does not expect the adoption of this standard to have a significant effect on the Company’s consolidated financial position or results of operations.

In December 2011, the FASB issued ASU No. 2011-12, *“Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05” (“ASU 2011-12”).* The amendments are being made to allow the Board time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. Management does not expect the adoption of this standard to have a significant effect on the Company’s consolidated financial position or results of operations.

Note 3—Goodwill and Other intangible Assets

Goodwill is the amount the Company paid to acquire 100% of the equity interests of Makou in excess of the fair value of Makou’s identifiable assets and liabilities. Annual impairment testing is performed during the fourth quarter of each year unless events or circumstances indicate earlier impairment testing is required. No impairment loss was recognized during the year ended December 31, 2011.

Other intangible assets include primarily the technical license related to liquefied natural gas business, which consisted of the following:

	December 31, 2011	December 31, 2010
Operating rights	$ 5,221,635	$ 5,032,541
Technical license (LNG)	10,527,223	-
Land use rights	3,147,108	2,014,413
Other	14,278	-
Total	$ 18,910,244	$ 7,046,954

The operating rights are deemed to have an indefinite useful life as cash flows are expected to continue indefinitely. The operating rights will not be amortized until their useful life is deemed to be no longer indefinite.

The technical license (LNG) is being amortized over its estimated useful life of 20 years. Amortization expense for the year ended December 31, 2011 was approximately $220,000. Accumulated amortization at December 31, 2011 was approximately $220,000.

The land use rights are being amortized over their estimated useful life of 30 years. For the years ended December 31, 2011, 2010 and 2009, amortization expense amounted to $116,701, $53,835 and $6,164, respectively. For the years ended December 31, 2011 and 2010, accumulated amortization was approximately $176,700 and $60,000, respectively.

Estimated amortization for the next five years and thereafter is as follows:

Date	
2012	$ 688,047
2013	688,047
2014	688,047
2015	688,047
2016	677,572
thereafter	10,244,571
	$ 13,674,331

Note 4 – Prepaid Expenses and Other Assets

Prepaid expenses and other assets consisted of the following:

	December 31, 2011	December 31, 2010
Prepaid rent – natural gas stations	$ 2,497,681	$ 2,317,270
Prepayment for acquiring land use right	4,596,080	3,822,840
Advances on purchasing equipment and construction in progress	2,297,909	3,358,008
Refundable security deposits	592,913	2,654,379
Long term investment deposit	991,620	-
Total	$ 10,976,203	$ 12,152,497

Prepaid rent represents prepayments for leasing the land of our fueling stations. In China, land rental usually need to be paid in advance and then amortized into expense on a straight-line basis over the term of the land lease.

All land in the PRC is government owned and the government leases land to users by granting land use rights. As of December 31, 2011 and 2010, the Company prepaid $4,596,080 and $3,822,840, respectively, to PRC local government authorities to purchase land use rights. The Company is in the process of negotiating the final purchase price with relevant local government and the land use rights have not yet been granted to the Company. Therefore, the Company did not amortize these amounts for land use rights.

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

Refundable security deposits are monies deposited with one of the Company’s major vendors and a gas station landlord. These amounts will be returned to the Company if the other party terminates the business relationship or upon the expiration of the lease.

Long term investment deposit represents the payment of $976,500 (RMB 6,300,000) made for the acquisition of Xiantao City Jinhua Gas and Oil Co., Ltd. (“XTJH”) by Xi’an Xilan Natural Gas Co., Ltd. , Ltd. (“XXNGC”). As of December 31, 2011, the transfer of the assets was under progress and the company has not exercised full control over its operations.

Subsequent to December 31, 2011, the Company paid additional deposits of approximately $647,000(RMB 4,142,857) in relation to the XTJH investment.

Note 5 –Senior Notes

The Company’s securities purchase agreement with Abax Lotus Ltd. (“Abax”) was amended on January 29, 2008 (as amended, the “Purchase Agreement”). Under the Purchase Agreement, on January 29, 2008, the Company sold to Abax $20,000,000 in principal amount of its 5.0% Guaranteed Senior Notes due January 30, 2014 (the “Senior Notes”) and warrants to purchase 1,450,000 shares of its common stock (the “Abax Warrants”) and, on March 3, 2008, the Company issued to Abax an additional $20,000,000 in principal amount of Senior Notes.

