China Natural Gas, Inc.
Form 10-Q
November 13, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from ____________ to __________

000-31539
(Commission file number)

CHINA NATURAL GAS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**98-0231607**
(State or other jurisdiction of incorporation or organization)	(IRS Employer of Identification No.)

Tang Xing Shu Ma Building, Suite 418
Tang Xing Road
Xian High Tech Area
Xian, Shaanxi Province, China
(Address of principal executive offices)

710075
(zip code)

86-29-88323325
(registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Number of shares of Common Stock outstanding as of November 11, 2008: 29,200,304

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

China Natural Gas, Inc. and Subsidiaries
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CHINA NATURAL GAS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2008 and DECEMBER 31, 2007

	September 30, 2008 (Unaudited)	December 31, 2007
ASSETS		
CURRENT ASSETS:		
Cash & cash equivalents	$ 20,384,702	$ 13,291,729
Short-term investments	-	238,554
Accounts receivable	1,622,508	306,179
Other receivable-employee advances	865,800	549,820
Inventories	445,420	231,339
Advances to suppliers	1,226,341	663,041
Prepaid expense and other current assets	891,255	109,722
Loan receivable	-	274,200
Total current assets	25,436,026	15,664,584
PROPERTY AND EQUIPMENT, net	55,153,057	32,291,995
CONSTRUCTION IN PROGRESS	19,410,492	2,210,367
DEFERRED FINANCING COSTS	1,849,288	-
OTHER ASSETS	10,278,250	3,123,052
TOTAL ASSETS	$ 112,127,113	$ 53,289,998
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 715,890	$ 487,710
Other payables	98,090	55,979
Unearned revenue	384,745	327,220
Accrued interest	350,002	-
Taxes payable	1,911,550	1,211,775
Total current liabilities	3,460,277	2,082,684
LONG-TERM LIABILITIES:		
Notes payable, net of $16,104,432 discount	23,895,568	-
Derivative liabilities - warrants	17,500,000	-
Total long-term liabilities	41,395,568	-
COMMITMENTS AND CONTINGENCIES	-	-
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.0001 per share; authorized 5,000,000 shares; none issued	-	-
Common stock, $0.0001 per share; 45,000,000 authorized shares 29,200,304 shares issued and outstanding at September 30, 2008 and December 31, 2007	2,920	2,920
Additional paid-in capital	32,098,740	32,046,879

Accumulative other comprehensive gain		8,031,065		3,477,025
Statutory reserves		3,228,224		1,802,735
Retained earnings		23,910,319		13,877,755
Total stockholders' equity		67,271,268		51,207,314
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	112,127,113	$	53,289,998

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

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CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007
(Unaudited)

	Three months ended September 30		Nine months ended September 30	
	2008	**2007**	**2008**	**2007**
Revenue				
Natural gas revenue	$ 15,354,461	$ 7,555,131	$ 40,494,646	$ 19,243,968
Installation and other	3,046,739	1,522,958	8,822,714	4,851,006
Total revenue	18,401,200	9,078,089	49,317,360	24,094,974
Cost of revenue				
Natural gas cost	6,973,035	4,020,039	20,369,778	9,975,932
Installation and other	1,935,798	738,211	5,700,976	2,138,734
Total cost of revenue	8,908,833	4,758,250	26,070,754	12,114,666
Gross profit	9,492,367	4,319,839	23,246,606	11,980,308
Operating expenses				
Selling	2,098,343	939,496	5,008,631	2,216,048
General and administrative	968,169	1,028,197	2,947,494	1,710,459
Total operating expenses	3,066,512	1,967,693	7,956,125	3,926,507
Income from operations	6,425,855	2,352,146	15,290,481	8,053,801
Non-operating income (expense):				
Interest income	13,536	23,831	120,297	41,570
Interest expense	(212,774)	-	(1,249,003)	-
Other income (expense)	(55,391)	31,148	(118,948)	39,504
Total non-operating income (expense)	(254,629)	54,979	(1,247,654)	81,074
Income before income tax	6,171,226	2,407,125	14,042,827	8,134,875
Provision for income tax	1,034,636	445,463	2,584,774	1,317,878
Net income	5,136,590	1,961,662	11,458,053	6,816,997
Other comprehensive income				
Foreign currency translation gain	756,316	455,308	4,554,040	1,320,878
Comprehensive Income	$ 5,892,906	$ 2,416,970	$ 16,012,093	$ 8,137,875

Weighted average shares outstanding								
Basic		29,200,304		27,122,196		29,200,304		25,191,521
Diluted		29,279,590		27,286,286		29,316,837		25,223,465
Earnings per share								
Basic	$	0.18	$	0.07	$	0.39	$	0.27
Diluted	$	0.18	$	0.07	$	0.39	$	0.27

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

CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007
(Unaudited)

	Nine months ended September 30	
	2008	**2007**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 11,458,053	$ 6,816,997
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,295,534	1,146,247
Loss on disposal of building improvements and equipment	12,265	-
Amortization of discount on senior notes	555,001	-
Amortization of financing costs	147,002	-
Stock based compensation	51,861	-
Change in assets and liabilities:		
Accounts receivable	(1,269,832)	257,002
Other receivable-employee advances	(273,759)	400,049
Inventories	(194,580)	222,112
Advances to suppliers	(508,417)	(31,464)
Prepaid expense and other current assets	(783,706)	59,855
Accounts payable and accrued lilibilities	193,212	195,660
Other payables	37,587	(204,215)
Accrued interest	350,002	-
Unearned revenue	34,855	187,825
Taxes payable	606,233	(1,019,262)
Net cash provided by operating activities	12,711,311	8,030,806
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from short term investments	249,464	-
Proceeds from loan receivable	286,740	-
Purchase of property and equipment	(21,693,376)	(5,871,571)
Additions to construction in progress	(16,679,747)	-
Prepayment on long term assets	(6,774,616)	-
Prepayment for land use rights	-	(967,150)
Net cash used in investing activities	(44,611,535)	(6,838,721)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Stock issued for cash	-	15,000,000
Proceeds from senior notes	40,000,000	-
Payment for offering costs	(2,122,509)	(1,176,533)
Net cash provided by financing activities	37,877,491	13,823,467
Effect of exchange rate changes on cash and cash equivalents	1,115,706	367,667
NET INCREASE IN CASH & CASH EQUIVALENTS	7,092,973	15,383,219

CASH & CASH EQUIVALENTS, BEGINNING OF PERIOD		13,291,729		5,294,213
CASH & CASH EQUIVALENTS, END OF PERIOD	$	20,384,702	$	20,677,432
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Interest paid	$	902,777	$	-
Income taxes paid	$	2,012,652	$	1,955,424

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

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
September 30, 2008
(Unaudited)

Note 1 - Organization

Organization and Line of Business

China Natural Gas, Inc. (the "Company") was incorporated in the state of Delaware on March 31, 1999. The Company through its wholly-owned subsidiaries and variable interest entities engages in distribution of natural gas to commercial, industrial and residential customers, construction of pipeline networks, and installation of natural gas fittings and parts for end-users.

On May 15, 2007, the Company's variable interest entity, through Xi'an Xilan Natural Gas Co, Ltd. ("XXNGC") established Xi'an Xilan Auto Bodyshop Co., Ltd ("XXABC") with registered capital of $519,200 in Shaanxi province, People's Republic of China ("PRC"). XXABC was established for the purpose of providing modification services to different types of automobiles to be able to use natural gas. XXABC is 100% owned by Xi'an Xilan Natural Gas Co, Ltd.

On March 18, 2008, Xilan Natural Gas Equipment Co., Ltd ("XNGE") increased its registered capital from $30,000,000 to $53,929,260. An additional $14,429,260 of registered capital was contributed by China Natural Gas, Inc on April 17, 2008 and $9,500,000 of registered capital was contributed by China Natural Gas Inc. as a payment to Chemtex International Inc on January 31, 2008, for the purchase of license, know-how, and design of constructing the Liquefied Natural Gas ("LNG") processing plant.

On April 22, 2008, Shaanxi Jingbian Liquefied Natural Gas Co., Ltd. ("SJLNG") increased its registered capital to $2,862,000. SJLNG is 100% owned by Xi'an Xilan Natural Gas Co., Ltd.

On April 30, 2008, the Industrial and Commercial Administration Bureau approved XXNGC to increase registered capital from $8,336,856 to $43,443,640 as an additional contribution by the shareholders of XXNGC under PRC Law. $15,513,526 was approved by the Industrial and Commercial Administration Bureau to be transferred out from the surplus reserve and retained earning as an increase of registered capital. Another $19,593,258 was contributed by XNGE cumulatively prior to April 30, 2008, which was previously classified as intercompany payable in XXNGC and was eliminated in the consolidated financial statements. The increase in registered capital in XXNGC was in compliance with the Addendum to Option Agreement entered by the Company through XXGE and XXNGC, Mr. Qinan Ji, chairman and shareholder of XXNGC, and each of the shareholders of XXNGC (hereafter collectively referred to as the "Transferor") on August 8, 2008, and made retroactive to June 30, 2008. See "Consolidation of Variable Interest Entity" section for further detail on the Addendum to Option Agreement.

On July 3, 2008, XXNGC formed Henan Xilan Natural Gas Co., Ltd. ("HXNGC") as a wholly-owned limited liability company, with registered capital of $4,383,000 in Henan province PRC. NXNGC was established for the purpose of natural gas city gasification engineering design, construction and technical advisory work services in Henan, PRC.

China Natural Gas, Inc. and Subsidiaries
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(Unaudited)

Note 2 – Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of China Natural Gas, Inc. and its wholly owned subsidiary, Xilan Natural Gas Equipment Co., Ltd and its 100% variable interest entities ("VIE"), Xi'an Xilan Natural Gas Co. Ltd., Shaanxi Jingbian Liquefied Natural Gas Co., Ltd., Xian Xilan Auto Bodyshop Co., Ltd and Henan Xilan Natural Gas Co., Ltd. All inter-company accounts and transactions have been eliminated in the consolidation.

In accordance with Financial Interpretation No. 46R, Consolidation of Variable Interest Entities ("FIN 46R"), VIEs are generally entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders lack adequate decision making ability. All VIEs with which the Company is involved must be evaluated to determine the primary beneficiary of the risks and rewards of the VIE. The primary beneficiary is required to consolidate the VIE for financial reporting purposes.

On February 21, 2006, we formed Xilan Natural Gas Equipment Co., Ltd as a wholly-owned foreign enterprise (WOFE). We then, through XNGE, entered into exclusive arrangements with Xian Xilan Natural Gas and its shareholders that give us the ability to substantially influence Xian Xilan Natural Gas' daily operations and financial affairs, appoint its senior executives and approve all matters requiring shareholder approval. We memorialized these arrangements on August 17, 2007. As a result, the Company consolidates the financial results of Xian Xilan Natural Gas as variable interest entity pursuant to Financial Interpretation No. 46R, "Consolidation of Variable Interest Entities." The arrangements consist of the following agreements:

a. Xian Xilan Natural Gas holds the licenses and approvals necessary to operate its natural gas business in China.

b. XNGE provides exclusive technology consulting and other general business operation services to Xian Xilan Natural Gas in return for a consulting services fee which is equal to Xian Xilan Natural Gas's revenue.

c. Xian Xilan Natural Gas's shareholders have pledged their equity interests in Xian Xilan Natural Gas to the Company.

d. Irrevocably granted the Company an exclusive option to purchase, to the extent permitted under PRC law, all or part of the equity interests in Xian Xilan Natural Gas and agreed to entrust all the rights to exercise their voting power to the person appointed by the Company.

