China Natural Gas, Inc.
Form 10-Q
May 19, 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 March 31, 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.)

19th Floor, Building B, Van Metropolis
Tang Yan Road, Hi-Tech Zone
Xi'an, 710065, Shaanxi Province, China
(Address of principal executive office)

710065

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

Number of shares of Common Stock outstanding as of May 14, 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

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China Natural Gas, Inc. and Subsidiaries
Consolidated Balance Sheet
As of March 31, 2008 and December 31, 2007

	March 31, 2008 (Unaudited)	December 31, 2007
ASSETS		
CURRENT ASSETS:		
Cash & cash equivalents	$ 41,254,130	$ 13,291,729
Short-term investments	-	238,554
Accounts receivable	486,111	306,179
Other receivable	362,187	549,820
Inventories	1,040,612	231,339
Advances	625,893	663,041
Prepaid expense and other current assets	586,756	109,722
Loan receivable	285,600	274,200
Total current assets	44,641,289	15,664,584
PROPERTY AND EQUIPMENT, net	33,827,732	32,291,995
CONSTRUCTION IN PROGRESS	12,130,620	2,210,367
DEFERRED OFFERING COSTS	2,054,204	-
OTHER ASSETS	7,138,669	3,123,052
TOTAL ASSETS	$ 99,792,514	$ 53,289,998
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 404,121	$ 293,970
Other payables and accured liabilities	175,715	249,719
Unearned revenue	364,025	327,220
Accured interest	236,111	-
Taxes payable	2,047,763	1,211,775
Total current liabilities	3,227,735	2,082,684
LONG TERM LIABILITIES:		
Notes payable, net of $17,254,108 discount	22,745,892	-
Derivative liabilities - warrants	17,500,000	-
Total long term liabilities	40,245,892	-
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 March 31, 2008 and December 31, 2007	2,920	2,920
Additional paid-in capital	32,046,879	32,046,879

Cumulative translation adjustment		5,780,027		3,477,025
Statutory reserves		2,168,501		1,802,735
Retained earnings		16,320,560		13,877,755
Total stockholders' equity		56,318,887		51,207,314
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	99,792,514	$	53,289,998

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

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China Natural Gas, Inc. and SubsidiariesConsolidated Statements of Income and Other Comprehensiv

	Three months ended March 31			
		2008		2007
Revenue				
Natural gas revenue	$	11,345,319	$	4,923,572
Installation and other		2,680,355		1,820,004
Total revenue		14,025,674		6,743,576
Cost of revenue				
Natural gas cost		6,182,274		2,492,651
Installation and other		1,754,924		733,566
Total cost of revenue		7,937,198		3,226,217
Gross profit		6,088,476		3,517,359
Operating expenses				
Selling expenses		1,341,614		594,129
General and administrative expenses		939,325		421,379
Total operating expenses		2,280,939		1,015,508
Income from operations		3,807,537		2,501,851
Non-operating income (expense):				
Interest income		55,285		9,409
Interest expense		(156,727)		-
Amortization of discount on senior notes		(146,663)		-
Amortization of deferred offering costs		(56,270)		-
Other income		674		383
Other expense		(7,800)		-
Total non-operating income (expense)		(311,501)		9,792

Income before income tax		3,496,036		2,511,643
Provision for income tax		687,465		401,317
Net income		2,808,571		2,110,326
Other comprehensive income				
Foreign currency translation gain		2,303,002		281,404
Comprehensive Income	$	5,111,573	$	2,391,730
Weighted average shares outstanding				
Basic		29,200,304		24,210,183
Diluted		29,334,084		24,210,183
Earnings per share				
Basic	$	0.10	$	0.09
Diluted	$	0.10	$	0.09

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

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China Natural Gas, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
For the Three Months Ended March 31, 2008 and 2007
(Unaudited)