On the dates set forth in the table below, the Company will be required to make repayments of the corresponding percentage of the principal amount (or such lesser principal amount as shall be outstanding then) in respect of the aggregate outstanding principal amount of the Senior Notes:

Date	Repayment Percentage	
July 30, 2011 (paid on August 5, 2011)	8.3333	%
January 30, 2012(paid on March 7, 2012)	8.3333	%
July 30, 2012	16.6667	%
January 30, 2013	16.6667	%
July 30, 2013	25.0000	%
January 30, 2014	25.0000	%

The second repayment for 8.3333% of the principal of the Senior Notes was due on January 30, 2012. After negotiation with Abax, the note-holders agreed that the Company could make the payment on or before March 9, 2012. On March 7, 2012, the Company paid the principal due on January 30, 2012 in full plus accrued interest for the period from July 30, 2011 to January 29, 2012, as well as a penalty interest of $7,393 for the period from February 6, 2012 to March 7, 2012. Abax issued a waiver to exempt the Company from any other consequences of the late payment.

Senior notes consist of the following:

	December 31,	
	2011	2010
Notes payable	$41,053,100	$40,000,000
Less discount	(5,590,267)	(9,384,331)
	35,462,833	30,615,669
Less current portion	(9,671,682)	(2,551,306)
	$25,791,151	$28,064,363

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The Company has the option to redeem all, but not less than all, of the Senior Notes at the redemption prices set forth below (in each case expressed as a percentage of the outstanding unpaid principal amount), plus accrued and unpaid interest, if redeemed during the twelve-month period commencing on January 29 of the years set forth below:

Year	% of Outstanding Unpaid Principal	
2012	102	%
2013	100	%

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 terms of the Indenture obligated the Company to complete a qualifying listing, as defined therein, by January 29, 2009. As the Company did not complete a qualifying listing by such date, the Company was obligated to pay to Abax an additional interest at the rate of 3.0% per annum, calculated from and including January 29, 2009 to the date of its qualifying listing. However, Abax caused the Trustee to waive the Company's obligation to pay such additional interest in February 2009. The waiver extended the deadline for a qualifying listing to May 4, 2009, but provided that if a qualifying listing were not completed by such date, additional interest of 3.0% per annum would be payable from January 29, 2009 to the date of the Company's qualifying listing. The Company completed its NASDAQ listing, which constituted a qualifying listing, on June 1, 2009, after the extended deadline of May 4, 2009. Therefore, under the terms of the initial waiver, the Company was required to pay additional interest at a rate of 3.0% per annum for the period from January 29, 2009 to June 1, 2009, or $406,667. However, in August 2009, the Company reached an agreement with Abax whereby the Company agreed to pay Abax $113,214, which reflected additional interest at the rate of 3.0% per annum for the period from April 30, 2009 to May 31, 2009, and $50,000, which reflected out-of-pocket expenses incurred by Abax in connection with a financing transaction proposed in 2008, but never consummated.

The indenture limits the Company's ability to incur debt and liens, make dividend payments and stock repurchases, make investments, reinvest proceeds from asset sales and enter into transactions with affiliates, among other things. The indenture also requires the Company to maintain certain financial ratios.

In connection with the issuance of the Senior Notes, the Company paid $2,122,509 in debt issuance costs, which are being amortized over the life of the Senior Notes. For the years ended December 31, 2011, 2010 and 2009, the Company recorded $409,832, $409,832 and $409,832, respectively, of the issuance costs, of which $409,832, $409,832 and $345,892 were capitalized and included in construction in progress.

Estimated amortization for the next five years and thereafter is as follows:

Year	
2012	$409,832
2013	107,502
	$517,334

For the year ended December 31, 2011 and 2010, accumulated amortization was approximately $1,605,175 and $1,195,343, respectively.

The Abax Warrants are presently exercisable and have an exercise price of $7.37 per share, although Abax has not exercised any of the Abax Warrants.