On August 8, 2008, the Company through XXGE entered into an Addendum to Option Agreement with Mr. Qinan Ji, chairman and shareholder of XXNGC, and each of the shareholders of XXNGC (hereafter collectively referred to as the "Transferor"), and made retroactive to June 30, 2008. According to the agreement, the Chairman and the Shareholders of XXNGC irrevocably grants to XNGE an option to purchase or cause any person designated by XNGE to purchase, to the extent permitted under PRC Law, according to the steps determined by XNGE, at $1.00 for each Transferors' Purchased Equity Interest or the lowest price permissible under the applicable laws if the applicable PRC laws stipulate restrictions on the purchase price of the Additional Equity Interest at the time that Equipment exercises the Option. The Agreement limits the XXNGC and the transferors' right to make certain equity interest related decisions. This Addendum supplements that certain Option Agreement entered into as of August 17, 2007 and

effective as of March 8, 2006 and is in addition to the rights granted in the Agreement.

China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
September 30, 2008
(Unaudited)

Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The Company's functional currency is the Chinese Renminbi ("RMB"); however, the Company's reporting currency is the United States Dollar ("USD"); therefore, the accompanying consolidated financial statements have been translated and presented in USD.

In the opinion of management, the unaudited consolidated financial statements furnished herein include all adjustments, all of which are of a normal recurring nature, necessary for a fair statement of the results for the interim period presented. Operating results for the period ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

Foreign Currency Translation

As of September 30, 2008 and December 31, 2007, the accounts of the Company were maintained, and their consolidated financial statements were expressed in RMB. Such consolidated financial statements were translated into USD in accordance with Statement of Financial Accounts Standards ("SFAS") No. 52, "Foreign Currency Translation," with the RMB as the functional currency. According to the Statement, all assets and liabilities were translated at the exchange rate as of the balance sheet date, stockholders' equity are translated at the historical rates and statements of income and cash flow items are translated at the weighted average exchange rate for the year. The resulting translation adjustments are reported under other comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income."

The balance sheet amounts with the exception of equity at September 30, 2008 were translated at 6.84 RMB to $1.00 USD as compared to 7.29 RMB at December 31, 2007. The equity accounts were stated at their historical rate. The average translation rates applied to income and cash flow statement amounts for the nine months ended September 30, 2008 and 2007 were 6.98 RMB and 7.65 RMB to $1.00 USD, respectively. Translation adjustments resulting from this process in the amount of $8,031,065 and $3,477,025 as of September 30, 2008 and December 31, 2007, respectively are classified as an item of other comprehensive income in the stockholders' equity section of the consolidated balance sheets. For the three months ended September 30, 2008 and 2007, other comprehensive income in the consolidated statements of income and other comprehensive income included translation gains of $756,316 and $455,308, respectively. During the nine months ended September 30, 2008 and 2007, other comprehensive income in the consolidated statements of income and other comprehensive income included translation gains of $4,554,040 and $1,320,878, respectively.

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(Unaudited)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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 the United States. The Company considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents.

Certain financial instruments, which subject the Company to concentration of credit risk, consist of cash. The Company maintains balances at financial institutions which, from time to time, may exceed Federal Deposit Insurance Corporation 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 September 30, 2008 and December 31, 2007, the Company had total deposits of $20,078,096 and $13,053,994, without insurance coverage. And as of September 30, 2008 and December 31, 2007, the Company had deposits in United States of $1,395,324 and $126,170 in excess of federally insured limits, respectively. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risks on its cash in bank accounts.

Short Term Investments

Short-term investments are securities classified as available for sale, held by a private investment trust company for investing activities. Gain or loss on securities is computed using cost basis of first-in, first-out (FIFO) basis. The fair value of securities at December 31, 2007 totaled $238,554, which equaled the original costs, and was returned to the Company in March 2008.

Accounts Receivable

Accounts and other receivable are recorded at net realizable value consisting of the carrying amount less an allowance for uncollectible accounts, as needed. The Company maintains reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. Reserves are recorded primarily on a specific identification basis in the period of the related sales. The Company’s management has determined that all receivables are collectible and there is no need for an allowance for uncollectible accounts as of September 30, 2008 and December 31, 2007. When amounts are identified as no longer collectible, the receivable and the reserve are written off.

Other Receivable-employee advances

From time to time, the Company advances predetermined amounts based upon internal Company policy to certain employees and internal units to ensure certain transactions to be performed in a timely manner. The Company has full oversight and control over the advanced accounts. Therefore, no allowance for uncollectible accounts is needed.

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(Unaudited)

Advances to suppliers

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

Inventory

Inventory is stated at the lower of cost, as determined on a first-in, first-out basis, or market. Management compares the cost of inventories with the market value, and allowance is made for writing down the inventories to their market value, if lower. Inventory consists of material used in the construction of pipelines and material used in repairing and modifying of vehicles. Inventory also consists of natural gas and gasoline.

The following are the details of the inventories:

	September 30, 2008 (Unaudited)	December 31, 2007
Materials and supplies	$ 266,402	$ 109,333
Natural gas and gasoline	179,018	122,006
Total inventories	$ 445,420	$ 231,339

Property and Equipment

Property and equipment are stated at cost. Expenditures for maintenance and repairs are charged to earnings as incurred while additions, renewals and betterments are capitalized. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method for substantially all assets with estimated lives as follows:

Office equipment	5 years
Operating equipment	5-20 years
Vehicles	5 years
Buildings	30 years

The following are the details of the property and equipment:

	September 30, 2008 (Unaudited)	December 31,2007
Office equipment	$ 217,981	$ 163,432
Operating equipment	38,844,394	22,413,270
Vehicles	2,157,667	1,484,892
Buildings	20,192,794	11,943,006
Total property and equipment	61,412,836	36,004,600
Less accumulated depreciation	(6,259,779)	(3,712,605)
Property and equipment, net	$ 55,153,057	$ 32,291,995

China Natural Gas, Inc. and Subsidiaries
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(Unaudited)

Depreciation expense for the three months ended September 30, 2008 and 2007 was $937,156 and $419,991, respectively. Depreciation expense for the nine months ended September 30, 2008 and 2007 was $ 2,295,534 and $1,146,247 respectively.

Long-Lived Assets

The Company applies the provision of Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144") to all long lived assets. SFAS 144 addresses accounting and reporting for impairment and disposal of long-lived assets. The Company periodically evaluates the carrying value of long-lived assets to be held and used in accordance with SFAS 144. SFAS 144 requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal. Based on its review, the Company believes that, as of September 30, 2008 there were no significant impairments of its long-lived assets.

Construction in Progress

Construction in progress consists of the cost of constructing property and equipment for the Company’s use. The major cost of construction in progress relates to material, labor and overhead.

Interest cost capitalized into construction in progress for the three months ended September 30, 2008 and 2007 amounted to $990,061 and $0, respectively. Interest cost capitalized into construction in progress for the nine months ended September 30, 2008 and 2007 amounted to $1,672,565 and $0, respectively.

Fair Value of Financial Instruments

On January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosures requirements for fair value measures. The carrying amounts reported in the balance sheets for receivables and current liabilities each qualify as financial instruments and 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 their current market rate of interest. The three levels are defined as follow:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

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- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Company analyzes all financial instruments with features of both liabilities and equity under SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," SFAS No 133, "Accounting for Derivative Instruments and Hedging Activities" and EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."

As required by SFAS No. 157, 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 do not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets.

The following table sets forth by level within the fair value hierarchy our financial assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2008.

	Carrying Value at September 30, 2008	Fair Value Measurements at September 30, 2008 Using Level 1	Level 2	Level 3
Senior Notes	$ 23,895,568	$ -	$ 43,306,665	$ -
Derivative Liability - Warrants	17,500,000	-	6,769,351	-
Total liability measured at fair value	$ 41,395,568	$ -	$ 50,076,016	$ -

The Company did not identify any other non-recurring assets and liabilities that are required to be presented on the balance sheet at fair value in accordance with SFAS No. 157.

Derivative Accounting

The financial instruments are accounted for in accordance with Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", which established accounting and reporting requirements for derivative instruments and hedging activities. SFAS No. 133, as amended by SFAS No. 138 and 149, requires that all derivative instruments subject to the requirements of the statement be measured at fair value and recognized as assets or liabilities in the balance sheet. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation is generally established at the inception of a derivative. For derivatives designated as cash flow hedges and meeting the effectiveness guidelines of SFAS No. 133, changes in fair value, to the extent effective, are recognized in other comprehensive income until the hedged item is recognized in earnings. Hedge effectiveness is measured at least quarterly based on the relative changes in fair value between the derivative contract and the hedged item over time. Any change in fair value of a derivative resulting from

ineffectiveness or an excluded component of the gain/loss is recognized immediately in the statement of operations.

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(Unaudited)

The Company elected not to apply hedge accounting; therefore the change in fair value is recognized in earnings each reporting period. The Company did not have any derivatives during the period.

Revenue Recognition

The Company's revenue recognition policies are in accordance with Staff Accounting Bulletin (SAB) 104. Revenue is recognized when services are rendered to customers, when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of the Company exist and collectability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as unearned revenue. Revenue from gas and gasoline sales is recognized when gas and gasoline is pumped through pipelines to the end users. Revenue from installation of pipelines is recorded when the contract is completed and accepted by the customers. The construction contracts are usually completed within one to two months. Revenue from repairing and modifying vehicles is recorded when service are rendered to and accepted by the customers.

Unearned Revenue

Unearned revenue represents prepayments by customers for gas purchases and advance payments on installation of pipeline contracts. The Company records such prepayment as unearned revenue when the payments are received.

Advertising Costs

The Company expenses the cost of advertising as incurred or, as appropriate, the first time the advertising takes place. Advertising costs for the three and nine months ended September 30, 2008 and 2007 were insignificant.

Stock-Based Compensation

The Company records and reports stock-based compensation pursuant to SFAS 123R “Accounting for Stock-Based Compensation”, which defines a fair-value-based method of accounting for stock-based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from non-employees. Stock compensation for stock granted to non-employees has been determined in accordance with SFAS 123R and the Emerging Issues Task Force consensus Issue No. (EITF) 96-18, "Accounting for Equity Instruments that are issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services", as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

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Income Taxes

The Company utilizes SFAS No. 109, "Accounting for Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of temporary differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. At September 30, 2008 and December 31, 2007, there was no significant book to tax differences. There is no difference between book depreciation and tax depreciation as the Company uses the same method for both book and tax. The Company adopted FASB Interpretation 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), as of January 1, 2007. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The adoption had no affect on the Company’s financial statements.

Local PRC Income Tax

The Company’s subsidiary or variable interest entities operate in China. Starting January 1, 2008, pursuant to the tax laws of China, general enterprises are subject to income tax at an effective rate of 25% compare to 33% prior to 2008. The Company’s variable interest entity, XXNGC, is in the natural gas industry whose development is encouraged by the government. According to the income tax regulation, any company engaged in the natural gas industry enjoys a favorable tax rate. Accordingly, except for income from XNGE, SJLNG, XXABC, HXNGC which subjects to 25% PRC income tax rate, XXNGC’s income is subject to a reduced tax rate of 15%.

A reconciliation of tax at United States federal statutory rate to provision for income tax recorded in the financial statements is as follows:

	For three months ended September 30, (Unaudited)		For nine months ended September 30, (Unaudited)	
	2008	2007	2008	2007
Tax provision (credit) at statutory rate	34%	34%	34%	34%
Foreign tax rate difference	(9)%	(1)%	(9)%	(1)%
Effect of favorable tax rate	(8)%	(14)%	(7)%	(17)%
Effective rate	17%	19%	18%	16%

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The estimated tax savings for the three months ended September 30, 2008 and 2007 amounted to approximately $645,717 and $372,960, respectively. The net effect on earnings per share had the income tax been applied would decrease basic earnings per share for the three months ended September 30, 2008 and 2007 from $0.18 to $0.15 and $0.07 to $0.06, respectively, respectively. The estimated tax savings for the nine months ended September 30, 2008 and 2007 amounted to approximately $1,579,140 and $1,448,000, respectively. The net effect on earnings per share had the income tax been applied would decrease basic earnings per share for the nine months ended September 30, 2008 and 2007 from $0.39 to $0.34 and $0.27 to $0.21, respectively.