	Three months ended March 31	
	2008	**2007**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 2,808,571	$ 2,110,326
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	656,587	352,685
Loss on disposal of building improvements and equipment	11,957	-
Amortization of discount on senior notes	146,663	-
Amortization of deferred offering costs	56,270	-
Non-cash interest expense	156,727	-
Change in assets and liabilities:		
Accounts receivable	(163,656)	(59,700)
Other receivable	205,864	(197,081)
Inventories	(782,687)	172,905
Advances	63,341	246,228
Prepaid expense and other current assets	(462,880)	196,929
Accounts payable	95,847	21,770
Accrued expense	(83,010)	-
Other payables	1,129	(912,068)
Unearned revenue	22,709	482
Taxes payable	768,939	-
Net cash provided by operating activities	3,502,371	1,932,476
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(555,720)	(192,232)
Proceeds from short term investments	243,200	-
Additions to construction in progress	(9,586,215)	(377,901)
Prepayment on long term assets	(4,128,711)	-
Payment for land use rights	(25,091)	-
Net cash used in investing activities	(14,052,537)	(570,133)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from senior notes	40,000,000	-
Payment for offering costs	(2,122,509)	-
Net cash provided by financing activities	37,877,491	-
Effect of exchange rate changes on cash and cash equivalents	635,076	69,738
NET INCREASE IN CASH & CASH EQUIVALENTS	27,962,401	1,432,081
CASH & CASH EQUIVALENTS, BEGINNING OF PERIOD	13,291,729	5,294,213

CASH & CASH EQUIVALENTS, END OF PERIOD	$	41,254,130	$	6,726,294
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Interest paid	$	-	$	-
Income taxes paid	$	57,893	$	-

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

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China Natural Gas, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
March 31, 2008
(Unaudited)

Note 1 - Organization and Basis of Presentation

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 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 established Xi'an Xilan Auto Bodyshop Co., Ltd ("XXABC") with registered capital of $519,200 (RMB 4,000,000) 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. The additional $14,429,271 registered capital was contributed by China Natural Gas, Inc on April 17, 2008 and the $9,500,000 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, design of constructing the Liquefied Natural Gas ("LNG") processing plant. The Company is in the process of obtaining the approval and new business license from the PRC government.

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. ("XXNGC"), Shaanxi Jingbian Liquefied Natural Gas Co., Ltd ("SJLNG") and Xian Xilan Auto Bodyshop Co., Ltd. All inter-company accounts and transactions have been eliminated in the consolidation.

Consolidation of variable interest entity

In accordance with FASB 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 FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities." The arrangements consist of the following agreements:

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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.

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 March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

Foreign Currency Translation

As of March 31, 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 on the balance sheet date, stockholder's equity are translated at the historical rates and statement 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 March 31, 2008 were translated 7.00 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 three months ended March 31, 2008 and 2007 were 7.15 RMB and 7.75 RMB to $1.00 USD, respectively. Translation adjustments resulting from this process of $5,780,027 and $3,477,025 as of March 31, 2008 and December 31, 2007, respectively are classified as an item of other comprehensive income in the stockholders' equity section of the consolidated balance sheet. During the three months ended March 31, 2008 and 2007, other comprehensive income in the consolidated statements of income and other comprehensive income included translation gains of $2,302,002 and $281,404, respectively.

Note 2 – Summary of Significant Accounting Policies

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 cash in banks maintained with state owned with 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 Unites States. Balances at financial institutions or state owned banks within the PRC are not covered by insurance. As of March 31, 2008 and December 31, 2007, the Company had deposits in excess of federally insured limits total of $40,954,130 and $13,053,994, 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 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 allowance for uncollectible accounts is not significant.

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. The Company's management has determined that all receivables are collectible and there is no need for a reserve for bad debts as of March 31, 2008 and December 31, 2007.

Other Receivable

As needed for normal business purpose, 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, the allowance for the uncollectible accounts is nil.

Advances

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.

