China Natural Gas, Inc.
Form 10-K
April 01, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number: 001-34373

CHINA NATURAL GAS, INC.

(Exact Name of Registrant as specified in its charter)

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

19th Floor, Building B, Van Metropolis

Tang Yan Road, Hi-Tech Zone

Xi'an, 710065, Shaanxi Province, China

(Address of principal executive office)

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

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

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

Common Stock, $.0001 par value per share

(Title of Class)

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

Yes ¨ No x

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

Yes ¨ No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.45 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

Form 10-K. ¨

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

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

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

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of June 30, 2012, was $18,539,208. All executive officers, directors and holders of 5% or more of our outstanding common stocks have been deemed, solely for the purpose of the foregoing calculation, to be "affiliates" of the registrant.

As of March 23, 2013 there were 21,458,654 shares of the issuer's common stock, $0.0001 par value per share, issued and outstanding.

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PART I

FORWARD-LOOKING STATEMENTS

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

ITEM 1. BUSINESS

Overview

We are an integrated natural gas operator in the Peoples’ Republic of China (referred to herein as China or the PRC), primarily involved in the distribution of compressed natural gas, or CNG, through CNG fueling stations owned by our variable interest entity, or VIE, Xi’an Xilan Natural Gas Co., Ltd. (referred to as XXNGC). As of December 31, 2012, we operated 20 CNG fueling stations in Shaanxi Province,10 CNG fueling stations in Henan Province and 1 CNG fueling station in Hubei Province. Our VIE owns our CNG fueling stations while we lease the land upon which our CNG fueling stations operate. For the year ended December 31, 2012, we sold 142,449,576 cubic meters of CNG through the fueling stations, compared to 162,752,780 cubic meters for the year ended December 31, 2011. Our VIE and its subsidiary, Lingbao Yuxi Natural Gas Co. Ltd. (“LYNG”), also install natural gas pipelines for, and distribute

and sell piped natural gas to, residential and commercial customers in the city of Xi'an in Shaanxi Province, including Lantian County, and the districts of Lintong and Baqiao, in Shaanxi Province, and in the city of Lingbao in Henan Province, through a high pressure pipeline network of approximately 120 kilometers,

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

We currently operate five main business lines:

- distribution and sales of CNG through our VIE-owned CNG fueling stations serving hybrid (natural gas/gasoline) powered vehicles. As of December 31, 2012, our VIE owned and operated 31 fueling stations in total;

- installation, distribution and sales of piped natural gas to residential and commercial customers through our VIE-owned pipelines. We distributed and sold piped natural gas to approximately 122,020 residential customers as of December 31, 2012;

- production and sales of LNG through our LNG production facility in Jingbian County, Shaanxi Province. Revenues from commercial production and sales of LNG started on July 16, 2011. We have seven semi-trailers in operation serving LNG powered vehicles as of December 31, 2012.

- distribution and sales of gasoline through our VIE-owned CNG fueling stations for gasoline and hybrid (natural gas/gasoline) powered vehicles (two of our VIE-owned CNG fueling stations were selling gasoline as of December 31, 2012); and

- conversion of gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles at our automobile conversion workshops.

We purchase all of the natural gas that we sell and distribute to our customers. We are not directly involved in the mining or production of natural gas and have no plans to do so during 2013. We currently sell our natural gas in three forms: (i) we compress natural gas into CNG and sell it to our customers through CNG fueling stations, (ii) we distribute natural gas through pipelines to commercial and residential customers, (iii) we liquefy natural gas and sell and distribute it to our customers.

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

We had total revenues of $145,281,288 and $124,221,526 for the years ended December 31, 2012 and 2011, respectively. We had net income of $11,037,269 and $15,261,932 for the years ended December 31, 2012 and 2011, respectively. We had total assets of $288,500,809 and $276,983,808 as of December 31, 2012 and 2011, respectively.

Our Corporate History and Structure

On June 28, 2011, our VIE, XXNGC, entered into an Equity Transfer Agreement (the “Transfer Agreement”) with five individual shareholders of Xiantao City Jinhua Gas and Oil Co., Ltd. (“XTJH”). Pursuant to the Transfer Agreement, XXNGC acquired a 58.5284% ownership of XTJH for a total purchase price of $1,905,099 (RMB 12,290,964). During the first quarter of 2012, we completed the acquisition of XTJH, and have our own fueling station available

locally, which increases our revenue and share in the local market.