China Natural Gas, Inc. was incorporated in the United States and has incurred net operating loss for income tax purpose for 2008. The net operating loss carry forwards for United States income tax purposes amounted to $4,867,724 which may be available to reduce future years' taxable income. These carry forwards will expire, if not utilized, through 2027. Management believes that the realization of the benefits arising from this loss appear to be uncertain due to Company's limited operating history and continuing losses for United States income tax purposes. Accordingly, the Company has provided a 100% valuation allowance at September 30, 2008. The valuation allowance at September 30, 2008 was $1,655,000. Management will review this valuation allowance periodically and make adjustments as warranted.

Value added tax

Sales revenue represents the invoiced value of goods, net of a value-added tax (“VAT”). All of the Company’s variable interest entity XXNGC’s products that are sold in the PRC are subject to a Chinese value-added tax at a rate of 13% of the gross sales price. This VAT may be offset by VAT paid by the XXNGC on raw materials and other materials included in the cost of producing their finished product. XXNGC recorded VAT payable and VAT receivable net of payments in the financial statements. The VAT tax return is filed offsetting the payables against the receivables.

All revenues from XXABC subject to a Chinese value-added tax at a rate of 6%. This VAT cannot offset with VAT paid for materials included in the cost of revenues.

Basic and Diluted Earning Per Share

Earning per share is calculated in accordance with the SFAS 128, “Earnings per share”. Basic net earnings per share is based upon the weighted average number of common shares outstanding. Diluted net earnings per share is based on the assumption that all dilutive convertible shares and stock options were converted or exercised. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period.

Statement of Cash Flows

In accordance with Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows," cash flows from the Company's operations is calculated based upon the local currencies and translated to USD at average translation rates for the period. As a result, translation adjustment amounts related to assets and liabilities reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet.

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Reclassifications

Certain prior period amounts have been reclassified to conform to current period presentation. These reclassifications had no effect on net income or cash flows as previously reported.

Recent Pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115 ("FAS 159"). FAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of FAS 159 is to provide opportunities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply hedge accounting provisions. FAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The Company adopted SFAS No. 159 on January 1, 2008. The Company chose not to elect the option to measure the fair value of eligible financial assets and liabilities.

In June 2007, the FASB issued FASB Staff Position No. EITF 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for use in Future Research and Development Activities" ("FSP EITF 07-3"), which addresses whether nonrefundable advance payments for goods or services that used or rendered for research and development activities should be expensed when the advance payment is made or when the research and development activity has been performed. The Company adopted FSP EITF 07-3 and expensed the research and development as incurred.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company has not determined the effect that the application of SFAS 160 will have on its consolidated financial statements.

In December 2007, Statement of Financial Accounting Standards No. 141(R), *Business Combinations*, was issued. SFAS No. 141R replaces SFAS No. 141, *Business Combinations.* SFAS 141R retains the fundamental requirements in SFAS 141 that the acquisition method of accounting (which SFAS 141 called the *purchase method*) be used for all business combinations and for an acquirer to be identified for each business combination. SFAS 141R requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. This replaces SFAS 141's cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. SFAS 141R also requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with SFAS 141R). SFAS 141R applies prospectively to business combinations for

which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. The Company is currently evaluating the impact that adopting SFAS No. 141R will have on its financial statements.

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In March 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 161, "Disclosures about Derivative Instruments and Hedging Activities – An Amendment of SFAS No. 133" ("SFAS 161"). SFAS 161 seeks to improve financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures regarding the impact on financial position, financial performance, and cash flows. To achieve this increased transparency, SFAS 161 requires (1) the disclosure of the fair value of derivative instruments and gains and losses in a tabular format; (2) the disclosure of derivative features that are credit risk-related; and (3) cross-referencing within the footnotes. SFAS 161 is effective on January 1, 2009. The Company is in the process of evaluating the new disclosure requirements under SFAS 161.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("FAS 162"). FAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. FAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company is in the process of evaluating the impact of adoption of this statement on the results of operations, financial position or cash flows.

In June 2008, the FASB issued Emerging Issues Task Force Issue 07-5 "Determining whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock" ("EITF No. 07-5"). This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of Statement of Financial Accounting Standard No 133 "Accounting for Derivatives and Hedging Activities" ("SFAS 133") specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF No.07-5 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 SFAS 133 paragraph 11(a) scope exception. This standard will trigger liability accounting on all options and warrants exercisable at strike prices denominated in any currency other than the functional currency in China (Renminbi). The Company is currently evaluating the impact of adoption of EITF No. 07-5 on the Company's consolidated financial statements.

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In September 2008, the FASB issued FASB Staff Positions FSP FAS 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161". This FSP amends FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, to require disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument. This FSP also amends FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, to require an additional disclosure about the current status of the payment/performance risk of a guarantee. Further, this FSP clarifies the Board's intent about the effective date of FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities. The provisions of this FSP that amend Statement 133 and Interpretation 45 shall be effective for reporting periods (annual or interim) ending after November 15, 2008. The Company is in the process of evaluating the new disclosure requirements under this FSP.

Note 3 – Other Assets

Other assets consisted of the following,

		September 30 2008 (Unaudited)		December 31, 2007
Prepaid rent – natural gas stations	$	265,504		225,924
Prepayment for acquiring land use right		1,060,675		993,975
Advances on equipment and construction in progress		8,632,303		1,501,443
Refundable security deposits		263,340		356,460
Others		56,428		45,250
Total	$	10,278,250	$	3,123,052

All land in the People's Republic of China is government owned. However, the government grants the user a land use right to use the land. As of September 30, 2008 and December 31, 2007, the Company prepaid $1,060,675 and $993,975, respectively, to the PRC local government to purchase land use rights. The Company is in the process of negotiating the final purchase price with the local government and the land use rights have not been granted to the Company. Therefore, the Company did not amortize the prepaid land use rights.

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

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

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Note 4 – Senior Notes Payable

On December 30, 2007, the Company entered into a Securities Purchase Agreement with Abax Lotus Ltd. (the "Investor"). The Purchase Agreement was subsequently amended on January 29, 2008, pursuant to which the Company (i) agreed to issue 5.00% Guaranteed Senior Notes due 2014 (the "Senior Notes") of approximately $20,000,000, (ii) agreed to issue to the Investor Senior Notes in aggregate principal amount of approximately $20,000,000 on or before March 3, 2008 subject to the Company meeting certain closing conditions, (iii) granted the Investor an option to purchase up to approximately $10,000,000 in principal amount of its Senior Notes and (iv) agreed to issue to the Investor seven-year warrants exercisable for up to 2,900,000 shares of the Company's common stock (the "Warrants") at an initial exercise price equal to $7.3652 per share, subject to certain adjustments. On January 29, 2008, the Company issued $20,000,000 Senior Notes 2,900,000 warrants pursuant to the Purchase Agreement. On March 3, 2008, the Investor exercised its first option for an additional $20,000,000 of Senior Notes. On March 10, 2008, the Company issued $20,000,000 in additional Senior Notes resulting in total Senior Notes of $40,000,000.

At the closing, the Company entered into:

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

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

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

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

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

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

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

The indenture requires the Company to pay additional interest at the rate of 3.0% per annum of the Senior Notes if the Company has not obtained a listing of its common stock on the Nasdaq Global Market, the Nasdaq Capital Market or the New York Stock Exchange by January 29, 2009 and maintained such listing continuously thereafter as long as the Senior Notes are outstanding. Pursuant to the registration rights agreement (described herein), the Company has agreed to pay additional interest at the rate of 1.0% per annum of the Senior Notes principal amount outstanding for each 90-day period in which the Company has failed to comply with the registration obligations under the registration rights agreement.

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.

The Company also entered into an investor rights agreement, pursuant to which, as long as an investor holds at least 10% of the aggregate principal amount of the Senior Notes issued and outstanding or at least 3% of the Company’s issued and outstanding common stock pursuant to the warrants on an as-exercised basis (“Minimum Holding”), the Company has agreed not to undertake certain corporate actions without prior Investor approval. In addition, so long as an Investor owns the Minimum Holding, such Investor shall have a right of first refusal for future debt securities offerings by the Company and the Company is subject to certain transfer restrictions on its securities and certain other properties.

From the Closing Date and as long as the Investor continues to hold more than 10% of the outstanding shares of common stock on an as-converted, fully-diluted basis, the Investor shall be entitled to appoint one of the Company’s board of directors (the “Investor Director”). The Investor Director shall be entitled to serve on each committee of the board, except that, the Investor Director shall not serve on the audit committee unless it is an independent director. Mr. Ji has agreed to vote his shares for the election of the Investor Director.

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The Company is required to prepare and file a registration statement covering the sales of all of the shares of common stock issuable upon exercise of the warrants (the "Warrant Shares"). In the event that effectiveness of the registration statement is suspended at any time other than pursuant to a suspension notice, for each 90-day period during which the registration default remains uncured, the Company shall be required to pay additional interest at the rate of one percent (1%) of the Senior Notes.

On March 3, 2008, the Investor exercised its option to purchase an additional $20,000,000 of Senior Notes. On March 10, 2008, the Company issued the additional $20,000,000 in Senior Notes resulting in total Senior Notes of $40,000,000.

In connection with the issuance of the Securities Purchase Agreement, the Company paid $2,122,509 in debt issuance costs which is being amortized over the life of the Senior Notes. For the three months ended September 30, 2008, the Company amortized $24,410 of the aforesaid issuance costs, net of capitalized interest. For the nine months ended September 30, 2008, the Company amortized $147,002 of the aforesaid issuance costs, net of capitalized interest.

In connection with the Securities Purchase Agreement, the Company agreed to issue to the Investor seven-year warrants exercisable for up to 2,900,000 shares of the Company's common stock at an initial exercise price equal to $7.3652 per share, subject to certain adjustments. The exercise price of the Warrants is adjusted on the first anniversary of issuance and thereafter, at every six month anniversary beginning in the fiscal year 2009 if the volume weighted average price, or VWAP, (as defined therein) for the 15 trading days prior to the applicable reset date is less than the then applicable exercise price, in which case the exercise price shall be adjusted downward to the then current VWAP; provided, however, that in no event shall the exercise price be adjusted below $3.6826 per share.

If the Company's consolidated net profit after tax does not reach the stated level for 2007 or 2008, the exercise price of the warrants shall be adjusted by multiplying the current exercise price by a fraction, the numerator of which is the sum of (i) the number of shares of the Company's common stock outstanding immediately prior to such adjustment and (ii) 87,000, and the denominator of which is the number of shares of the Company's common stock outstanding immediately prior to such adjustment. Pursuant to the terms of the warrant agreement, a holder cannot exercise the Warrants to the extent that the number of shares of Common Stock beneficially owned by the holder would, following such exercise, exceed 9.9% of the outstanding shares of common stock at the time of exercise.

The warrants granted to the Investor on January 29, 2008 are considered derivative instruments that need to be bifurcated from the original security. If the Warrants have not been exercised within the seven year period, then the Investor can have the Company purchase the 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 three months ended September 30, 2008, the Company amortized $95,528 of the aforesaid discounts, net of capitalized interest. For the nine months ended September 30, 2008, the Company amortized $555,001 of the aforesaid discounts, net of capitalized interest. As of September 30, 2008, $16,104,432 has not been amortized.