The Abax Warrants are considered derivative instruments required to be bifurcated from the original security because there is a redemption requirement if the holder does not exercise the Warrants. If Abax does not exercise the Abax Warrants prior to their expiration date of January 29, 2015, Abax can require the Company to repurchase the Abax Warrants for $17,500,000. This amount is shown as a debt discount and is being amortized over the term of the Senior Notes. For the years ended December 31, 2011, 2010 and 2009, the Company amortized $3,794,064, $3,323,382 and $2,770,682, respectively, of the aforesaid discounts, of which $3,794,064, $3,323,382 and $2,490,432, respectively, were capitalized into construction in progress.

Note 6 – Bank Loan Payable

The Company’s bank loan payable as of December 31, 2011 consists of:

A loan from Pudong Development Bank Xi’an Branch, due various dates from 2012 to 2014	$14,166,000
Less current portion	(4,722,000)
	$9,444,000

The loan is secured by XXNGC’s equipment and vehicles located within the PRC. The net carrying value of the assets pledged is $11,249,330 as of December 31, 2011. Interest expense for the year ended December 31, 2011 and 2010 was $1,150,295 and $760,199, respectively (interest rate applied at December 31, 2011was 6.22%). According to the loan agreement, the interest rate is fixed throughout each single year and will only be adjusted at the beginning of the next year, based on the base interest rate on the same category of loans for the same term published by the People’s Bank of China. XXNGC also entered into a guaranty with the lender to guarantee the repayment of the loans. As the People’s Bank of China adjusted the standard interest rate three times in February, April and July 2011, beginning January 1, 2012 the interest rate of these loans will be 6.90%. According to an amendment to the loan agreement with the Bank, which was signed on October 2011, the Company is required to make repayments on the long term loan as follows:

	Repayment Percentage		Repayment Amount
October 5, 2011 (paid on October 10, 2011)	4.2	%	$787,000
December 5, 2011 (paid on December 5, 2011)	20.8	%	3,935,000
March 5, 2012 (paid on March 5, 2012)	4.2	%	787,000
December 5, 2012	20.8	%	3,935,000
March 5, 2013	8.3	%	1,574,000
December 5, 2013	16.7	%	3,148,000
March 5, 2014	8.3	%	1,574,000
December 5, 2014	16.7	%	3,148,000

$18,888,000

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Note 7 – Warrants

No warrants were granted, forfeited or exercised during the years ended December 31, 2011, 2010 and 2009, respectively.

The following is a summary of the warrants outstanding and exercisable as of December 31, 2011 and 2010:

Warrants Outstanding and Exercisable as of December 31, 2011

Exercise Price	Number	Average Remaining Contractual Life
$ 14.86	383,654	0.82
$ 7.37	1,450,000	3.08
	1,833,654	

Warrants Outstanding and Exercisable as of December 31, 2010

Exercise Price	Number	Average Remaining Contractual Life
$ 14.86	383,654	1.59
$ 7.37	1,450,000	4.08
	1,833,654	

Note 8 – Defined Contribution Plan

The Company is required to participate in a defined contribution plan operated by the local municipal government in accordance with PRC law and regulations. The contribution was $676,166, $389,219 and $224,949 for the years ended December 31, 2011, 2010 and 2009, respectively.

Note 9 – Stockholders' Equity

a) Statutory Reserve

The PRC Company Law, which is applicable to PRC companies with foreign ownership, stipulates that net income after taxation can only be distributed as dividends after appropriation has been made for the following:

i. making up cumulative prior years' losses, if any;

ii. allocations to the "statutory surplus reserve" of at least 10% of income after tax, as determined under PRC accounting rules and regulations, until the fund amounts to 50% of the Company's registered capital; and

iii. allocations to the discretionary surplus reserve, if approved in the shareholders' general meeting.