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

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

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

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

On October 27, 2009, XXNGC formed Henan CNPC Kunlun Xilan Compressed Natural Gas Co., Ltd., or the JV, as a joint venture with China National Petroleum Corporation Kunlun Natural Gas Co., Ltd., or CNPC Kunlun, in Henan province, PRC. The JV was established to build and operate CNG compressor stations and fueling stations, sell CNG, provide vehicle conversion services from gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles and technical advisory work services in Henan Province, PRC. CNPC Kunlun holds 51% ownership of the JV and XXNGC holds 49% ownership.

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

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

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

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

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

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

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

The following illustrates our corporate and share ownership structure as of December 31, 2012:

Our Variable Interest Entity Agreements

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

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

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

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

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

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

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

Our Products, Services and Customers

CNG and Gasoline Fueling Stations

As of December 31, 2012, our VIE operated 20 CNG fueling stations in the Shaanxi Province, 10 CNG fueling stations in Henan Province and 1 CNG fueling station in Hubei Province. Through these VIE-owned fueling stations, CNG is sold to taxis, buses and private cars that operate with CNG technology. During the year ended December 31, 2012, we purchased natural gas at an average cost of $0.26 (RMB 1.64) per cubic meter and sold each cubic meter for $0.50 (RMB 3.13), net of value-added taxes, in Shaanxi Province, and we purchased natural gas at an average cost of $0.29 (RMB 1.80) per cubic meter and sold each cubic meter for $0.50 (RMB 3.14), net of value-added taxes, in Henan Province.

During the first quarter of 2011, we closed one CNG fueling station in Shaanxi Province due to changes in market conditions, in October, 2011, we closed another CNG fueling station in Shaanxi Province because the district will be

demolished for urban redevelopment, in March 2012, we acquired one CNG fueling station in Hubei Province, in April 2012, we closed one fueling station in Shaanxi Province due to the construction of main subway lines in Xi'an, in May 2012, we ceased operations of two fueling stations in Henan province due to adverse market conditions, we closed three fueling stations in September 2012, and one fueling station in October 2012 in Shaanxi Province due to the change of the Company's strategy to reduce the scale of our CNG fueling stations, and focus on establishing of LNG fueling stations. During the third quarter of 2012, we disposed all the buildings, equipment, and other fixed assets of five CNG fueling stations.

Our VIE and its subsidiary, Makou, own three natural gas compressor stations as of December 31, 2012. The first one, Hongqing station, is located in Xi'an City and was acquired in July 2005, near our pipeline network; the second station is located in Xianyang City and was acquired in January 2008; the third station is located in Hanchuan City, Hubei Province and was acquired in the third quarter of 2010. We sold the Changsheng station, which was acquired in September 2008, on May 31, 2010, for a consideration of $1.63 million (RMB 11 million). A compressor station compresses natural gas and allows trucks to transport CNG to fueling stations. We currently have a daily processing capacity of 250,000 cubic meters of CNG.

We began to distribute and sell gasoline during the fourth quarter of 2007 in an effort to support our sales of CNG by attracting more natural gas/gasoline hybrid car owners through providing a one-stop refueling option for such customers. Our gasoline facilities were either installed by us at our existing CNG stations or acquired through our acquisition of CNG fueling stations that have both CNG and gasoline-fueling capability. As of December 31, 2012, we distributed and sold gasoline at two of our VIE-owned CNG fueling stations for gasoline and hybrid (natural gas/gasoline) powered vehicles in Xi'an City. During the year ended December 31, 2012, we purchased gasoline at an average cost of $1.00 (RMB 6.31) per liter and sold each liter at an average price of $1.06 (RMB 6.68), net of VAT, in Xi'an City.

Our Pipeline Distribution System

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

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

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

Our Automobile Conversion Sites

We began our automobile conversion business during the second quarter of 2007. Our automobile conversion sites convert gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles. As of December 31, 2012, we have four automobile conversion sites, all of which operate in the Xi'an City area.

