

China Natural Gas, Inc.
Form 10-Q/A
February 29, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Amendment No.1)

(Mark One)

☒ QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2011

☐ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
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 No.)

19th Floor, Building B, Van Metropolis

35 Tang Yan Road, Hi-Tech Zone

Xi'an, 710065, Shaanxi Province, China

+86-29-8832-7391

(Address, including zip code, and telephone number, including area code, of registrant's

principal executive offices)

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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☒

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

Large accelerated filer ☐ Accelerated filer ☒
Non-accelerated filer ☐ Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

The number of shares outstanding of the registrant's common stock as of August 2, 2011 was 21,458,654.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (the “Amended Filing”) amends the Quarterly Report of China Natural Gas, Inc. (the “Company”) on Form 10-Q for the quarter ended June 30, 2011, originally filed on August 8, 2011 (the “Original Filing”).

As disclosed in the Company's Quarterly Report on Form 10-Q/A (Amendment No. 3) for the quarter ended March 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.

As a result, the Company filed a Current Report on Form 8-K on September 21, 2011 to disclose that its quarterly financial statements for the three months ended March 31, 2010, June 30, 2010 and September 30, 2010, respectively, and its annual financial statements for the year ended December 31, 2010, should no longer be relied upon due to a failure to correctly disclose the Wang Loan as a related party transaction.

The purpose of this Amended Filing is to reclassify the Wang Loan and properly disclose the related party transaction nature of the Wang Loan. The amendments herein include: (i) reclassification of the Wang Loan from Loan Receivables to Loan Receivables – Related Party, (ii) disclosure of the related party transaction nature of the Wang Loan; and (iii) other disclosures related to the foregoing, including additional material weaknesses in the Company's disclosure controls and procedures and internal control over financial reporting and certain remediation measures related thereto.

In accordance with Rule 12b-15 under the Exchange Act, each item of the Original Filing that is amended by this Amended Filing is also restated in its entirety, and this Amended Filing is accompanied by currently dated certifications on Exhibits 31.1, 31.2, 32.1 and 32.2 by the Company's Chief Executive Officer and Chief Financial Officer. Except as described above, this Amended Filing does not amend, update, or change any items, financial

statements, or other disclosures in the Original Filing, and does not reflect events occurring after the filing of the Original Filing, including as to any exhibits to the Original Filing, affected by subsequent events. Information not affected by the changes described above is unchanged and reflects the disclosures made at the time of the Original Filing. Accordingly, this Amended Filing should be read in conjunction with the Original Filing and our other SEC filings subsequent to the filing of the Original Filing, including any other amendments to those filings. Capitalized terms not defined in the Amended Filing are as defined by the Original Filing.

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PART I — FINANCIAL INFORMATION**Item 1. Financial Statements****CHINA NATURAL GAS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

	June 30, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 12,221,545	\$ 10,046,249
Accounts receivable, net	2,712,502	1,821,595
Other receivables	312,331	188,364
Employee advances	305,415	302,532
Inventories	1,766,505	815,884
Advances to suppliers	1,429,156	8,434,995
Prepaid expense and other current assets	4,879,524	4,249,353
Total current assets	23,626,978	25,858,972
Investment in unconsolidated joint ventures	1,547,000	1,517,000
Property and equipment, net	93,983,731	82,769,171
Construction in progress	126,708,395	116,569,871
Deferred financing cost, net	722,250	927,166
Other assets	23,133,004	19,806,375
TOTAL ASSETS	\$ 269,721,358	\$ 247,448,555
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Notes payable - current maturities	\$ 2,708,489	\$ 2,551,306
Long-term debt - current portion	4,641,000	-
Accounts payable and accrued liabilities	6,527,948	5,428,669
Other payable - related party	773,500	-
Short-term borrowing - related party	2,319,945	-
Unearned revenue	5,826,531	2,376,563
Accrued interest	1,010,229	646,528
Taxes payable	2,417,076	2,377,765
Total current liabilities	26,224,718	13,380,831

LONG-TERM LIABILITIES:

Notes payable, net of current portion	29,793,495	28,064,363
Long-term debt	13,923,000	18,204,000
Derivative liabilities – warrants	17,512,256	17,752,066
Total long-term liabilities	61,228,751	64,020,429
Total liabilities	87,453,469	77,401,260

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY:

Preferred stock, par value \$0.0001 per share, 50,000,000 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 June 30, 2011 and December 31, 2010, respectively	2,145	2,132
Additional paid-in capital	82,510,535	81,611,763
Accumulated other comprehensive income	20,109,437	15,667,145
Statutory reserves	8,968,479	7,918,634
Retained earnings	70,677,293	64,847,621
Total stockholders' equity	182,267,889	170,047,296
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 269,721,358	\$ 247,448,555