At March 31, 2008 and December 31, 2007, the following are the details of the inventories:

	2008	2007
Materials and supplies	$ 258,671	$ 109,333
Natural gas and gasoline	781,941	122,006
	$ 1,040,612	$ 231,339

Property and Equipment

Property and equipment are stated at cost. Expenditures for maintenance and repairs are charged to earnings as incurred; 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

At March 31, 2008 and December 31, 2007, the following are the details of the property and equipment:

	2008	2007
Office equipment	$ 170,710	$ 163,432
Operating equipment	23,896,744	22,413,270
Vehicles	1,546,627	1,484,892
Buildings	12,708,024	11,943,006
	38,322,105	36,004,600
Less accumulated depreciation	(4,494,373)	(3,712,605)
	$ 33,827,732	$ 32,291,995

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Depreciation expense for the three months ended March 31, 2008 and 2007 was $656,524 and $351,776, 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 March 31, 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 March 31, 2008 and 2007 amounted to $190,648 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, 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 1inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2inputs 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 3inputs 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."

The Company's warrant liability is carried at fair value totaling $17,500,000 as of March 31, 2008. The Company used Level 2 inputs for its valuation methodology for the warrant liability, and their fair values are determined by the price that the Company would be required to repurchase the warrants if they are not exercised.

	Fair Value As of March 31, 2008	Fair Value Measurements at March 31, 2008 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Liabilities				
Warrant liability	$ 17,500,000		$ 17,500,000	

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.

<u>Derivative Accounting</u>

The Company entered into a 15 days foreign currency forward contract on March 20, 2008. As of March 31, 2008, the fair value of the contract is $8,000,000 (or 788,800,000 Japanese Yen) and is recorded in cash and cash equivalents in the accompanying consolidated balance sheets due to the short term nature of the investment.

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 market 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.

The Company elected not to apply hedge accounting. For a derivative instrument that is not designated, as a hedge, the change in fair value is recognized in earnings in the period of change. For the period ended March 31, 2008, no gain or loss was incurred.

Revenue Recognition

The Company's revenue recognition policies are in compliance 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 collectibility 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 time. 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 months ended March 31, 2008 and 2007 were insignificant.

Stock-Based Compensation

The Company accounts for its stock-based compensation in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 123R, "Share-Based Payment, an Amendment of Financial Accounting Standards Board (“FASB”) Statement No. 123." The Company recognizes in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees and non-employees. The Company did not grant any options and no options were cancelled or exercised during the period ended March 31, 2008 and the year ended December 31, 2007. As of March 31, 2008 and December 31, 2007, there were no options outstanding.

The Company accounts for non-employee stock-based compensation expense in accordance with EITF Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employee for Acquiring, or in Conjunction with Selling, Goods or Services (“EITF 96-18”). The Company used the Black-Scholes option-pricing model as its method of valuation for share-based awards granted. The Company’s determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company’s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, the Company’s expected stock price volatility over the term of the awards and the expected term of the awards.

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 differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. At March 31, 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, 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 the period Ended March 31,	
	2008	2007
Tax provision (credit) at statutory rate	34%	34%
Foreign tax rate difference	(9)%	(1)%
Effect of favorable tax rate	(4)%	(14)%
	21%	19%

The estimated tax savings for the period ended March 31, 2008 and 2007 amounted to approximately $402,051 and $481,871, 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 March 31, 2008 and 2007 from $0.10 to $0.08 and $0.09 to $0.07, respectively.

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 Statement of Financial Accounting Standards No. 128 (“SFAS No. 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 adjustments 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.

Reclassifications

Certain prior period amounts have been reclassified to conform to current period’s presentation. This reclassification had no material effect on operations or cash flows.

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.

Note 3 –- Other Assets

Other assets at March 31, 2008 and December 31, 2007 consisted of the following,

		2008		2007
Prepaid rent – natural gas stations	$	260,951	$	225,924
Prepayment for acquiring land use right		1,035,300		993,975
Advances on purchasing equipment/construction in progress		5,167,031		1,501,443
Refundable security deposits		628,320		356,460
Others		47,067		45,250
Total	$	7,138,669	$	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 March 31, 2008 and December 31, 2007, the Company prepaid $1,035,300 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 deposit is monies deposited to one of its major vendor and gas station landlord. These amounts will be returned to the Company if they terminate the business relationship or at the end of the lease.