Our Liquefied Natural Gas Business

On July 16, 2011, we completed most of the construction of Phase I of the LNG plant and began commercial production and sale of LNG. Phase I of the LNG plant has a processing capacity of 500,000 cubic meters of LNG per day, or approximately 150 million cubic meters of LNG per year. During the year ended December 31, 2012, the average cost of LNG per cubic meter was $0.29 (RMB 1.81), and we sold each cubic meter at an average price of $0.35 (RMB 2.22), net of value-added taxes. Customers of our LNG business mainly include city gas companies supplying industrial, commercial and residential pipeline end users, such as ENN Energy Holdings Ltd., Kunlun Energy Company Ltd. and Shanxi Guoyun Liquefied Natural Gas Ltd. The launch of the LNG plant is an important part of our integration strategies, which include strategic plans to develop our own network of LNG fueling stations in Shaanxi, Henan and Hubei Provinces.

On September 2, 2010, we announced the completion of our first LNG fueling station. The station is located in Hongqing District, Xi'an, and we believe it is the first LNG fueling station in Shaanxi Province. The LNG fueling station is in operation and developing the potential LNG market. As of December 31, 2012, 11 LNG fueling stations were under construction in various locations in Shaanxi and Henan Provinces, and our VIE, XXNGC signed a contract with Zhangjiagang CIMC Sanctum Cryogenic Equipment Co., Ltd to buy 50 smart semi-trailers, seven of which have begun operations as of December 31, 2012.

As of December 31, 2012, we had made certain progress in the expansion of our LNG businesses into Hubei Province. In April 2010, we received the approval from local government authorities in Hubei Province to build LNG fueling stations, both inland and in harbors, and reserve LNG stations, along the Yangtze River. We are currently going through necessary procedures to prepare for the building of these LNG stations.

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

Our CNG Market

As of December 31, 2012, there were approximately 8,000 buses and 14,000 taxis powered by CNG in Xi'an City, that accounts for approximately 99% of the total number of all buses and taxis in Xi'an City, respectively. According to the PRC Ministry of Science and Technology, each bus uses an average of approximately 100 cubic meters of CNG per day and each taxi uses an average of approximately 30 cubic meters of CNG per day (source: PRC Ministry of Science and Technology). Compared to gasoline and diesel, we believe that natural gas, as one kind of vehicular fuel, is cheaper, cleaner and safer. The PRC government's Clean Energy Policy encourages the use of CNG as a vehicular fuel.

We estimate that each of the CNG fueling stations in Xi'an City, including ours, sold approximately 11,000 cubic meters of CNG on average per day in 2012. As of December 31, 2012, we estimated that there were 74 CNG fueling stations in Xi'an City and, accordingly, we estimate that in total approximately 814,000 cubic meters of CNG was sold per day during 2012. We believe that there is unmet demand for CNG as vehicular fuel in Xi'an City area.

As of December 31, 2012, there were approximately 5,000 buses and 10,807 taxis powered by CNG in Zhengzhou City, which accounts for approximately 85% of the total number of all buses and taxis in Zhengzhou City, respectively. We estimate that each bus uses an average of approximately 100 cubic meters of CNG per day and each taxi uses an average of approximately 30 cubic meters of CNG per day.

We estimate that on average each CNG station in Henan Province sold approximately 11,000 cubic meters of CNG per day in 2012. As of December 31, 2012, we estimated that there were 67 CNG fueling stations in Henan Province and we estimate that approximately 737,000 cubic meters of CNG was pumped per day during 2012. We believe that there is unmet demand for CNG as vehicular fuel in Henan Province.

As of December 31, 2012, there were approximately 2,500 buses and 15,000 taxis powered by CNG in Wuhan City, Hubei Province, which accounts for approximately 35% and 95% of the total number of all buses and taxis in Wuhan City, respectively. We estimate that each bus uses an average of approximately 100 cubic meters of CNG per day and each taxi uses an average of approximately 30 cubic meters of CNG per day.

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

Our Pipeline Network Customers

As of December 31, 2012, we had 122,020 customers for our pipeline network, including residential and commercial customers. We continue to expand our customer base in Xi’an City's newly developed business and residential areas including Baqiao, Hongqing and Xihang as well as Lingbao in Henan Province. We are not dependent upon any single customer or group of customers for a material portion of our natural gas sales or revenues.