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Note 5 – Stockholders' Equity

Common stock

On August 2, 2007, the Company entered into a Securities Purchase Agreement with investors to sell 4,615,385 shares of the Company's common stock and attached warrants to purchase up to 692,308 shares of Common stock ("Investor warrants") for $3.25 per share (or an aggregate purchase price of $15,000,000) and for total net proceeds of $13,823,467. Warrants are exercisable for a period of five years with exercise price of $7.79 per share.

In connection with the above-mentioned offering, the Company entered into a finance representation agreement ("Agreement") with a placement agent ("Agent"). Pursuant to the agreement, the Company agreed to pay the Agent $10,000 and issued a warrant ("Placement Agent Warrants") to acquire 75,000 shares of the Company's common stock. In addition, the Company paid a $1,050,000 fee (7% of the gross proceeds).

Warrants associated with the above-mentioned issuance of common stock were issued in October 2007 upon the effective filing of its certificate of Amendment of Articles of Incorporation to increase the authorized number of shares of common stock from 30,000,000 to 45,000,000.

Both Investor Warrants and Placement Agent Warrants meet the conditions for equity classification pursuant to FAS 133 "Accounting for Derivatives" and EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." Therefore, these warrants were classified as equity and accounted as common stock issuance cost.

In connection with the Securities Purchase Agreement, the Company agreed to issue to the Investor seven-year warrants exercisable for up to 2,900,000 shares of the Company's common stock at an initial exercise price equal to $7.3652 per share, subject to certain adjustments. The warrants have been determined to be derivative liabilities instruments because there is a required redemption requirement if the holder does not exercise the Warrants. However, the warrants does not required to be value at mark to market, rather, to be at its undiscounted amount of $17.5 million according to FAS 150.

Following is a summary of the warrant activity:

	Warrants Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding, December 31, 2006	1,140,286	$ 3.60	-
Granted	767,308	$ 7.79	-
Forfeited	-	-	-
Exercised	(819,110)	$ 3.60	-
Outstanding, December 31, 2007	1,088,484	$ 6.55	$ 376,977
Granted	2,900,000	$ 7.37	-
Forfeited	-	-	-
Exercised	-	-	-
Outstanding, September 30, 2008 (Unaudited)	3,988,484	$ 7.14	$ -

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Following is a summary of the status of warrants outstanding at September 30, 2008:

Outstanding Warrants			Exercisable Warrants	
Exercise Price	Number	Average Remaining Contractual Life	Average Exercise Price	Number
$ 3.60	321,176	0.28	$ 3.60	321,176
$ 7.37	2,900,000	6.33	$ 7.37	2,900,000
$ 7.79	767,308	3.84	$ 7.79	767,308
$ 7.14	3,988,484	5.36	$ 7.14	3,988,484

Note 6 – Defined Contribution Plan

The Company is required to participate in a defined contribution plan operated by the local municipal government in accordance with Chinese law and regulations. The Company makes annual contributions of 14% of all employees' salaries to the plan. Starting from 2008, no minimum contribution is required but the maximum contribution cannot be more than 14% of the current salary expense. The total contribution for the above plan was $0 and $33,032 for the three months ended September 30, 2008 and 2007, respectively. The total contribution for the above plan was $0 and $88,024 for the nine months ended September 30, 2008 and 2007, respectively.

Note 7 – Statutory Reserve

As stipulated by the Company Law of the People’s Republic of China (PRC) as applicable to Chinese companies with foreign ownership, 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;

iii. Allocations to the discretionary surplus reserve, if approved in the shareholders’ general meeting.

The Company had appropriated $574,161 and $232,402 as reserve for the statutory surplus reserve for three months ended September 30, 2008 and 2007. The Company has appropriated $1,425,489 and $726,785 as reserve for the statutory surplus reserve for nine months ended September 30, 2008 and 2007.

Note 8 – Accounting for stock-based compensation

On September 22, 2007, Mr. Qinan Ji, chairman and shareholder of the Company, transferred 100,000 of his personally-owned options to the Company’s attorney to cover certain Company legal expenses. 30% of the options vest on September 22, 2008, 30% vest on September 22, 2009, and the remaining 40% vest on September 22, 2010. Upon termination of service to the Company, the attorney is required to return all unvested options. These options expire June 1, 2012.

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The Company used the Black-Sholes model to value the options at the time they were issued, based on the stock price on its grant date, the stated exercise prices and expiration dates of the instruments and using a risk-free rate of 4.10%. The estimated life is based on one half of the sum of the vesting period and the contractual life of the option. This is the same as assuming that the options are exercised at the mid-point between the vesting date and expiration date. $51,861 of compensation expense was recorded during the quarter ended September 30, 2008.

As of September 30, 2008, approximately $147,402 of estimated expense with respect to non-vested stock-based compensation has yet to be recognized and will be recognized in expense over the remaining vesting period of 2 years.

Note 9 – Earnings Per Share

Earnings per share for the period ended September 30, 2008 and 2007 is determined by dividing net income for the periods by the weighted average number of both basic and diluted shares of common stock and common stock equivalents outstanding. The following is an analysis of the differences between basic and diluted earnings per common share in accordance with Statement of Financial Accounting Standards No. 128, “Earnings Per Share.”

The following demonstrates the calculation for earnings per share:

	For three months ended September 30,		For nine months ended September 30,	
	2008	2007	2008	2007
Basic earning per share				
Net income	$ 5,136,590	$ 1,961,662	$ 11,458,053	$ 6,816,997
Weighted shares outstanding-Basic	29,200,304	27,122,196	29,200,304	25,191,521
Earnings per share-Basic	$ 0.18	$ 0.07	$ 0.39	$ 0.27
Diluted earning per share				
Net income	$ 5,136,590	$ 1,961,662	$ 11,458,053	$ 6,816,997
Weighted shares outstanding-Basic	29,200,304	27,122,196	29,200,304	25,191,521
Effect of diluted securities-Warrants	79,286	164,090	116,533	31,944
Weighted shares outstanding-Diluted	29,279,590	27,286,286	29,316,837	25,223,465
Earnings per share -Diluted	$ 0.18	$ 0.07	$ 0.39	$ 0.27

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At September 30, 2008 and 2007, the Company had outstanding warrants of 3,988,484 and 1,140,286, respectively. For the three months ended September 30, 2008, the average stock price was greater than the exercise prices of the 321,176 warrants which resulted in additional weighted average common stock equivalents of 79,286; 3,667,308 outstanding warrants were excluded from the diluted earnings per share calculation as they are anti-dilutive. For the nine months ended September 30, 2008, the average stock price was greater than the exercise prices of the 321,176 warrants which resulted in additional weighted average common stock equivalents of 116,533; 3,667,308 outstanding warrants were excluded from the diluted earnings per share calculation as they are anti-dilutive.

Note 10 – Current Vulnerability Due to Certain Concentrations

Concentrations of natural gas vendors:

	Number of natural gas vendors	Percentage of total natural gas purchase
Three months ended September 30, 2008	4	97.4%
Three months ended September 30, 2007	3	99.1%
Nine months ended September 30, 2008	4	98.4%
Nine months ended September 30, 2007	3	97.2%

Except for Shaanxi Natural Gas Co Ltd, no amount was owed to other three vendors as of September 30, 2008. The other three vendors have long-term agreements with the Company without minimum purchase requirements. The Company has had annual agreements from December 31, 2007 to December 31, 2008 with Shaanxi Natural Gas Co Ltd to purchase certain amount of natural gas. For the year ending December 31, 2008, the minimum purchase was 25.58 million cubic meters. Contracts are renewed on an annual basis. The Company's management reports that it does not expect any issues or difficulty in continuing to renew the supply contracts with these vendors going forward. Price points for natural gas are strictly controlled by the government and have remained stable over the past 3 years.

Concentrations of installation revenue:

	Number of customers	Percentage of total installation revenue
Three months ended September 30, 2008	3	89.8%
Three months ended September 30, 2007	3	86.1%
Nine months ended September 30, 2008	5	75.0%

Nine months ended September 30, 2007	5	69.2%

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The Company's operations are carried out in the People's Republic of China. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the People's Republic of China, by the general state of the People's Republic of China's economy. The Company's business may be influenced by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

Note 11 – Commitments and Contingencies

(a) Lease Commitments

The Company recognizes lease expense on a straight line basis over the term of the lease in accordance to SFAS 13, "Accounting for leases." The Company entered into series of long term lease agreements with outside parties to lease land use right to the self-built Natural Gas filing stations located in the PRC. The agreements have terms ranging from 10 to 30 years. The Company makes annual prepayment for most lease agreements. The Company also entered into two office leases in Xian, PRC and New York, NY. The minimum future payment for leasing land use rights and offices is as follows:

Three months ending December 31, 2008	$ 434,356
Year ending December 31, 2009	1,436,956
Year ending December 31, 2010	1,441,547
Year ending December 31, 2011	1,415,124
Year ending December 31, 2012	1,355,864
Thereafter	14,670,599
Total	$ 20,754,446

For the three months ended September 30, 2008 and 2007, the land use right and office lease expenses were $256,876 and $ 68,135, respectively. For the nine months ended September 30, 2008 and 2007, the land use right and office lease expenses were $630,821 and $ 142,579, respectively.

(b) Property and Equipment

In January 2008, the Company entered into a contract with Chemtex International Inc. to purchase equipment supply for LNG plant and LNG storage tank located in Jingbian county, Shannxi Province China, in the total amount of $13,700,000. On May 16, 2008, SJLNG entered into an agreement with Hebei Tongchan Import and Export Co. Ltd. (Hebei) and agreed that Hebei will act as the trade agency for SJLNG. On June 16, 2008, the Company entered into an equipment supply contract with Chemtex Internaitonal Inc. to supply imported equipment for a LNG plant and a storage tank to be built by Jingbian Xilan LNG Co. Ltd. As of September 30, 2008, the Company advanced $6,290,000 to the trade agency and the future commitment for equipment is $7,410,000.

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(c) Legal Proceedings

A former member of the board of directors filed a lawsuit against the Company in New York State Supreme Court, Nassau County, in which he has sought, among other things; to recover a portion of his monthly compensation plus 20,000 options that he alleges are due to him pursuant to a written agreement. After the plaintiff rejected an offer by the Company that included the options that plaintiff alleged were due to him, the Company moved to dismiss the complaint. The judge ordered the Company to issue the 20,000 options to the plaintiff subject to any restrictions required by applicable securities laws, which was essentially what the Company had previously offered, and dismissed all of the plaintiff's remaining claims against the Company. The current board of directors has complied with the court's decision by tendering an options agreement to the plaintiff consistent with the court's decision, but the plaintiff has refused to execute the agreement, and instead has filed an appeal. Regardless of the outcome of the appeal, the Company believes that any liability it would incur will not have a materially adverse effect on its financial condition or its results of operations, and, accordingly, this matter has not been reflected on the Company's financial statements.

Item 2.Management's Discussion and Analysis of Financial Condition and Results of Operations

CAUTIONARY STATEMENT

The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto included in this Report. Unless otherwise noted, all amounts are expressed in U.S. dollars. The following discussion regarding the Company and its business and operations contains forward-looking statements that consist of any statement other than a recitation of historical fact and can be identified by the use of forward-looking terminology such as "may," "expect," "anticipate," "estimate" or "continue" or the negative thereof or other variations thereon or comparable terminology. In particular, these include statements relating to our expectation that we will continue to have adequate liquidity from cash flow from operations and the other risks and uncertainties, which are described below under "RISK FACTORS." The reader is cautioned that all forward-looking statements are necessarily speculative and there are certain risks and uncertainties that could cause actual events or results to differ materially from those referred to in such forward-looking statements, including the risk factors discussed in this Report. The Company does not have a policy of updating or revising forward-looking statements and thus it should not be assumed that silence by management of the Company over time means that actual events are bearing out as estimated in such forward-looking statements.