Note 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 to the Investor 5.00% Guaranteed Senior Notes due 2014 (the "Senior Notes") in aggregate principal amount of RMB 145,000,000 (approximately $20,000,000), (ii) agreed to issue to the Investor Senior Notes in aggregate principal amount of RMB145,000,000 (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 RMB 73,000,000 (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 completed the sale of RMB145,000,000 (or approximately $20,000,000) in principal amount of the Senior Notes and the issuance of the warrants pursuant to the Purchase Agreement. 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-competition agreement for the benefit of the Investor.

The Senior Note in the amount of RMB 145,000,000 was 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 Amount
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%

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

Year	Percent of Principal
2009	108.0%
2010	106.0%
2011	104.0%
2012	102.0%
2013 and thereafter	100.0%

Upon the happening 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.

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"), subject to any limitation required by applicable of Rule 415 of the SEC pursuant to the Securities Act of 1933 and to have the registration statement declared effective by June 27, 2008. In the event that the registration statement has not been declared effective by the SEC on or before June 27, 2008 or if 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 the First Option Notes for an additional RMB145,000,000 (approximately $20,000,000) in aggregate principal amount of Senior Notes. On March 10, 2008, the Company issued Senior Notes for an additional aggregate principal amount of RMB145,000,000 (approximately $20,000,000) representing the First Option Notes for total Senior Notes of RMB290,000,000 (approximately $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 March 31, 208, the Company amortized $56,270 of the aforesaid issuance costs, net of capitalized of 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 March 31, 2008, the Company amortized $146,663 of the aforesaid discounts, net of capitalized of interest.

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 $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 filling of its certificate of Amendment of Articles of Incorporation to increase the authorized number 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.

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, March 31, 2008	3,988,484	$ 7.14	-

Following is a summary of the status of warrants outstanding at March 31, 2008:

Outstanding warrants				Exercisable Warrants		
Exercise Price		Number	Average Remaining Contractual Life	Average Exercise Price		Number
$	3.60	321,176	0.78	$	3.60	321,176
$	7.37	2,900,000	6.83	$	7.37	2,900,000
$	7.79	767,308	4.34	$	7.79	767,308
$	7.14	3,988,484	5.86	$	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 $20,132 for the three months ended March 31, 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 has appropriated $365,766 and $341,860 as reserve for the statutory surplus reserve for the three months ended March 31, 2008 and 2007, respectively.

Note 8 – Earnings Per Share

Earnings per share for the period ended March 31, 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 the period ended March 31, 2008 and 2007:

	Three Months Ended March 31,	
	2008	2007
Basic earning per share		
Net income	$ 2,808,571	$ 2,110,326
Weighted shares outstanding-Basic	29,200,304	24,210,183
Earnings per share-Basic	$ 0.10	$ 0.09
Diluted earning per share		
Net income	$ 2,808,571	$ 2,110,326
Weighted shares outstanding-Basic	29,200,304	24,210,183
Effect of diluted securities-Warrants	133,780	-
Weighted shares outstanding-Diluted	29,334,084	24,210,183
Earnings per share -Diluted	$ 0.10	$ 0.09

At March 31, 2008 and 2007, the Company had outstanding warrants of 3,988,484 and 1,140,286, respectively. For the three months ended March 31, 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 133,780; 3,667,308 outstanding warrants were excluded from the diluted earnings per share calculation as they are anti-dilutive. For the three months ended March 31, 2007, all outstanding warrants were excluded from the diluted earnings per share calculation as they are anti-dilutive.