As of December 31, 2011 and 2010, the remaining amount needed to fulfill the 50% registered capital requirement was approximately $63,202,798 and $65,408,874, respectively.

b) Stock-based Compensation

2009 Stock Option and Stock Award Plan

On March 11, 2009, the Board approved by written consent the China Natural Gas, Inc. 2009 Employee Stock Option and Stock Award Plan (the "Plan"). Pursuant to the Plan, there are currently 1,460,000 shares of Company common stock authorized for issuance and the Company has granted 669,900 stock options as of December 31, 2011, of which 274,750 had been exercised and 176,700 had been cancelled and were available for reissuance. Thus, there were currently 966,800 shares of common stock of the Company available for future issuance under the Plan and 218,450 options outstanding. The exercise price for all of the outstanding options is $4.90 per share.

Stock-based compensation expenses of $627,660 and $1,018,303 were recorded during the years ended December 31, 2011 and 2010, respectively, relating to options granted under the Plan.

As of December 31, 2011, $740,190 of estimated expense with respect to non-vested stock-based compensation had yet to be recognized and would be recognized in expense over the optionee's remaining weighted average service period of approximately 1.25 years.

The following is a summary of the stock option activity:

	Options		Weighted Average Exercise Price	Aggregate Intrinsic Value
	Outstanding	Exercisable		
Balance, January 1, 2009	-	-	$ -	$ -
Granted	318,850		4.90	
Forfeited	(75,000)		-	
Exercised	-	-	-	-
Balance, December 31, 2009	243,850	-	$ 4.90	$ 1,516,747
Granted	380,850		4.90	
Forfeited	(127,400)		-	
Exercised	(138,000)		-	
Balance, December 31, 2010	359,300	2,750	$ 4.90	$ 219,173
Granted	31,900		4.90	
Forfeited	(36,000)		-	

Exercised	(136,750)		-	
Balance, December 31, 2011	218,450	3,750	$ 4.90	$-

The following is a summary of the status of stock options outstanding and exercisable as of December 31, 2011 and 2010:

December 31, 2011

Outstanding Options			Exercisable Options		
		Average			Average
Exercise Price	Number	Remaining	Exercise Price	Number	Remaining
		Contractual Life			Contractual Life
$4.90	218,450	3.25 years	$4.90	3,750	3.25 years

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December 31, 2010

Outstanding Options			Exercisable Options		
Exercise Price	Number	Average Remaining Contractual Life	Exercise Price	Number	Average Remaining Contractual Life
$4.90	359,300	4.25 years	$4.90	2,750	4.25 years

Note 10 – Earnings per Share

The following is a calculation of basic and diluted earnings per common share for the years ended December 31, 2011, 2010 and 2009:

	For the years ended December 31,		
	2011	2010	2009
Basic earnings per share			
Net income	$15,261,932	$17,220,372	$18,830,787
Weighted shares outstanding-Basic	21,418,389	21,268,972	16,624,294
Earnings per share-Basic	$0.71	$0.81	$1.13
Diluted earnings per share			
Net income	$15,261,932	$17,220,372	$18,830,787
Weighted shares outstanding -Basic	21,418,389	21,268,972	16,624,294
Effect of diluted securities-Warrants	-	46,644	206,613
Effect of diluted securities-Options	-	115,251	-
Weighted shares outstanding-Diluted	21,418,389	21,430,867	16,830,907
Earnings per share-Diluted	$0.71	$0.80	$1.12

The Company had outstanding warrants of 1,833,654 as of December 31, 2011, 2010 and 2009. For the year ended December 31, 2011, all 1,833,654 outstanding warrants were excluded from the diluted earnings per share calculation as the exercise price was greater than the average stock price during these periods. For the year ended December 31, 2010, the average stock price was greater than the exercise prices of the 1,450,000 warrants which resulted in additional weighted average common stock equivalents of 46,644; 383,654 outstanding warrants that were excluded from the diluted earnings per share calculation as they are anti-dilutive. For the year ended December 31, 2009, the average stock price was greater than the exercise prices of the 1,450,000 warrants which resulted in additional weighted average common stock equivalents of 206,613; 383,654 outstanding warrants were excluded from the diluted earnings per share calculation as they are anti-dilutive.

The Company had 218,450 outstanding employee stock options at December 31, 2011. For the year ended December 31, 2011and 2009, the outstanding options were excluded from the diluted earnings per share calculation as the exercise price was greater than the average option price during these periods. For the year ended December 31, 2010, the average stock price was greater than the exercise price of the options which resulted in additional weighted average common stock equivalents of 115,251.