Overview

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.

On December 6, 2005, we issued an aggregate of 4 million shares to all of the registered shareholders of Xi’an Xilan Natural Gas Co., Ltd., and entered into exclusive arrangements with Xi’an Xilan Natural Gas Co., Ltd. The shareholders that give us the ability to substantially influence Xi’an Xilan Natural Gas’ daily operations and financial affairs, appoint our senior executives and approve all matters requiring shareholder approval. On December 19, 2005, we changed our name to China Natural Gas, Inc.

On February 21, 2006, we formed Xilan Natural Gas Equipment Ltd., (“Xilan Equipment”) as a wholly owned foreign enterprise (WOFE). We then, through Xilan Equipment, entered into exclusive arrangements with Xi’an Xilan Natural Gas Co., Ltd. and these shareholders that give us the ability to substantially influence Xi’an Xilan Natural Gas’ daily operations and financial affairs, appoint its senior executives and approve all matters requiring shareholder approval. We memorialized these arrangements on August 17, 2007, and made retroactive to March 8, 2006. As a result, the Company consolidates the financial results of Xi’an Xilan Natural Gas as variable interest entity pursuant to FASB Interpretation No. 46R, “Consolidation of Variable Interest Entities”, effective on March 8, 2006.

We transport, distribute and sell natural gas to commercial, industrial and residential customers in the Xi’an area, including Lantian County and the districts of Lintong and Baqiao, in the Shaanxi Province of The People's Republic of China ("China" or the "PRC") through a network of 120km high pressure pipelines. During the three months ended September 30, 2008, the pipeline’s average daily throughput capacity is 28,977 cubic meters; in the first nine months of 2008, its average daily throughput capacity is 29,595 cubic meters. We also distribute and sell CNG as vehicular fuel through a network of approximately 35 CNG fueling stations in Shaanxi and Henan Provinces. As of September 30, 2008, we own and operate 23 CNG fueling stations in Shaanxi Province and 12 CNG fueling stations in Henan Province. During the three months ended September 30, 2008, we had sold compressed natural gas of 40,547,584 cubic meters through our fueling stations; in the first nine months of 2008, we had sold compressed natural gas of 107,226,877 cubic meters.

We operate three primary business lines:

- Distribution and sale of compressed natural gas (CNG) through Company-owned CNG fueling stations for hybrid (natural gas/gasoline) powered vehicles (35 stations as of September 30, 2008);

- Distribution of piped natural gas to residential, commercial and industrial customers through Company-owned pipelines as well as installation of natural gas devices for our pipeline customers. The Company distributes and sells natural gas to 92,984 homes and businesses as of September 30, 2008; and

- Conversion of gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles at our Auto Conversion Division.

We buy all of the natural gas that we sell and distribute to our customers. We do not mine or produce any of our own natural gas and have no plans to do so during the next 12 months. The natural gas that we buy is available in two forms: (i) piped natural gas; and (ii) CNG.

On October 24, 2006, Xi'an Xilan Natural Gas formed a wholly-owned subsidiary, Shaanxi Jingbian Liquified Natural Gas Co., Ltd., for the purpose of constructing a liquefied natural gas facility to be located in Jingbian, Shaanxi Province. We plan to invest approximately $40 million to construct this facility, and we have secured such funding for this project through security purchase agreement with Abax Lotus Ltd. The LNG plant is under construction and is expected to start operation in late 2009. Once completed, the plant has LNG processing capacity of 500,000 cubic meters per day, or approximately 150 million cubic meters on an annual basis.

CONSOLIDATED RESULTS OF OPERATIONS

Comparing Three Months Ended September 30, 2008 and 2007:

The following table presents certain consolidated statement of income information. The three months financial information is presented below:.

	September 30, 2008	September 30, 2007
Revenues	$ 18,401,200	$ 9,078,089
Cost of Revenues	8,908,833	4,758,250
Operating Expenses	3,066,512	1,967,693
Income from Operations	6,425,855	2,352,146
Net Income	$ 5,136,590	$ 1,961,662

Revenues: We generated revenue of $15,354,461, 83.44% of our total revenues, during the three months ended September 30, 2008 from the sale of natural gas, and revenue of $3,046,739, 16.56% of our total revenues from installation fees, conversion fees, and other sources. Sales of natural gas at the Company-owned fueling stations accounted for 80.20% of our total revenues in the three months ended September 30, 2008, or $14,757,762, which was the largest contribution of our three business lines. Sales to end-user customers connected to our pipeline distribution system accounted for 9.76% of our total revenues during the three months ended September 30, 2008, or $1,767,511, including both natural gas sales and installation fees.

We had total revenues of $18,401,200 for the three months ended September 30, 2008, an increase of $9,323,111 or 102.70%, compared to $9,078,089 for the three months ended September 30, 2007. The sales of natural gas increased 103.23% and our installation and other revenues increased 100.05% over the same period in 2007. The increase in revenues was primarily due to the material increase in the number of Company-owned fueling stations and pipeline customers. As of September 30, 2008, the Company had 92,984 pipeline customers, an increase of 8,921 customers over the same period in 2007, and has constructed and acquired 35 fueling stations, an increase of 15 stations over the same period in 2007.

During the third quarter of 2008, we had sold compressed natural gas of 40,547,584 cubic meters, compared to 22,462,111 cubic meters in the same period of 2007, through Company-owned fueling stations. In terms of average station sales value and volume, in the third quarter of 2008, we had sold approximately $423,000 and 1,180,000 cubic meters of compressed natural gas per station, compared to approximately $380,000 and 1,182,000 cubic meters in the same period of 2007. As for natural gas pipeline business, during the third quarter of 2008, we had sold 2,665,947 cubic meters, compared to 1,705,668 cubic meters in the same period of 2007, through our pipeline network.

Furthermore, during the third quarter of 2008, three major customers contributed 89.83% of the total installation revenue, compared to 86.1% of the Company’s installation revenue from three customers for the same period of 2007. Due to the relatively small portion of the installation business and our close relationship with other potential customers, we believe that the loss of any one of these three customers would not have a material adverse effect on our operations.

The Company expects natural gas revenues to increase on both an actual basis and as a percentage of revenue in the remaining period of 2008.

Cost of Revenues: Our cost of revenues consists of both the cost of natural gas and the cost of installation and other. Cost of natural gas consists primarily of the price that we pay for natural gas purchased from our supplier. Cost of installation and other includes certain connection costs related to connecting customers to our pipeline system that are generally expensed when incurred and vehicle conversion cost related to converting gasoline-fueled vehicles into natural gas hybrid vehicles.

Cost of revenues during the three months ended September 30, 2008 was $8,908,833, an increase of $4,150,583 or 87.23% over the same period in 2007. Cost of natural gas increased by 73.46% to $6,973,035 during the three months ended September 30, 2008, as compared with $4,020,039 for the same period in 2007. The opening cost per station during the three months ended September 30, 2008 is approximately $1,200,000, compared to approximately $900,000 over the same period of 2007. During the three months ended September 30, 2008, the transportation cost-per-million cubic meters is approximately $7,700. In addition, cost of installation and other increased by 162.23% to $1,935,798 during the three months ended September 30, 2008, as compared with $738,211 for the same period in 2007. The increase in our cost of revenues was primarily related to a material increase in the amount of gas sold. We had sold natural gas of 43,213,531 cubic meters during the third quarter of 2008, compared to 24,167,779 cubic meters over the same period of 2007. The increase of installation and other cost is mainly due to the increase in the number of pipeline customers, the vehicles the Company had converted and the gasoline sales through our existing fueling stations. We converted 713 vehicles to become hybrid in the third quarter of 2008, compared to 498 vehicles over the same period of 2007.

We purchase our natural gas for resale mainly from four vendors: PetroChina Changqing Oilfield Company, Jiyuan Yuhai Natural Gas Co Ltd, Shaanxi Natural Gas Co. Ltd and Jingcheng city Mingshi Coal Bed Methane Exploitage Ltd. We renewed the supplying contracts on an annual or semiannual basis and do not think we will have difficulty in doing so in the foreseeable future. The four major vendors supplied 97.37% of total natural gas we purchased in the third quarter of 2008.

As the government owns all land in China, the government controls and owns all the natural resources coming from the ground, thus the government controls the price and flow of the natural gas. Due to the soaring crude oil price and ever-increasing demand for energy consumption, the National Development and Reform Commission, which regulates the energy price in China, adjusted the upstream natural gas price for industrial users and vehicular CNG distributors upward by RMB ¥0.4/CM, or 35% in November, 2007. The retail price for vehicular CNG was adjusted upward at a ratio of 0.75:1 to the retail price of #90 gasoline in November, 2007. Many large cities see dramatic increase in retail vehicular CNG price, for example 66% in Shanghai and 21% (taxi) and 38% (bus) in Tianjin. However, the natural gas price for residential customers is not adjusted. As China shifts from a centrally-planned economy to a market economy, we believe that it is in the government's best interest to keep prices stable, and maintain a stable flow of supply. The government has also undertaken programs to promote the economic growth of the region in which we are located. Therefore, we expect supply and price to continue to be stable in the future.

Gross profit: The Company earned a gross profit of $9,492,367 for the three months ended September 30, 2008, an increase of $5,172,528 or 119.74%, compared to $4,319,839 for the three months ended September 30, 2007. The increase in gross profit is due to a material increase in natural gas sales and installation revenue in this quarter, partially offset by an increase in cost of revenues.

Gross margin: Gross margin, as a percentage of revenues, increased to 51.59% for the three months ended September 30, 2008, from 47.59% for the three months ended September 30, 2007. The increase in gross margin is primarily due to the higher margin from the natural gas sold in fueling stations in Henan province in the third quarter of 2008 compared to the same period of 2007. From July 2007, the Company renewed its supply contract with a local natural gas vendor in Henan at a much lower supply cost of RMB ¥1.0/CM.

Operating expenses: The Company incurred operating expenses of $3,066,512 for the three months ended September 30, 2008, an increase of $1,098,819, or 55.84%, compared to $1,967,693 for the three months ended September 30, 2007. Our selling expenses increased by 123.35%, from $939,496 for three months ended September 30, 2007 to $2,098,343 for the same period of 2008, primarily as a result of expenses related to the operation of 15 newly added CNG stations since September 30, 2007, the depreciation of more equipment, recruitment of more employees as well as the ongoing related selling expenses. However, the general and administrative expenses decreased by 5.84% to $968,169 for three months period ended September 30, 2008 from $1,028,197 for the same period of 2007, which demonstrated the Company's cost control ability and the benefit of economy of scale over centralized corporate functions.

Provision for income tax was $1,034,636 for the three months ended September 30, 2008, as compared to $445,463 for the three months ended September 30, 2007. The increase in income tax was mainly attributed to the growth of revenues from our fueling stations and pipeline business.

Net Income: Net income increased to $5,136,590 for the three months ended September 30, 2008, an increase of $3,174,928 or 161.85% from $1,961,662 during the corresponding period in 2007. The increased net income reflects the fueling station business's strong and steady profit-generating ability and the successful outcome of the Company's continuous efforts in sourcing lower natural gas suppliers, which were offset by the increase of interest expense and amortization expenses due to the issuance of $40 million senior note on January 29th, 2008.

Comparing Nine Months Ended September 30, 2008 and 2007:

The following table presents certain consolidated statement of income information. Financial information is presented for the nine months ended September 30, 2008 and 2007.