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

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

Our LNG Project

In September 2007, we began the construction of an LNG processing and distribution plant in Jingbian, Shaanxi Province, or the LNG Project. We expect the construction of all facilities of Phase I of the LNG plant to be completed by March 2014, and estimate an aggregate investment of approximately $68.7 million for Phase I of the LNG plant, that was funded through the sales of senior notes to Abax and our September 2009 equity financing, as well as cash flows from operations. On July 16, 2011, we completed most of the construction of Phase I of the LNG plant and began commercial production and sale of LNG. The launch of the LNG plant is an important part of our integration strategies, which include strategic plans to develop our own network of LNG fueling stations in Shaanxi, Henan and Hubei Provinces.

On September 2, 2010, we announced the completion of our first LNG fueling station. The station is located in Hongqing District, Xi'an, and we believe it is the first LNG fueling station in Shaanxi Province. The LNG fueling station is in operation and developing the potential LNG market. As of December 31, 2012, 11 LNG fueling stations were under construction in various locations in Shaanxi and Henan Provinces, and our VIE, XXNGC signed a contract with Zhangjiagang CIMC Sanctum Cryogenic Equipment Co., Ltd to buy 50 smart semi-trailers, seven of which have begun operations as of December 31, 2012.

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

Suppliers

We purchase our natural gas mainly from four vendors, namely, PetroChina Chang Qing Oil Field Branch, Shaanxi Natural Gas Co. Ltd, Qinshui Lanyan Coal Bed Methane Co., Ltd and Zhongyou Hengran Petrochemical Co., Ltd. Our supply contract with one of our suppliers, Shaanxi Natural Gas Co. Ltd., is renewed on an annual basis. We continued to seek lower-cost sources of supply and did not have commitments for the purchasing volume of natural gas from any suppliers except Qinshui Lanyan. Pursuant to the agreement with Qinshui Lanyan, we would purchase from Qinshui Lanyan a daily volume of approximately 200,000 cubic meters of coal bed gas. Our average procurement price in Henan Province decreased slightly from $0.29 (RMB 1.86) per cubic meter in 2011 to $0.29 (RMB 1.80) per cubic meter in 2012. Two of our major vendors in Henan Province are Qinshui Lanyan Coal Bed Methane Co., Ltd and Zhongyou Hengran Petrochemical Co., Ltd. Our average procurement price in Xi’an City decreased slightly from $0.26 (RMB 1.68) per cubic meter in 2011 to $0.26 (RMB 1.64) per cubic meter in 2012. Two of our major vendors in Xi’an City are PetroChina Chang Qing Oil Field Branch and Shaanxi Natural Gas Co. Ltd. We

do not anticipate the procurement price to increase materially in 2013.

On October 19, 2006, we received a letter from PetroChina Company Limited, or PetroChina (also known as CNPC), pursuant to which PetroChina agreed in principle to supply up to 150 million cubic meters of natural gas annually to our LNG Project subsidiary subject to the negotiation of a final agreement once our LNG plant is near completion. Once an agreement is signed, the quota of supply of natural gas can be used as long as the agreement is in effect. Pursuant to the above arrangement, we entered into an agreement with CNPC Changqing Oil Field Branch Company, or CNPC Changqing, dated November 25, 2010. The agreement between CNPC Changqing and JBLNG, one of our wholly owned subsidiaries, provided that CNPC Changqing would supply us with natural gas for JBLNG effective through to December 31, 2011, and the agreement would be renewed on an annual basis thereafter. Under the terms of the agreement, we have the option to purchase up to 500,000 cubic meters of natural gas per day, or 150 million cubic meters per year, from CNPC Changqing at a purchase price of $0.21 (RMB 1.355) per cubic meter, which increases to $0.24 (RMB 1.4905) per cubic meter beginning on November 1, 2012. The agreement was renewed on December 23, 2011, effective through December 31, 2012, and is now in the process of renewing.

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

Intellectual Property

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

Governmental and Environmental Regulation

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

Xi’an Natural Gas Operations License, authorized by the Shaanxi Municipal Management Committee, effective from February 29, 2012 to February 28, 2013, which was renewed and is effective from February 29, 2013 to February 28, 2018.