Note 11 – Related Party Transactions

a) Other payable - related party

On February 24, 2011, the Company borrowed $787,000 from the JV for working capital purposes. This payable is due on demand with no interest rate.

b) Borrowings from related party

During year ended December 31, 2011, the Company borrowed a total of $2,679,945 from Mr. Hao Qu, a former employee of XXNGC and a shareholder of the Company, for working capital purposes. The loans were originally due in one year and required interest of 4.4075% per year, which is the annual USD lending rate applied by the Bank of China. The principal and interest was required to be paid on specified due dates beginning on February 16, 2012 through October 31, 2012. On March 22, 2012, the Company entered into an agreement with Mr. Qu, pursuant to which certain borrowings would be due in 2013, rather than in 2012, and would bear a higher rate of interest. The Company hasn't repaid any principal of the borrowings to date.

Borrowings from Mr. Qu at December 31, 2011, consist of the following:

Short-term at 4.4075% maturing on	
May 16, 2012	$699,975
May 17, 2012	299,970
October 31, 2012	360,000
	$1,359,945

Long-term at 6.225% maturing on	
February 15, 2013	$900,000

March 27, 2013	420,000
	$1,320,000

c) The Wang Loan

Demaoxing was formed in November 2007 by relatives of Mr. Qinan Ji, the Company's former Chief Executive Officer and current Chairman of the Company's Board of Directors (the "Demaoxing Promoters"). In January 2010, SXNGE, one of the Company's major subsidiaries, extended a loan of US$9,858,240 to Ms. Taoxiang Wang (the "Wang Loan"), who obtained a 40% ownership interest in Demaoxing on January 21, 2010. Ms. Taoxiang Wang used her 40% ownership interest in Demaoxing and its assets as collateral for the Wang Loan. On January 26, 2010, the Wang Loan funds were remitted by SXNGE to an account of Demaoxing. Management of the Company believed that the Wang Loan was adequately secured by collateral. On January 21, 2010, the Demaoxing Promoters also transferred 30% of their ownership interests in Demaoxing to Shaanxi Rongxin Real Estate Co., Ltd. ("Rongxin"). The Board of Directors has determined that the Demaoxing Promoters retained indirect beneficial interests in Demaoxing after transferring their ownership interests and thus the Wang Loan was a related party transaction.

The Company's Board of Directors was not notified of the extension of the Wang Loan by the Company, and did not approve the Wang Loan. Upon learning of the existence of the Wang Loan in April 2010, the Board of Directors required that the Wang Loan be immediately repaid. In April 2010, Demaoxing repaid the principal of the Wang Loan and made an interest payment of US$140,722, settling the Wang Loan in full.

Note 12 –Concentrations

Concentration of natural gas vendors:

	For the years ended December 31, 2011	2010	2009
Numbers of natural gas vendors	2	4	4
Percentage of total natural gas purchases	69 %	86 %	98 %

As of December 31, 2011 and 2010, the Company had $450,553 prepayment and $159,513 payable to its major suppliers, respectively.

The Company maintained long-term natural gas purchase agreements with two of its vendors, Huojia Hualong Petrochemical Co., Ltd. ("Huojia Hualong") and Qinshui Lanyan Coal Bed Methane Co., Ltd ("Qinshui Lanyan"), as of December 31, 2011. The Company's management reports that it does not expect any issues or difficulty in renewing the supply contracts with these vendors going forward.

Note 13 – Commitments and Contingencies

Lease Commitments

The Company entered into a series of long-term lease agreements with outside parties to lease land use rights for the Company's CNG fueling stations located in the PRC. The agreements have terms ranging from 10 to 30 years. The Company makes annual prepayments for most of these lease agreements. The Company also entered into five office leases in Xi'an, PRC, one office lease in Wuhan, PRC, one office lease in Yichang, PRC, one office lease in Huangshi, PRC and one office lease in New York, New York, USA. The minimum future payments for leasing land use rights and offices at December 31, 2011 are follows:

Year ending December 31, 2012	$2,026,624
Year ending December 31, 2013	1,888,551
Year ending December 31, 2014	2,253,065

Year ending December 31, 2015	1,901,980
Year ending December 31, 2016	1,844,820
Thereafter	29,833,037
Total	$ 39,748,077

For the years ended December 31, 2011, 2010 and 2009, the land use right and office lease expenses were $2,013,039, $2,083,039 and $1,623,127, respectively.