	September 30, 2008	September 30, 2007
Revenues	$ 49,317,360	$ 24,094,974
Cost of Revenues	26,070,754	12,114,666
Operating Expenses	7,956,125	3,926,507
Income from Operations	15,290,481	8,053,801
Net Income	$ 11,458,053	$ 6,816,997

Revenues: We generated revenue of $40,494,646, 82.11% of our total revenues, during the nine months ended September 30, 2008 from the sale of natural gas, and revenue of $8,822,714, 17.89% of our total revenues from installation, vehicle conversion and gasoline sale activity. Sales of natural gas at the Company-owned fueling stations accounted for 78.33% of our total revenues in the nine months ended September 30, 2008, or $38,632,188, which was the largest contribution of our three business lines. Sales of natural gas to end-user customers connected to our pipeline distribution system accounted for 10.88% of our total revenues during the nine months ended September 30, 2008, or $5,365,729, including both natural gas sales and installation revenue. The Company expects natural gas revenues to increase on both an actual basis and as a percentage of revenue in 2008.

We had total revenues of $49,317,360 for the nine months ended September 30, 2008, an increase of $25,222,386 or 104.68%, compared to $24,094,974 for the nine months ended September 30, 2007. The sales of natural gas increased 110.43% and our installation and other revenues increased 81.87% over the same period in 2007. The increase in revenues was primarily due to the material increase in the number of Company-owned fueling stations and pipeline customers. As of September 30, 2008, the Company had 92,984 pipeline customers, an increase of 8,921 customers over the same period in 2007, and has constructed and acquired 35 fueling stations, an increase of 15 stations over the same period in 2007.

During the nine months ended September 30, 2008, we sold compressed natural gas of 107,226,877 cubic meters, compared to 58,537,895 cubic meters in the same period of 2007, through Company-owned fueling stations. In terms of average station sales value and volume, during the first nine months ended September 30, 2008, we sold approximately $1,292,000 and 3,650,000 cubic meters compressed natural gas per station, compared to approximately $1,260,000 and 4,050,000 cubic meters in the same period of 2007. As for natural gas pipeline business, during the first nine months ended September 30, 2008, we sold 8,079,460 cubic meters, compared to 5,346,207 cubic meters in the same period of 2007, through our pipeline network.

Furthermore, in the nine months ended September 30, 2008, five major customers contributed 75.02% of the total installation revenue, compared to 69.2% of the Company's installation revenue from five customers for the same period of 2007. Due to the relatively small portion of the installation business and our close relationship with other potential customers, we believe that the loss of any one of these five customers would not have a material adverse effect on our operations.

The Company expects natural gas revenues to increase on both an actual basis and as a percentage of revenue in the remaining period of 2008.

Cost of Revenues: Our cost of revenues consists of both the cost of natural gas and the cost of installation and other. Cost of natural gas consists primarily of the price that we pay for natural gas purchased from our suppliers, Cost of installation includes certain connection costs related to connecting customers to our pipeline system that are generally expensed when incurred and vehicle conversion cost related to converting gasoline-fueled vehicles into natural gas hybrid vehicles.

Cost of revenues during the nine months ended September 30, 2008 was $26,070,754, an increase of $13,956,088 or 115.20% over the same period in 2007. Cost of natural gas increased by 104.19% to $20,369,778 during the nine months ended September 30, 2008, as compared with $9,975,932 for the same period in 2007. During the nine months ended September 30, 2008, the transportation cost-per-million cubic meters is approximately $7,000. In addition, cost of installation and other increased by 166.56% to $5,700,976 during the nine months ended September 30, 2008, as compared with $2,138,734 for the same period in 2007. The increase in our cost of revenues was primarily related to a material increase in the amount of gas sold. We had sold natural gas of 115,306,337 cubic meters in the first nine months of 2008, compared to 63,884,102 cubic meters over the same period of 2007. The increase of installation and other cost is mainly due to the increase of pipeline customers, the vehicles the Company had converted, and the gasoline sales through our existing fueling stations. We converted 1,980 vehicles to become hybrid during the nine months ended September 30, 2008, compared to 548 vehicles over the same period of 2007.

We purchase our natural gas for resale mainly from four vendors: PetroChina Changqing Oilfield Company, Jiyuan Yuhai Natural Gas Co Ltd, Jingcheng city Mingshi Coal Bed Methane Exploitage Ltd and Shaanxi Natural Gas Co. Ltd. We renewed the supplying contracts on an annual or semiannual basis and do not think we will have difficulty in doing so in the foreseeable future. The four major vendors supplied 98.42% of total natural gas we purchased during the first nine months period of 2008.

As the government owns all land in China, the government controls and owns all the natural resources coming from the ground, thus the government controls the price and flow of the natural gas. Due to the soaring crude oil price and ever increasing demand for energy consumption, the National Development and Reform Commission, which regulates the energy price in China, adjusted the upstream natural gas price for industrial users and vehicular CNG distributors upward by RMB ¥0.4/CM, or 35% in November, 2007. The retail price for vehicular CNG was adjusted upward at a ratio of 0.75:1 to the retail price of #90 gasoline in November, 2007. Many large cities see dramatic increase in retail vehicular CNG price, for example 66% in Shanghai and 21% (taxi) and 38% (bus) in Tianjin. However, natural gas price for residential customers is not adjusted. As China shifts from a centrally planned economy to a market economy, we believe that it is in the government's best interest to keep prices stable, and maintain a stable flow of supply. The government has also undertaken programs to promote the economic growth of the region in which we are located. Therefore, we expect supply and price to continue to be stable in the future.

Gross profit: The Company earned a gross profit of $23,246,606 for the nine months ended September 30, 2008, an increase of $11,266,298 or 94.04%, compared o $11,980,308 for the nine months ended September 30, 2007. The increase in gross profit is due to a material increase in natural gas sales and installation (and other) revenues in this period, partially offset by an increase in cost of sales.

Gross margin: Gross margin, as a percentage of revenues, decreased to 47.14% for the nine months ended September 30, 2008, from 49.72% for the nine months ended September 30, 2007. The decrease in gross margin is primarily due to the lower margin of natural gas sales in Henan province during the first six months of 2008, gasoline sales and vehicle conversion revenue during 2008. Although the gasoline sales only represented 7% of our total revenue during the 9 months ended September 30, 2008, the low gross margin of gasoline around 7.5% contributed to a decline in our overall gross margin.

Operating expenses: The Company incurred operating expenses of $7,956,125 for the nine months ended September 30, 2008, an increase of $4,029,618 or 102.63%, compared to $3,926,507 for the nine months ended September 30, 2007. Our selling expenses increased by 126.02% from $2,216,048 for nine months ended September 30, 2007 to $5,008,631 for the same period of 2008, primarily as a result of expenses related to the operation of 15 newly added CNG stations since September 30, 2007, the depreciation of more equipment, recruitment of more employees as well as the on-going related selling expenses. The general and administrative expenses increased by 72.32% to $2,947,494 for nine months period ended September 30, 2008 from $1,710,459 for the same period of 2007, which is primarily due to the Company’s engagement of more personnel to manage rapidly expanding business and continuous efforts on finding new acquisition opportunities, and also the rentals and operating expenses for new offices in Xi’an China and New York. Considering the percentage increase from the general and administrative expenses is lower than that of revenue, the Company also demonstrated the benefit of economy of scale over centralized corporate functions over the nine-month period of 2008.

Provision for income tax was $2,584,774 for the nine months ended September 30, 2008, as compared to $1,317,878 for the nine months ended September 30, 2007. The increase in income tax was mainly attributed to the growth of revenues from our fueling stations and pipeline business.

Net Income: Net income increased to $11,458,053 for the nine months ended September 30, 2008, an increase of $4,641,056 or 68.08% from $6,816,997 for the nine months ended September 30, 2007. The increased net income reflects the fueling stations business’s strong and steady profit-generating ability and the successful outcome of the Company’s continuous efforts in sourcing lower natural gas suppliers, which were offset by the increase of interest expense and amortization expenses due to the issuance of $40 million senior note on January 29th , 2008.

Liquidity and Capital Resources

As of September 30, 2008, the Company had $20,384,702 of cash and cash equivalents on hand compared to $20,677,432 of cash and cash equivalents as of September 30, 2007.

Cash flows provided by operating activities was $12,711,311 for the nine months ended September 30, 2008 compared to net cash provided by operations of $8,030,806 in the corresponding period last year. The primary reason for the change is attributed to the increased cash from net income generated from our CNG fueling stations business, which is offset by the higher working capital needs to support our operations in the nine months ended September 30, 2008.

Cash outflows for investing activities increased from $6,838,721 during the nine months ended September 30, 2007 to $44,611,535 for the same period in 2008 primarily because of the construction and acquisition of additional 15 fueling stations, the additions of construction in progress and the prepayment to equipment suppliers of our LNG plant, which the Company started to construct in September 2007.

Cash inflow for financing activities was $37,877,491 for the nine months ended September 30, 2008, compared to $13,823,467 in the corresponding previous period. The increased financing cash inflow comes from the sale of $40 million senior notes to Abax Lotus in the first quarter of 2008, partially offset by related offering costs. In the August 2007, the Company issued $15 million new shares at $3.25 per share through private placement.

In the next three months of 2008, the Company also expects to enter into an acquisition project, which is estimated to cost $10 million. The funds for these investing activities are expected to come primarily from the existing cash on hand and the Company's operating cash inflows. If the internally generated cash is not sufficient, the Company will consider securing funding from outside capital providers.

The Company paid $9.5 million for the right to use know-how and basic engineering design to construct the LNG plant and storage tank in the first quarter of 2008. The Company also made further investment of approximately $3.4 million and $6.9 million for the LNG plant related fee in the second and third quarter of 2008, respectively. The Company expects to continue to invest in LNG project in the subsequent quarters with funds already secured and internally generated cash flows, and the LNG projects is expected to be completed in October 2009.

Based on past performance and current expectations, we believe our existing cash combined with cash generated from operations, as well as future possible cash investments, will satisfy our working capital needs, capital expenditures (other than the possible acquisition of other fueling and compressor stations) and other liquidity requirements associated with our operations for at least the next 12 months.

The majority of the Company's revenues and expenses were denominated primarily in RMB, the currency of the People's Republic of China. There is no assurance that exchange rates between the RMB and the USD will remain stable. Inflation has not had a material impact on the Company's business.

OFF-BALANCE SHEET ARRANGEMENTS

None.

CRITICAL ACCOUNTING POLICIES

In presenting our financial statements in conformity with accounting principles generally accepted in the United States of America, we are required to make estimates and assumptions that affect the amounts reported therein. Several of the estimates and assumptions we are required to make relate to matters that are inherently uncertain as they pertain to future events. However, events that are outside of our control cannot be predicted and, as such, they cannot be contemplated in evaluating such estimates and assumptions. If there is a significant unfavorable change to current conditions, it will likely result in a material adverse impact to our consolidated results of operations, financial position and in liquidity. We believe that the estimates and assumptions we used when preparing our financial statements were the most appropriate at that time. Presented below are those accounting policies that we believe require subjective and complex judgments that could potentially affect reported results.

Use of Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to impairment of long-lived assets, and allowance for doubtful accounts. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions; however, we believe that our estimates, including those for the above-described items, are reasonable.

Areas that require estimates and assumptions include valuation of accounts receivable and determination of useful lives of property and equipment.

Long-Lived Assets

We periodically assess potential impairments to our long-lived assets in accordance with the provisions of SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” SFAS No. 144 requires, among other things, that an entity perform an impairment review whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. Factors considered by us include, but are not limited to: significant underperformance relative to expected historical or projected future operating results; significant changes in the manner of use of the acquired assets or the strategy for our overall business; and significant negative industry or economic trends. When we determine that the carrying value of a long-lived asset may not be recoverable based upon the existence of one or more of the above indicators of impairment, we estimate the future undiscounted cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future undiscounted cash flows and eventual disposition is less than the carrying amount of the asset, we recognize an impairment loss. An impairment loss is reflected as the amount by which the carrying amount of the asset exceeds the fair market value of the asset, based on the fair market value if available, or discounted cash flows. To date, there has been no impairment of long-lived assets.