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

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

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

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

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

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

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

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

Business license to operate Lingbao Yuxi Natural Gas Co., Ltd. effective from June 13, 2008 to June 6, 2016.

Business license to operate Hubei Xilan Natural Gas Co., Ltd., effective from December 17, 2009 to December 16, 2013.

Business license to operate Xilan Energy Co., Ltd., effective from October 27, 2012 to October 26, 2013.

Business license to operate Hanchuan Makou Yuntong Compressed Natural Gas Co., Ltd. effective from April 3, 2009 to June 4, 2029.

Business license to operate Xiantao City Jinhua Gas and Oil Co., Ltd. effective from October 16, 2007 to October 15, 2027.

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

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

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

Employees

As of December 31, 2012, we had 1,056 employees, including 96 in management, 22 in finance and accounting, and 938 in sales and operations. We have not experienced any labor disputes and we believe we have good relationships with our employees. We are not a party to any collective bargaining agreements.

Available Information

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

ITEM 1A. RISK FACTORS

RISK FACTORS

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

Risks Related to Our Business and the PRC Natural Gas Industry

We are in default of our 5% Guaranteed Senior Notes Due 2014 with Abax Lotus Ltd., if unresolved, we may not be able to sustain our business.

Due to the default of our senior notes payable, as of December 31, 2012, we had working capital deficit of current liabilities exceeding current assets by $54,750,409. Our creditors have filed an involuntary petition for bankruptcy against the Company. If we are not able to resolve the debt with Abax or successfully oppose the petition for bankruptcy, there could be material adverse effect on our business and in connection with the default, our auditor has given us a "going concern" qualification in its report on our financial statements for the year ended December 31, 2012, which questions our ability to continue as a going concern.

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

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

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

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

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

Natural gas sales accounted for 91.0% and 85.5% of our revenue for the years ended December 31, 2012 and 2011, respectively. However, the prices at which we purchase our natural gas supplies and sell our natural gas products are strictly regulated by the PRC central government, including the NDRC, and the local state price bureaus that have the discretion to set natural gas prices within the boundaries set by the PRC central government. Our results of operations for the periods reviewed have benefited from the natural gas procurement and sale prices set by government authorities. There is no assurance that the government authorities will continue to set natural gas procurement and sale prices at levels that will allow us to improve or even maintain our margins. Increased natural gas prices affect the cost of natural gas to us and will adversely impact our margins in cases where we are unable to pass on the increased costs to our customers. In addition, higher natural gas prices may adversely impact the adoption of CNG and LNG by consumers and have a material and adverse effect on our financial condition and results of operations.

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

We expect to face intense competition in the natural gas industry, including in both the CNG and LNG industries. Our current, and potential, competitors include companies that are part of much larger companies, including state-owned

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In August 2008, the board of directors of XXNGC passed a resolution to increase the registered capital of JBLNG to RMB118, 305,000 through the form of intangible asset contributions. In September 2008, JBLNG obtained its updated business license reflecting the increased registered capital. Pursuant to XXNGC's board resolution, China

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

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

During the second half of 2010 and continuing into 2012, numerous media reports in the United States and elsewhere made negative claims or suggestions regarding China-based companies listed on U.S. stock exchanges, including claims and suggestions relating to the accuracy and completeness of such companies' financial information. Many of these reports appear to have been based, at least in part, on discrepancies between financial information set forth in a company's filings with the U.S. SEC and filings with the PRC's State Administration for Industry and Commerce. If we are associated with companies that are the subject of negative media reports because our operating entities are based in China or otherwise, or if we become the subject of such a report, the price of our common stock may be adversely affected.

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

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

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

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

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

We rely on suppliers of LNG technology.

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

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

business may suffer.

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

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

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

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

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

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

The occurrence of a significant event for which we are not fully insured or indemnified, and/or the failure of a party to meet its underwriting or indemnification obligations, could materially and adversely affect our operations and

financial conditions. Moreover, no assurance can be given that we will be able to maintain adequate insurance in the future at rates we consider reasonable.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

their claim in legal proceedings. If these six individuals are found to have legitimate ownership over these shares, XXNGC's shareholding structure may change and our revenues from our contractual arrangements with XXNGC may be reduced.