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

CHINA NATURAL GAS, INC. AND SUBSIDIARIES**CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND****COMPREHENSIVE INCOME****(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenues				
Natural gas	\$ 22,285,730	\$ 16,221,003	\$ 42,633,560	31,704,632
Gasoline	1,974,377	2,033,840	3,281,550	3,502,656
Installation and others	3,053,062	2,880,756	5,506,167	5,295,134
	27,313,169	21,135,599	51,421,277	40,502,422
Cost of revenues				
Natural gas	12,870,450	8,357,990	24,969,900	16,222,644
Gasoline	1,902,709	1,910,294	3,127,433	3,277,572
Installation and others	1,308,916	1,251,783	2,372,548	2,291,706
	16,082,075	11,520,067	30,469,881	21,791,922
Gross profit	11,231,094	9,615,532	20,951,396	18,710,500
Operating expenses				
Selling	4,041,412	3,054,992	7,621,333	5,946,782
General and administrative	1,851,785	1,913,866	4,762,756	3,731,522
	5,893,197	4,968,858	12,384,089	9,678,304
Income from operations	5,337,897	4,646,674	8,567,307	9,032,196
Non-operating income (expense):				
Interest income	9,273	260,021	15,920	349,387
Interest expense	-	-	(4,666)	-
Other (expense) income, net	(9,091)	(3,031)	87,865	43,538
Change in fair value of warrants	123,630	665,115	239,810	1,058,183
Foreign currency exchange loss	(4,006)	(34,665)	(7,048)	(42,775)
	119,806	887,440	331,881	1,408,333
Income before income tax	5,457,703	5,534,114	8,899,188	10,440,529
Provision for income tax	1,064,018	973,611	2,019,671	1,884,756
Net income	4,393,685	4,560,503	6,879,517	8,555,773

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Other comprehensive income				
Foreign currency translation gain	2,993,637	797,858	4,442,292	759,004
Comprehensive income	\$7,387,322	\$5,358,361	\$11,321,809	\$9,314,777
Weighted average shares outstanding				
Basic	21,428,265	21,246,771	21,375,085	21,215,337
Diluted	21,428,265	21,582,662	21,377,407	21,619,989
Earnings per share				
Basic	\$0.21	\$0.21	\$0.32	0.40
Diluted	\$0.21	\$0.21	\$0.32	0.40

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

CHINA NATURAL GAS, INC. AND SUBSIDIARIES**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	For the Six Months Ended June 30,	
	2011	2010
Net income	\$6,879,517	\$8,555,773
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,744,657	3,070,705
Provision for doubtful accounts	20,810	42,390
Stock-based compensation	228,711	867,096
Change in fair value of warrants	(239,810)	(1,058,183)
Change in assets and liabilities:		
Accounts receivable	(866,852)	76,830
Other receivables	(118,999)	658,742
Employee advances	2,796	50,142
Inventories	(712,617)	3,008
Advances to suppliers	(381,947)	(782,495)
Prepaid expense and other current assets	(548,647)	(2,594,001)
Accounts payable and accrued liabilities	992,566	1,455,262
Other payables	-	15,266
Unearned revenue	3,367,774	459,057
Accrued interest	363,701	(79,987)
Taxes payable	(7,632)	141,433
Net cash provided by operating activities	12,724,028	10,881,038
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payment for acquisition of property and equipment	(5,723,603)	(6,260,885)
Loans to related party	-	(9,858,240)
Loans to third party	-	(4,401,000)
Repayment of loans receivable – related party	-	9,858,240
Repayment of loans receivable – third parties	-	4,694,380
Additions to construction in progress	(5,232,444)	(14,317,621)
Prepayment on long-term assets	(3,499,321)	(6,520,371)
Payment for acquisition of business	-	(3,637,912)
Return of acquisition deposit	-	1,613,590
Payment for intangible assets	(141,129)	(4,869,242)
Payment for land use rights	-	(1,147,360)
Net cash used in investing activities	(14,596,497)	(34,846,421)

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from exercise of stock options	670,075	676,201
Proceeds from short-term debt and other payable, related parties	3,085,445	-
Proceeds from long-term debt	-	17,602,800
Net cash provided by financing activities	3,755,520	18,279,001
Effect of exchange rate changes on cash and cash equivalents	292,245	114,998
NET INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	2,175,296	(5,571,384)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	10,046,249	48,177,794
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 12,221,545	\$ 42,606,410
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid, including capitalized interest	\$ 1,700,611	\$ 1,288,328
Income taxes paid	\$ 2,062,496	\$ 2,030,575
Non-cash transactions for investing and financing activities:		
Construction material transferred to construction in progress	\$ 5,346,835	\$ -
Construction in progress transferred to property and equipment	\$ 12,781,821	\$ 4,107,320
Advances to suppliers transferred to construction in process	\$ 7,480,412	\$ 1,678,940
Other assets transferred to construction in progress	\$ 640,767	\$ -
Capitalized interest - amortization of discount of notes payable and issuance cost	\$ 2,091,230	\$ 1,777,516

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

China Natural Gas, Inc. and Subsidiaries

Notes to Unaudited Condensed 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 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. The condensed consolidated balance sheets as of June 30, 2011 and December 31, 2010, the condensed consolidated statements of income and comprehensive income for the three and six months ended June 30, 2011 and 2010 and cash flows for the six months ended June 30, 2011 and 2010 include the accounts of China Natural Gas, Inc. and subsidiaries and VIE. 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 operation and commenced commercial production and sale.

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") Pursuant to the contract, XXNGC will acquire 58.5284% ownership of XTJH at a total purchase price of approximately \$1,909,000. The acquisition is subject to the satisfaction of all the following closing conditions:

the transferor, or the shareholders of XTJH, as applicable, must satis