Construction in Progress

Construction in progress consists of the cost of constructing property and equipment for the Company's use. The major cost of construction in progress relates to material, labor and overhead. Interest cost amounted to $1,672,565 was capitalized into construction in progress up to date.

Revenue Recognition

Our revenue recognition policies are in accordance with Staff Accounting Bulletin (SAB) 104. Revenue is recognized when services are rendered to customers, when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of the Company exist and collectability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as unearned revenue. Revenue from gas sales is recognized when gas is pumped through pipelines to the end users. Revenue from installation of pipelines is recorded when the contract is completed and accepted by the customers. The construction contracts are usually completed within one to two months. Revenue from repairing and modifying vehicles is recorded when service are rendered to and accepted by the customers.

Unearned Revenue

Unearned revenue represents prepayments by customers for gas purchases and advance payments on installation of pipeline contracts. We record such prepayment as unearned revenue when the payments are received.

Recent Pronouncements

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities". This Statement permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company chose not to elect the option to measure the fair value of eligible financial assets and liabilities.

In June 2007, the FASB issued FASB Staff Position No. EITF 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for use in Future Research and Development Activities" ("FSP EITF 07-3"), which addresses whether nonrefundable advance payments for goods or services that used or rendered for research and development activities should be expensed when the advance payment is made or when the research and development activity has been performed. Management is currently evaluating the effect of this pronouncement on financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations." SFAS No. 141 (Revised 2007) changes how a reporting enterprise accounts for the acquisition of a business. SFAS No. 141 (Revised 2007) requires an acquiring entity to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value, with limited exceptions, and applies to a wider range of transactions or events. SFAS No. 141 (Revised 2007) is effective for fiscal years beginning on or after December 15, 2008 and early adoption and retrospective application is prohibited. The Company is currently evaluating the impact that adopting SFAS No. 141R will have on its financial statements.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements”, which is an amendment of Accounting Research Bulletin (“ARB”) No. 51. This statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This statement changes the way the consolidated income statement is presented, thus requiring consolidated net income to be reported at amounts that include the amounts attributable to both parent and the noncontrolling interest. This statement is effective for the fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Based on current conditions, the Company does not expect the adoption of SFAS 160 to have a significant impact on its results of operations or financial position.

In March 2008, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 161, “Disclosures about Derivative Instruments and Hedging Activities – An Amendment of SFAS No. 133” (“SFAS 161”). SFAS 161 seeks to improve financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures regarding the impact on financial position, financial performance, and cash flows. To achieve this increased transparency, SFAS 161 requires (1) the disclosure of the fair value of derivative instruments and gains and losses in a tabular format; (2) the disclosure of derivative features that are credit risk-related; and (3) cross-referencing within the footnotes. SFAS 161 is effective on January 1, 2009. The Company is in the process of evaluating the new disclosure requirements under SFAS 161.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("FAS 162"). FAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. FAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company is in the process of evaluating the impact of adoption of this statement on the results of operations, financial position or cash flows.

In June 2008, the FASB issued Emerging Issues Task Force Issue 07-5 “Determining whether an Instrument (or Embedded Feature) is indexed to an Entity’s Own Stock” (“EITF No. 07-5”). This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of Statement of Financial Accounting Standard No 133 “Accounting for Derivatives and Hedging Activities” (“SFAS 133”) specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company’s own stock and (b) classified in stockholders’ equity in the statement of financial position would not be considered a derivative financial instrument. EITF No.07-5 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 SFAS 133 paragraph 11(a) scope exception. The Company is currently evaluating the impact of adoption of EITF No. 07-5 on the Company’s consolidated financial statements.

In September 2008, the FASB issued FASB Staff Positions FSP FAS 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161". This FSP amends FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, to require disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument. This FSP also amends FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, to require an additional disclosure about the current status of the payment/performance risk of a guarantee. Further, this FSP clarifies the Board's intent about the effective date of FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities. The provisions of this FSP that amend Statement 133 and Interpretation 45 shall be effective for reporting periods (annual or interim) ending after November 15, 2008. The Company is in the process of evaluating the new disclosure requirements under this FSP.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's management has evaluated, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operations of the Company's disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)), as of the end of the period covered by this quarterly report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the evaluation of the effectiveness of our disclosure controls and procedures was completed; our disclosure controls and procedures were effective subject to the following:

- Inadequate US GAAP expertise - The current staff in the accounting department is inexperienced and they were primarily engaged in ensuring compliance with PRC accounting and reporting requirement for our operating subsidiaries and were not required to meet or apply U.S. GAAP requirements. They need substantial training so as to meet with the higher demands of being a U.S. public company. The accounting skills and understanding necessary to fulfill the requirements of US GAAP-based reporting, including the skills of subsidiary financial statements consolidation, are inadequate.

We have engaged a US Certified Public Accountant to serve as our accounting consultant. The US CPA is mainly engaged to perform our financial statements consolidation and to prepare our financial statements. In particular, we are seeking accountants experienced in several key areas of accounting, including persons with experience in Chinese and U.S. GAAP, U.S. GAAP consolidation requirements, and SEC financial reporting requirements.

In addition, we plan to allocate additional resources to train our existing accounting staff and continue this effort in the future.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

A former member of the board of directors filed a lawsuit against the Company in New York State Supreme Court, Nassau County, in which he has sought, among other things to recover a portion of his monthly compensation plus 20,000 options that he alleges are due to him pursuant to a written agreement. After the plaintiff rejected an offer by the Company that included the options that plaintiff alleged were due to him, the Company moved to dismiss the complaint. The judge ordered the Company to issue the 20,000 options to the plaintiff subject to any restrictions required by applicable securities laws, which was essentially what the Company had previously offered, and dismissed all of the plaintiff's remaining claims against the Company. The current board of directors has complied with the court's decision by tendering an options agreement to the plaintiff consistent with the court's decision, but the plaintiff has refused to execute the agreement, and instead has filed an appeal. Regardless of the outcome of the appeal, the Company believes that any liability it would incur will not have a materially adverse effect on its financial condition or its results of operations.

Item 1 A. Risk Factors

An investment in our common stock is speculative and 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 the consolidated financial statements and notes thereto of our Company, before deciding to invest in our common stock. The risks described below are not the only ones facing our Company. Additional risks not presently known to us or that we presently consider immaterial may also adversely affect our Company. 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

Prices of natural gas can be subject to significant fluctuations, which may affect and bring uncertainty to our business and financial condition.

We obtain most of our natural gas from government owned entities and our supply contracts are subject to review every six months. The supply price for natural gas is strictly controlled by the PRC government and has remained stable over the past three years. We do not expect any difficulty in renewing our supply contracts during the next 12 months, nor do we expect any significant change to natural gas supply price in China during the same period. However, the price level of natural gas could fluctuate in response to changing national or international market forces, to political events, OPEC actions and other factors over the short to medium term, and to industry economics over the long term. Accordingly, the PRC government may adjust its controlled price limit and our suppliers may be able to increase or decrease their supply price to us. This would bring uncertainty to our business and may affect our financial condition.

We are dependent on supplies of natural gas to deliver to our customers.

With the exception of certain compressed and liquid natural gas supplies, we obtain our supplies of natural gas from one supplier which is a government owned entity. 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, it could prevent us making deliveries to our customers. While we have supply contracts, we do not control the government owned suppliers or other suppliers, nor are we able to control the amount of time and effort they put forth on our behalf. It is possible that our suppliers will not perform as expected, and that they may breach or terminate their agreements with us. It is also possible that, after a regular semi-annual review of our primary supply contract, they choose to provide services to a competitor. Any failure to obtain supplies of natural gas could prevent us from delivering such to our customers and could have a material adverse affect on our business and financial condition.

Our business operations are subject to a high degree of risk and insurance may not be adequate to cover liabilities resulting from accidents or injuries that may occur.

Our operations are subject to potential hazards incident to the gathering, processing, separation and storage of natural gas, such as explosions, product spills, leaks, emissions and fires. These hazards can cause personal injury and loss of life, severe damage to and destruction of property and equipment, and pollution or other environmental damage, and may result in curtailment or suspension of our operations.

We have maintained adequate coverage at reasonable rates and have experienced no material uninsured losses. However, the occurrence of an unexpected while significant event for which we are not fully insured or indemnified, and/or the failure of a party to meet its indemnification obligations, may result in our incurring substantial costs and materially and adversely affect our operations and financial condition. Moreover, no assurance can be given that we will be able to maintain adequate insurance in the future at rates considered as reasonable.

Changes in the regulatory atmosphere could adversely affect our business.

The distribution of natural gas and operations of fueling stations are highly regulated requiring registrations for the issuance of licenses required by various governing authorities in China. In addition, various standards must be met for fueling stations including handling and storage of natural gas, tanker handling, and compressor operation which are regulated. The costs of complying with regulations in the future may harm our business. Furthermore, future changes in environmental laws and regulations could result in stricter standards and enforcement, larger fines and liability, and increased capital expenditures and operating costs, any of which could have a material adverse effect on our financial condition or results of operations.

We depend on our senior management's experience and knowledge of the industry and would be adversely affected by the loss of any of our senior managers.

Our future success depends heavily upon the continuing services of the members of our senior management team, particularly Mr. Ji, who is the founder, Chief Executive Officer, Chairman of the Board, and a major shareholder of our company. We rely on Mr. Ji’s expertise in our business operations and on his personal relationships with the relevant regulatory authorities, customers and suppliers. We do not currently have employment contracts with our senior executives. If, for any reason, our senior executives do not continue to be active in management, our business, or the financial condition of our Company, our results of operations could be adversely affected. In addition, we do not maintain life insurance on our senior executives and other key employees.

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 acquisitions and business development plans.

If in the future, we are not capable of generating sufficient revenues from operations and our capital resources are insufficient to meet future requirements, we may have to raise funds to continue the development, commercialization and marketing of our business. The projects we are currently pursuing include the LNG project, the Xi'an International Port District project, and Baliu Ecological Park project.

We cannot be certain that funding will be available. To the extent that we raise additional funds by issuing equity securities, our stockholders may experience significant dilution. Any debt financing, if available, may involve restrictive covenants that impact our ability to conduct our business. If we are unable to raise additional capital when required or on acceptable terms, we may have to delay, scale back, discontinue our planned acquisitions or business development plans or obtain funds by entering into agreements on unattractive terms.

Our strategy of geographic expansion and our effort of acquiring additional fueling stations may fail.

As part of our business strategy, we continue to expand our operations into more regions in China as we address growth in our natural gas user base and market opportunities. We are constructing new CNG fueling stations and acquiring existing stations in those regions. These actions may require a significant amount of capital investment, and involve uncertainties and risks. We might not be as familiar with the local markets as we are in Henan Province and in our home market Shaanxi Province. Our effort of geographic expansion may fail resulting in loss of investment, competitive edge, and the opportunity to enter into those markets in the near future.

We may not be able to manage our expanding operations effectively.

To manage the potential growth of our operations and personnel, as well as geographically dispersed CNG fueling stations, we will be required to improve operational and financial systems, procedures and controls, and expand, train and manage our growing employee base, including staff from acquired CNG fueling stations. This requires significant time and resource commitments from us and our senior management, who will also be required to maintain and expand our relationships with local governments. We cannot assure you that our current and planned personnel, systems, procedures and controls will be adequate to support our future operations. Our failure to manage growth and operate efficiently could harm our business and adversely affect our financial conditions.

RISKS RELATED TO THE PEOPLE'S REPUBLIC OF CHINA

China's economic policies could affect our business.