Property and Equipment Purchase Commitments

As of December 31, 2011, the Company had purchase commitments totaling $7,569,187 for materials, supplies, services and property and equipment for constructing the LNG plant and other construction projects.

Natural Gas Purchase Commitments

The Company has existing long-term natural gas purchase agreements with its major suppliers.

The Company continued to seek lower-cost sources of supply and did not have commitments for the purchasing volume of natural gas with any suppliers except Qinshui Lanyan. According to the agreement with Qinshui Lanyan, the Company should purchase from Qinshui Lanyan a daily volume of approximately 200,000 cubic meters of coal bed gas. Prices of natural gas are strictly controlled by the PRC government.

Capital Contribution

We failed to comply with PRC law in our recent contribution of capital to JBLNG and will be subject to possible fines, penalties and administrative actions until the capital contribution is registered in compliance with PRC law.

In August 2008, the board of directors of XXNGC passed a resolution to increase the registered capital of JBLNG to RMB118, 305,000 through the form of intangible asset contributions. In September 2008, JBLNG obtained its updated business license reflecting the increased registered capital. Pursuant to XXNGC's board resolution, China Natural Gas, Inc. transferred its right to use the two licenses it obtained relating to the design of our LNG facility directly to JBLNG as JBLNG's registered capital. However, we are not a shareholder of JBLNG and are therefore not permitted under PRC law to contribute capital to JBLNG. In addition, PRC law does not allow the contribution of capital in the form of an intangible asset, such as the licenses in issue, where the assets are not owned by the contributor. We are restructuring the capital contribution as a cash contribution and revising our LNG licenses so that the licensee is JBLNG and believe that this capital contribution and license restructuring will comply with PRC laws. However, until we have completed this process, the relevant regulatory authorities may impose fines or penalties, or require us to cease the operations of JBLNG, until such time as these defects are remedied. Any such fines, penalties or delay in operations could have a material and adverse effect on our LNG business in terms of our future growth, financial conditions and results of operations. Currently we do not estimate such fines, penalties and administrative actions to be probable, so we do not recognize them as contingent liabilities in our consolidated financial statements.

VIE Structure

In order to comply with PRC laws limiting foreign ownership of Chinese companies, we conduct our natural gas business through Xi'an Xilan Natural Gas Co., Ltd. by means of contractual arrangements which may not be as effective as direct ownership or may be deemed in violation of PRC restrictions on foreign investment in our industry.

The government of the PRC restricts foreign investment in natural gas businesses in China. Accordingly, we operate our business in China through our VIE, XXNGC. XXNGC holds the licenses, approvals and assets necessary to operate our natural gas business in China. We have no equity ownership interest in XXNGC and rely on contractual arrangements with XXNGC and its shareholders that allow us to substantially control and operate XXNGC. These contractual arrangements may not be as effective in providing control over XXNGC as direct ownership would be. For example, XXNGC could fail to take actions required for our business despite its contractual obligation to do so. If XXNGC fails to perform under its agreements with us, we may have to spend substantial costs and resources to enforce such arrangements and may have to rely on legal remedies under the laws of the PRC, which may not be effective. In addition, we cannot assure you that XXNGC’s shareholders and management would always act in our best interests.

Although we believe that we comply with current regulations of the PRC, we cannot assure you that the PRC government would agree that our structure or operating arrangements comply with the PRC’s licensing, registration or other regulatory requirements under existing policies or with requirements or policies that may be adopted in the future. If the PRC government determines that our structure or operating arrangements do not comply with applicable laws, it could revoke our business and operating licenses, require us to discontinue or restrict our operations, restrict our right to collect revenues, require us to restructure our operations, impose additional conditions or requirements with which we may not be able to comply, impose restrictions on our business operations or on our customers, or take other regulatory or enforcement actions against us that could be harmful to our business. In addition, the equity pledge in the Equity Pledge Agreement between SXNGE and XXNGC and XXNGC's shareholders has not been registered and may be deemed to be unenforceable under PRC laws.