Note 9 – Current Vulnerability Due to Certain Concentrations

For the period ended March 31, 2008 and 2007, the Company purchased all of the natural gas for resale from three vendors, PetroChina Changqing Oilfield Company, Shaanxi Natural Gas Co Ltd, and Jingcheng city Mingshi Coal Bed Methane Exploitage Ltd. No amount was owed to these vendors at March 31, 2008. Except for Shaanxi Natural Gas Co Ltd, the other two vendors have long-term agreements with the Company without minimum purchase requirements. The Company has had annual agreements from July 1, 2007 to June 30, 2008 with Shaanxi Natural Gas Co Ltd to purchase certain amount of natural gas. For the year ending June 30, 2008, the minimum purchase was 12.93 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.

For the period ended March 31, 2008, three suppliers accounted for 64.18%of the total inventory purchased by the Company and for the period ended March 31, 2007, two supplier accounts for 90.90% of the total inventory purchased by the Company

For the period ended March 31, 2008, two suppliers accounted for 61.55 %of the total equipment purchased by the Company and for the period ended March 31, 2007, two suppliers accounted for 44.9% of the total equipment purchased by the Company.

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Four customers accounted for 7.92 % of the Company's installation revenue for the period ended March 31, 2008 and four customers accounted for 42.6% of the Company's installation revenue for the period ended March 31, 2007.

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 10 – Commitments and Contingencies

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:

Nine months ending December 31, 2008	$ 537,222
Year ended December 31, 2009	716,296
Year ended December 31, 2010	716,296
Year ended December 31, 2011	705,454
Year ended December 31, 2012	650,771
Thereafter	2,336,584
Total	$ 5,662,623

For the period ended March 31, 2008 and 2007, the land use right and office lease expenses were $63,247 and $ 22,723, respectively.

Note 11 – Subsequent Event

On April 8, 2008, the Company has entered into an agreement with the Xi'an Internal Port Administrative Committee to participate in the development of both Xi'an International Port District and Baliu Ecological Park.

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. 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. 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. 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."

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. We also distribute and sell CNG as vehicular fuel through a network of approximately 27 CNG filling stations in Shaanxi and Henan Provinces. As of March 31, 2008, we own and operate 17 CNG filling stations in Shaanxi Province and 10 CNG filling stations in Henan Province.

We operate three primary business lines:

- Distribution and sale of compressed natural gas (CNG) through Company-owned CNG filling stations for hybrid (natural gas/gasoline) powered vehicles (27 stations as of March 31, 2008);

- Distribution and sale of piped natural gas to residential, commercial and industrial customers through Company-owned pipelines. The Company distributes and sells natural gas to approximately 90,269 homes and businesses as of March 31, 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 March 31, 2008 and 2007:

The following table presents certain consolidated statement of operations information. Financial information is presented for the three months ended March 31, 2008 and 2007.

	March 31, 2008	March 31, 2007
Revenues	$ 14,025,674	$ 6,743,576
Cost of Revenues	7,937,198	3,226,217
Operating Expenses	2,280,939	1,015,508
Income from Operations	3,807,537	2,501,851
Net Income	$ 2,808,571	$ 2,110,326

Revenues: We generated approximately 80.89% of our revenues in the three months ended March 31, 2008 from the sale of natural gas and approximately 19.11% of our revenues from installation fees, conversion fees, and other sources. Sales of natural gas at the Company-owned filling stations accounted for approximately 77.30% of our total revenues in the three months ended March 31, 2008, or approximately $10,842,155 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 approximately 11.89% of our total revenues in the three months ended March 31, 2008, or approximately $1,667,929, including both natural gas sales and installation fees. The Company expects natural gas revenues to increase on both an actual basis and as a percentage of revenue in 2008.

As of March 31, 2008, the Company had approximately 90,269 pipeline customers, an increase of approximately 15,269 customers over the same period in 2007, and had constructed and acquired 27 filling stations, an increase of 13 stations over the same period in 2007. In the second quarter of 2008, the Company expects to add up to 4,500 pipeline customers and 5 additional filling stations, which the Company estimates will increase sales of natural gas by 37.7 million cubic meters.