Substantially all of our assets are located in China and substantially all of our revenue is derived from our operations in China. Accordingly, our results of operations and prospects are subject, to a significant extent, to the economic, political and legal developments in China.

While China's economy has experienced a significant growth in the past twenty years, growth has been irregular, both geographically and among various sectors of the economy. The Chinese government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall economy of China, but may also have a negative effect on us. For example, our operating results and financial condition may be adversely affected by the government control over capital investments or changes in tax regulations.

The economy of China has been transitioning from a planned economy to a more market-oriented economy. In recent years the Chinese government has implemented measures emphasizing the utilization of market forces for economic reform and the reduction of state ownership of productive assets and the establishment of corporate governance in business enterprises; however, a substantial portion of productive assets in China are still owned by the Chinese government. In addition, the Chinese government continues to play a significant role in regulating industry development by imposing industrial policies. It also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies.

China’s Tax Policies could affect our earnings results.

The PRC government currently grants companies in the natural gas industry a reduced tax rate to encourage the development of the industry. Our variable interest entity, XXNGC, enjoys the reduced tax rate of 15%. If there’s any change in this favorable policy, though not currently expected, it could adversely affect our earnings results.

Capital outflow policies in The People's Republic of China may hamper our ability to remit income to the United States.

The PRC government imposes controls on the convertibility of Renminbi into foreign currencies and, in certain cases, on the remittance of currency outside of the PRC. We receive substantially all of our revenues in Renminbi. Under our current structure, our income is primarily derived from payments from Xi’an Xilan Natural Gas Co. Shortages in the availability of foreign currency may restrict the ability of Xi’an Xilan Natural Gas to remit sufficient foreign currency to pay dividends, if any, or other payments to us, or otherwise satisfy its foreign currency denominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade-related transactions, can be made in foreign currencies without prior approval from the PRC State Administration of Foreign Exchange by complying with certain procedural requirements. However, approval from appropriate government authorities is required in those cases in which Renminbi is to be converted into foreign currency and remitted out of the PRC to pay capital expenses, such as the repayment of bank loans denominated in foreign currencies. The PRC government also may at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends, if any, in foreign currencies to our shareholders.

Although we do not import goods into or export goods out of The People's Republic of China, fluctuation of the RMB may indirectly affect our financial condition by affecting the volume of cross-border money flow.

The value of the RMB fluctuates and is subject to changes in the People's Republic of China political and economic conditions. Since July 2005, the conversion of RMB into foreign currencies, including USD, has been based on rates set by the People's Bank of China which are set based upon the interbank foreign exchange market rates and current exchange rates of a basket of currencies on the world financial markets. As of September 30, 2008, the exchange rate between the RMB and the United States dollar was 6.835 RMB to every one USD (middle price).

We may face obstacles from the communist system in The People's Republic of China.

Foreign companies conducting operations in The People's Republic of China face significant political, economic and legal risks. The Communist regime in The People's Republic of China, including a stifling bureaucracy may hinder Western investment.

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

The People's Republic of China 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 People's Republic of China. 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 account and corporate records and instituting business practices that meet Western standards.

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

We are a holding company, and all of our assets are located in the Republic of China. In addition, a majority 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 People’s Republic of China would enforce:

- 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

- In original actions brought in the People’s Republic of China, liabilities against us or non-residents predicated upon the securities laws of the United States or any state. Enforcement of a foreign judgment in the Republic of China 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.

The PRC legal system embodies uncertainties, which could limit law enforcement availability.

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, decided legal cases have little precedence. 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 1979 has significantly enhanced the protections afforded to various forms of foreign investment in China. Each of our PRC operating subsidiaries and affiliates is subject to PRC laws and regulations. However, these laws and regulations change frequently and the interpretation and enforcement involve uncertainties. For instance, we may have to resort to administrative and court proceedings to enforce the legal protection that we are entitled to by law or contract. However, since PRC administrative and court authorities have significant discretion in interpreting statutory and contractual terms, it may be difficult to evaluate the outcome of administrative court proceedings and the level of law enforcement that we would receive in more developed legal systems. Such uncertainties, including the inability to enforce our contracts, could affect our business and operation. In addition, intellectual property rights and confidentiality protections in China may not be as effective as in the United States or other countries. Accordingly, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the industries in which we operate, including the promulgation of new laws. This may include changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. These uncertainties could limit the availability of law enforcement, including our ability to enforce our agreements with the government entities and other foreign investors.

The admission of China into the World Trade Organization could lead to increased foreign competition.

China officially entered the WTO on December 11, 2001. As the country follows its timetable in the WTO accession agreements to release restrictions on international trade and to improve the investment environment, countries with large natural gas reserves including Saudi Arabia may gain more access to China's natural gas market, and foreign investments may be allowed to invest in natural gas industry. Such events could lead to increased competition in the natural gas industry in China.

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 VIE, Xi'an Xilan Natural Gas, and its shareholders. We are considered a foreign person or foreign invested enterprise under PRC law. As a result, we are subject to PRC law 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 uncertainty. 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 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 condition and results of operations.

We may be adversely affected by complexity, uncertainties and changes in PRC regulation 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 uncertainty. 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 regulation of the natural gas industry include, but are not limited to, the following:

- We only have contractual control over Xi’an Xilan Natural Gas. We do not own it due to the restriction of foreign investment in Chinese businesses; and

- Uncertainties relating to the regulation of the natural gas business in China, including evolving licensing practices, means that permits, licenses or operations at 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.

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 by means of contractual arrangements. If the PRC government determines that these contractual arrangements do not comply with applicable regulations, our business could be adversely affected.

The PRC government restricts foreign investment in natural gas businesses in China. Accordingly, we operate our business in China through Xi’an Xilan Natural Gas. Xi’an Xilan Natural Gas holds the licenses and approvals necessary to operate our natural gas business in China. We have contractual arrangements with Xi’an Xilan Natural Gas and its shareholders that allow us to substantially control Xi’an Xilan Natural Gas. We cannot assure you, however, that we will be able to enforce these contracts.

Although we believe we comply with current PRC regulations, we cannot assure you that the PRC government would agree that these operating arrangements comply with PRC licensing, registration or other regulatory requirements, with existing policies or with requirements or policies that may be adopted in the future. If the PRC government determines that we do not comply with applicable law, 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.

Our contractual arrangements with Xi'an Xilan Natural Gas and its shareholders may not be as effective in providing control over these entities as direct ownership.

Since PRC law limits foreign equity ownership in natural gas companies in China, we operate our business through Xi'an Xilan Natural Gas. We have no equity ownership interest in Xi'an Xilan Natural Gas and rely on contractual arrangements to control and operate such businesses. These contractual arrangements may not be as effective in providing control over Xi'an Xilan Natural Gas as direct ownership. For example, Xi'an Xilan Natural Gas could fail to take actions required for our business despite its contractual obligation to do so. If Xi'an Xilan Natural Gas fails to perform under their agreements with us, we may have to incur substantial costs and resources to enforce such arrangements and may have to rely on legal remedies under PRC law, which may not be effective. In addition, we cannot assure you that Xi'an Xilan Natural Gas's shareholders would always act in our best interests.

RISKS RELATED TO CORPORATE AND STOCK MATTERS

Our largest stockholder has significant influence over our management and affairs and could exercise this influence against your best interests.

At September 30, 2008, Mr. Qinan Ji, our founder, Chairman of the Board and Chief Executive Officer and our largest stockholder, beneficially owned approximately 20.3% of our outstanding shares of common stock. As a result, pursuant to our Bylaws and applicable laws and regulations, our controlling shareholder and our other executive officers and directors are able to exercise significant influence over our Company, including, but not limited to, any stockholder approvals for the election of our directors and, indirectly, the selection of our senior management, the amount of dividend payments, if any, our annual budget, increases or decreases in our share capital, new securities issuance, mergers and acquisitions and any amendments to our Bylaws. Furthermore, this concentration of ownership may delay or prevent a change of control or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of us, which could decrease the market price of our shares. The limited prior public market and trading market may cause volatility in the market price of our common stock.

We have incurred and will continue to incur increased costs as a result of being a public company.

As a public company, we have incurred and will continue to incur significant legal, accounting and other expenses that we did not incur as a private company. We have incurred and will continue to incur costs associated with our public company reporting and compliance requirements, including corporate governance requirements under the Sarbanes-Oxley Act of 2002 and rules implemented by the Securities and Exchange Commission, or the SEC. We expect these rules and regulations to increase our legal and financial compliance costs and to make certain activities more time-consuming and costly.

We may have exposure to greater than anticipated tax liabilities.

We are subject to income tax, business tax and other taxes in many provinces and cities in China and our tax structure is subject to review by various local tax authorities. The determination of our provision for income tax and other tax liabilities requires significant judgment and in the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our estimates are reasonable, the ultimate decisions by the relevant tax authorities may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

The limited prior public market and trading market may cause volatility in the market price of our common stock.

Our common stock is currently traded on a limited basis on the OTCBB under the symbol, "CHNG.OB" The quotation of our common stock on the OTCBB does not assure that a meaningful, consistent and liquid trading market currently exists, and in recent years, such market has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies like us. Our common stock is thus subject to volatility. In the absence of an active trading market:

- investors may have difficulty buying and selling or obtaining market quotations;
- market visibility for our common stock may be limited; and
- a lack of visibility for our common stock may have a depressive effect on the market for our common stock.

Trading of our stock may be restricted by the SEC's penny stock regulations which may limit a stockholder's ability to buy and sell our stock if our stock trades below $5.00 per share.

The SEC has adopted Rule 15g-9 which generally defines "penny stock" to be any equity security that has a market price (as defined) less than $5.00 per share or an exercise price of less than $5.00 per share, subject to certain exceptions. Our securities are covered by the penny stock rules, which impose additional sales practice requirements on broker-dealers who sell to persons other than established customers and "accredited investors". The term "accredited investor" refers generally to institutions with assets in excess of $5,000,000 or individuals with a net worth in excess of $1,000,000 or annual income exceeding $200,000 or $300,000 jointly with their spouse. The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document in a form prepared by the SEC which provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations, and the broker-dealer and salesperson compensation information, must be given to the customer orally or in writing prior to effecting the transaction and must be given to the customer in writing before or with the customer's confirmation. In addition, the penny stock rules require that prior to a transaction in a penny stock not otherwise exempt from these rules, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for the stock that is subject to these penny stock rules. Consequently, these penny stock rules may affect the ability of broker-dealers to trade our securities. We believe that the penny stock rules discourage investor interest in and limit the marketability of our 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, 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 one-year 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 two-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.

If we or our independent registered public accountants cannot attest our adequacy in the internal control measures over our financial reporting, as required by Section 404 of the U.S. Sarbanes-Oxley Act, we may be adversely affected.

As a public company, we are subject to report our internal control structure and procedures for financial reporting in our annual reports on Form 10-K, as a requirement of Section 404 of the U.S. Sarbanes-Oxley Act of 2002 by the U.S. Securities and Exchange Commission (the "SEC"). The report must contain an assessment by management about the effectiveness of our internal controls over financial reporting. Moreover, the independent registered public accountants of our Company must attest to and report on management's assessment of the same. Even if our management attests to our internal control measures to be effective, our independent registered public accountants may not be satisfied with our internal control structure and procedures. We cannot guarantee the outcome of the report and it could result in an adverse impact on us in the financial marketplace due to the loss of investor confidence in the reliability of our financial statements, which could negative influence to our stock market price.

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.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Description of Exhibit
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)

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	China Natural Gas, Inc.	
November 13, 2008	By:	/s/ Qinan Ji Qinan Ji Chief Executive Officer (Principal Executive Officer)
November 13, 2008	By:	/s/ Richard P. Wu Richard P. Wu Chief Financial Officer (Principal Financial and Accounting Officer)