Other than the proxy agreement between SXNGE, XXNGC and XXNGC's chairman and shareholders, which does not contain a choice of law or jurisdictional clause, our contractual arrangements with XXNGC are governed by PRC laws and they provide for the resolution of disputes through arbitration in the PRC. Accordingly, these contracts would be interpreted in accordance with PRC laws and any disputes would be resolved in accordance with PRC legal procedures. If XXNGC or its shareholders fail to perform their respective obligations under these contractual arrangements, we may have to (i) spend substantial costs and resources to enforce such arrangements, and (ii) rely on legal remedies under PRC laws, including seeking specific performance or injunctive relief, and claiming damages, which we cannot be sure would be effective. However, the legal environment in the PRC is not as developed as in the United States and uncertainties in the Chinese legal system could limit our ability to enforce these contractual arrangements. In the event that we are unable to enforce these contractual arrangements, our business, financial condition and results of operations could be materially and adversely affected. Currently we do not estimate the possibility of such defaults in enforcing the contractual arrangements to be probable, and it will be extremely difficult to make any reliable to the amounts of the potential losses that may be caused by such defaults, so we do not recognize it as a contingent liability in our consolidated financial statements.

Individuals Claims to Certain Shares

Certain shares in XXNGC, our VIE, may be subject to adverse claims.

Six individuals have previously claimed to own 1,200,000 shares of XXNGC's common stock, our main operating company and VIE. They have claimed that they acquired these shares from other shareholders of XXNGC. Based on XXNGC's registered capital of RMB69,000,000 when it became a joint stock limited company in 2004, we believe that the 1,200,000 shares represented 1.74% of XXNGC's outstanding common stock at the time when the six individuals claimed to have acquired the 1,200,000 shares of XXNGC. While we and XXNGC dispute their claim of ownership over the 1,200,000 shares, there is no assurance that XXNGC will prevail if these six individuals pursue their claim in legal proceedings. If these six individuals are found to have legitimate ownership over these shares, XXNGC's shareholding structure may change and our revenues from our contractual arrangements with XXNGC may be reduced. Currently we do not estimate the possibility of such change to the shareholding structure to be probable, so we do not recognize it as a contingent liability in our financial statements.

Legal Proceedings

Other than described below, there have been no material developments in the legal proceedings in which we were involved during the year ended December 30, 2011. For a description of previously reported legal proceedings refer to Part I, Item 3, "Legal Proceedings" of the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

a) Vandevelde v. China Natural Gas, Inc., et al. (Case No. 1:10CV00728, United States District Court for the District of Delaware). As previously disclosed, on August 26, 2010, plaintiff Maxwell Vandevelde filed a putative class action against the Company and certain of its current and former officers and directors alleging that the defendants violated U.S. federal securities laws. On August 12, 2011, the Court entered an order appointing Robert Skeway, an individual investor, as lead plaintiff and approving his selection of lead counsel. Lead plaintiff and Raimundo Jo-Fung, another individual investor, who together seek to represent a class of all purchasers and acquirers of the Company's common stock between March 10, 2010 and September 21, 2011, filed an amended complaint on October 11, 2011. Plaintiffs assert claims for violations of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder. The amended complaint alleges the defendants made false or misleading statements in the Company's Annual Reports on Form 10-K for the years ended December 31, 2009, and December 31, 2010, and in various quarterly reports, by purportedly failing to disclose a series of loans and related party transactions. The amended complaint also asserts claims against certain of the Company's current and former officers and directors for violations of Section 20(a) of the Securities Exchange Act of 1934. The suit seeks unspecified monetary damages.

Pursuant to a stipulation agreed on by the parties and order by the Court, the Company is required to answer, move to dismiss or otherwise respond to the amended complaint by December 12, 2011. The Company cannot provide at this time any assurance that the outcome of this suit will not be materially adverse to our financial condition, consolidated results of operations, cash flows or business prospects.