We had total revenues of $14,025,674 for the three months ended March 31, 2008, an increase of $7,282,098 or 107.99%, compared to $6,743,576 for the three months ended March 31, 2007. The increase in revenues was primarily due to the material increase in the number of company owned filling stations as well as an increase in the number of residential, commercial and industrial pipeline customers from approximately 75,000 in the three months ended March 31, 2007 to approximately 90,269 in the three months ended March 31, 2008.

New pipeline customers pay approximately 60% of the installation costs to connect to our pipeline system up front and the balance is payable as part of their monthly natural gas bill. During the three months ended March 31, 2008, our installation revenues decreased approximately 41.66% over the same period in 2007 and our sales of natural gas increased approximately 130.43% over the previous year. Two customers accounted for approximately 6.87% of the Company's installation revenue for the three months ended March 31, 2008.

Cost of Revenues: Our cost of revenues consists of both the cost of natural gas and the cost of installation. Cost of natural gas consists primarily of the cost that we pay for natural gas purchased from our supplier, together with transportation costs and depreciation of equipment. Cost of connection includes certain installation costs related to connecting customers to our pipeline system that are generally expensed when incurred.

Cost of revenues in the three months ended March 31, 2008 was $7,937,198, an increase of $4,710,981 or approximately 146.02% over the same period in 2007. Cost of natural gas increased by approximately 148.02% to $6,182,274 in the three months ended March 31, 2008, as compared with $2,492,651 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. In addition, our installation costs decreased in the three months ended March 31, 2008 by approximately 46.26% to $394,231, as compared with $733,566 in the same period in 2007 as a result of the decrease in new pipeline customers.

We purchase all of our natural gas for resale from three vendors, PetroChina Changqing Oilfield Company, Shaanxi Natural Gas Co Ltd, and Jingcheng city Mingshi Coal Bed Methane Exploitage Ltd. 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 ¥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 at 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 economy 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 $6,088,476 for the three months ended March 31, 2008, an increase of $2,571,117 or approximately 73.10%, compared to $3,517,359 for the three months ended March 31, 2007. The increase in gross profit is due to a material increase in gas sales and installation revenues in this quarter, partially offset by an increase in cost of sales.

Gross margin: Gross margin, as a percentage of revenues, decreased to approximately 43.41% for the three months ended March 31, 2008, from approximately 52.16% for the three months ended March 31, 2007. The decrease in gross margin is primarily due to the lower margin from CNG stations in Henan region which contribute larger portion of total gross profit than those from the same period in 2007. In addition, Auto Conversion division, which did not exist in the first quarter in 2007, is another factor contributed to lower margin in the three months period ended March 31, 2008.

Operating expenses: The Company incurred operating expenses of $2,280,939 for the three months ended March 31, 2008, an increase of $1,265,431, or approximately 124.61%, compared to $1,015,508 for the three months ended March 31, 2007. Our operating expenses increased primarily as a result of expenses related to the operation of 13 newly added CNG stations since March 31, 2007, recruitment of more employees as well as the on-going expenses related to the identification of possible locations for additional filling stations and the governmental licensing and approval process. In addition, sales and marketing costs increased in the three months ended March 31, 2008 as we increased our efforts to obtain new residential and commercial customers and attract customers to our filling stations by hiring more sales persons, purchasing more tankers and using more utilities.

For the three months ended March 31, 2008, two suppliers accounted for 91.25% of the total equipment we purchased for installation activities. We believe that as a result of our relationships within the construction industry and the construction equipment vendor community and the availability of other vendors to supply the construction equipment and materials, the loss of any one of these two vendors would not have a material adverse effect on our operations.

Income tax was $687,465 for the three months ended March 31, 2008, as compared to $401,317 for the three months ended March 31, 2007. The increase in income tax was attributed to the growth of installation fees and the sale of natural gas.

Net Income: Net income increased to $2,808,571 for the three months ended March 31, 2008, an increase of $698,245 or approximately 33.09% from $2,110,326 for the three months ended March 31, 2007. The increased net income reflects the Company's strong and steady profit generating ability. The Company expects natural gas revenues continue to increase on both an actual basis and as a percentage of revenue. In the second quarter of 2008, the Company expects to add up to 4,500 pipeline customers and add additional 5 filling stations, which the Company estimates will increase sales of natural gas by 37.7 million cubic meters.