On August 12, 2011, the Court entered an order appointing Robert Skeway, an individual investor, as lead plaintiff and approving his selection of lead counsel. Lead plaintiff and Raimundo Jo-Fung, another individual investor, who together seek to represent a class of all purchasers and acquirers of the Company's common stock between March 10, 2010 and September 21, 2011, filed an amended complaint on October 11, 2011. On December 12, 2011, we filed a motion to dismiss. Plaintiff's counsel filed its opposition to the motion to dismiss on March 2, 2012. We have until April 16, 2012 to file our reply brief with the court.

b) On June 16, 2008, James A. Garner, a former independent member of the Company's board filed a lawsuit against the Company and two other board members in New York State Supreme Court, Nassau County. The plaintiff alleges violations of Labor Law § 740, defamation, breach of contract, and fraud. The court ordered the Company to issue 20,000 options to the plaintiff subject to any restrictions required by applicable securities laws and dismissed all of plaintiff's remaining claims. On June 29, 2010, the Court of Appeals of New York denied plaintiff's motion for leave to appeal.

c) On December 5, 2011, plaintiff Haitham J. Kousa filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, Yang Xiang Dong, China Natural Gas, Inc. and The Nasdaq Stock Market, LLC, as defendants (C.A. No. 11-1202-SLR), and on January 17, 2012, plaintiff Robert Mallano also filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, Yang Xiang Dong, China Natural Gas, Inc., as defendants (C.A. No. 12-0048-SLR) (the "Constituent Actions"). The Constituent Actions allege, inter alia, breach of fiduciary duties, self-dealing, and misconduct by management for related-party loans to management and the failure to disclose such loans. The Constituent Actions were consolidated on February 14, 2012 and bear the following caption, In re China Natural Gas, Inc. Shareholder and Derivative Litigation (Consol. C.A. No. 11-1202-SLR). On March 19, 2012 the court granted Nasdaq's motion to dismiss, denied plaintiff's motion for appointment of a receiver and dismissed plaintiff's motion for expedited discovery.

d) On February 8, 2012, plaintiff Rick Steinmetz, filed an action in the U.S. District Court for the District of Delaware against Qinan Ji, Zhiqiang Wang, Lawrence W. Leighton, Frank Waung, David She, Carl Yeung, Yang Xiang Dong, China Natural Gas, Inc., alleging the same or similar claims as in the Constituent Actions. This case has not yet been consolidated with the Constituent Actions, although we believe consolidation will occur soon.

We intend to defend these cases vigorously. We currently cannot estimate the outcome of these matters as of the date of this Report.

In addition, the Company is involved in disputes and legal actions from time to time in the ordinary course of our business. The Company does not believe that any of these matters, individually or in the aggregate, will have a material adverse effect on our operations.

Note 14 – Quarterly Financial Information (Unaudited)

Year Ended December 31, 2011	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Revenues	$24,108,108	$27,313,169	$36,897,375	$35,902,874	$124,221,526
Gross profit	9,720,301	11,231,094	14,178,924	13,087,757	48,218,076
Net income	2,485,831	4,393,685	4,545,093	3,837,323	15,261,932
Basic EPS	0.12	0.21	0.21	0.17	0.71
Diluted EPS	0.12	0.21	0.21	0.17	0.71

Year Ended December 31, 2010	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Revenues	$19,366,823	$21,135,599	$22,326,474	$27,124,727	$89,953,623
Gross profit	9,094,968	9,615,532	9,389,195	11,313,769	39,413,464
Net income	3,995,270	4,560,503	3,584,842	5,079,757	17,220,372
Basic EPS	0.19	0.21	0.17	0.24	0.81
Diluted EPS	0.19	0.21	0.17	0.23	0.80

Year Ended December 31, 2009	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Revenues	$18,527,666	$20,742,520	$20,125,184	$21,670,748	$81,066,118
Gross profit	9,633,652	10,278,190	9,717,692	10,531,545	40,161,079
Net income	4,201,623	3,862,756	4,647,519	6,118,889	18,830,787
Basic EPS	0.29	0.26	0.29	0.29	1.13
Diluted EPS	0.29	0.26	0.29	0.28	1.12