Liquidity and Capital Resources

As of March 31, 2008, the Company had $41,254,130 of cash and cash equivalents on hand compared to $13,291,729 of cash and cash equivalents as of December 31, 2007.

Cash flows provided by operating activities was $3,502,371 for the three months ended March 31, 2008 compared to net cash provided by operations of $1,932,476 in the corresponding period last year. The primary reason for the change is attributed to the income generated from revenue, decrease in other receivables and increase in taxes payable.

Cash outflows for investing activities increased from $570,133 in the three months ended March 31, 2007 to $14,052,537 for the same period in 2008 primarily because of the prepayment to equipment suppliers of the LNG plant and additions to construction in progress, as well as purchasing other long term assets and payment for land use rights.

Cash inflow for financing activities was $37,877,491 for the three months ended March 31, 2008, compared to zero in the corresponding previous year. The financing cash flow comes from the sale of senior notes to Abax Lotus, partially offset by the offering cost.

The Company expects to add 5 additional CNG filling stations in the second quarter of 2008. The Company expects to invest between $4.0 million and $6.0 million in new stations, and the funds for these investing activities will primarily come from the Company's operating and financing cash flows.

The Company paid $9.5 million for the LNG processing plant as a prepayment on equipments as well as consulting fees. The Company expects to pay the LNG related fees in the subsequent quarters with funds already secured and internally generated cash flows.

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 LNG Project and acquisition of other filling 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

We entered in to a foreign currency forward contract in March 2008 and please refer to footnote under “Derivative Accounting” for more details. We also entered into series of long term lease agreements with outside parties to lease land use right to the self-built natural gas filling stations located in the PRC, and please refer to footnote 4 to the financial statements for details. We have purchase agreements with several natural gas suppliers and please see footnote 9 for more explanations. We do not have any other off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our investors.

CRITICAL ACCOUNTING POLICIES

In presenting our financial statements in conformity with accounting principles generally accepted in the United States, 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.

Revenue Recognition

Our revenue recognition policies are in compliance 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 collectibility 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 time. 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.

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 satisfactory subject to the following:

- Inadequate US GAAP expertise - The current staff in the accounting department is inexperienced and they was primarily engaged in ensuring compliance with PRC accounting and reporting requirement for our operating subsidiaries and was 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 Pickard & Green, CPAs, a Certified Public Accounting firm in Valencia, CA, to serve as our accountant. They are 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

None

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 government owned entities. 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 filling 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 filling 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 filling 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 filling 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 filling 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 filling 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 March 31, 2008, the exchange rate between the RMB and the United States dollar was 7.00 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, 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 over the past 27 years 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, Xian 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 Xian 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 Xian 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 Xian Xilan Natural Gas. Xian Xilan Natural Gas holds the licenses and approvals necessary to operate our natural gas business in China. We have contractual arrangements with Xian Xilan Natural Gas and its shareholders that allow us to substantially control Xian 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 Xian 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 Xian Xilan Natural Gas. We have no equity ownership interest in Xian 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 Xian Xilan Natural Gas as direct ownership. For example, Xian Xilan Natural Gas could fail to take actions required for our business despite its contractual obligation to do so. If Xian 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 Xian 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 March 13, 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.

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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.

We may be exposed to potential risks relating to our internal controls over financial reporting and our ability to have the operating effectiveness of our internal controls attested to by our independent auditors.

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-KSB, 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 that were not reported on a Form 8-K.

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
3.1	Certificate of Amendment to the Certificate of Incorporation (incorporated by reference to Exhibit 3.2 to the Company's Form SB-2 filed on November 2, 2007)
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.

May 19, 2008	By:	/s/ Qinan Ji Qinan Ji Chief Executive Officer
May 19, 2008	By:	/s/ Lihong Guo Lihong Guo Chief Financial Officer (Principal Financial and Accounting Officer)