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

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

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

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

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

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

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

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

conditions and results of operations may be adversely affected.

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

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

Our business operations are subject to extensive government regulation.

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

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

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

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

Companies operating in China must comply with a variety of labor laws, including certain pension, housing and other welfare-oriented payment obligations. While we have made such payments beginning in July 2009, our failure to make previous payments may be in violation of applicable PRC labor laws and we cannot ensure that PRC governmental authorities will not impose penalties on us for failure to comply. In addition, in the event that any

current or former employee files a complaint with the PRC government, we may be subject to making up the social insurance payment obligations as well as paying administrative fines.

Risks Related to the People's Republic of China

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

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

level of government involvement;

level of development;

growth rate;

level and control of capital investment;

control of foreign exchange; and

allocation of resources.

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

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

Unlike common law systems, the PRC legal system is based on written statutes and decided legal cases have little precedential value. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. The overall effect of legislation since then has been to significantly enhance the protections afforded to various forms of foreign investment in China. Our PRC operating subsidiaries are subject to laws and regulations applicable to foreign investment in China. Our PRC affiliated entities

are subject to laws and regulations governing the formation and conduct of domestic PRC companies. Relevant PRC laws, regulations and legal requirements may change frequently, and their interpretation and enforcement involve uncertainties. For example, we may have to resort to administrative and court proceedings to enforce the legal protection that we enjoy either by law or contract. However, since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we enjoy than under more developed legal systems. Such uncertainties, including the inability to enforce our contracts and intellectual property rights, could materially and adversely affect our business and operations. Accordingly, we cannot predict the effect of future developments in the PRC legal system, particularly with respect to the natural gas sector, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. These uncertainties could limit the legal protections available to us and other foreign investors.

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

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

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

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

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

Since July 2005, the Renminbi has no longer been pegged to the U.S. dollar. Although currently the Renminbi exchange rate versus the U.S. dollar is restricted to a rise or fall of no more than 0.5% per day and the People’s Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the Renminbi may appreciate or depreciate significantly in value against the U.S. dollar in the medium- to long-term. In April 2012, the central bank expanded the floating range of trading price of RMB against U.S. dollar in the inter-bank spot foreign exchange market from 0.5% to 1%. Moreover, it is possible that in the future, PRC authorities may lift restrictions on fluctuations in the Renminbi exchange rate and lessen intervention in the foreign exchange market.

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

SAFE regulations relating to offshore investment activities by PRC residents may increase our administrative burden and restrict our overseas and cross-border investment activities. If our shareholders and beneficial owners who are PRC residents fail to make any required applications and filings under such regulations, we may be unable to distribute profits and may become subject to liability under PRC laws.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

decline when mass layoffs become more common, local regulations may tighten the procedures by, among other things, requiring the employer to obtain approval from the relevant local authority before conducting any mass layoff. Such regulations can be expected to exacerbate the adverse effect of the economic environment on our results of operations and financial condition.

Risks Related to Corporate and Stock Matters

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

Because of the material weaknesses in our internal control over financial reporting and the ineffectiveness of our disclosure controls and procedures, we could be subject to sanctions or investigations by the exchange on which we list our shares, the SEC or other regulatory authorities. The SEC has commenced an investigation into the matters surrounding the Wang Loan and the acquisition of Lingbao Yuxi Natural Gas Co., Ltd. The Company has been cooperating with the investigation. The Company has restated quarterly reports on Form 10-Q/A for the three months ended March 31, 2010, six months ended June 30, 2010 and the nine months ended September 30, 2010 and the annual report on Form 10-K/A for the year ended December 31, 2010, and quarterly reports on Form 10-Q/A for the three months ended March 31, 2011, six months ended June 30, 2011 and the nine months ended September 30, 2011, regarding the above matters. In addition, NASDAQ has delisted the Company's common stock and, as a result, the Company's common stock is now quoted on the OTC Markets. On May 14, 2012, SEC filed a complaint against the company, and has agreed in principle with the Company to a settlement of the SEC Action. The market price of our common stock has declined and because of these events, investor perceptions of the Company may suffer, and this could cause a further decline in the market price of our stock. If we are unable to remediate the material deficiencies in our internal control effectively or efficiently, it could harm our operations, financial reporting or financial results and could result in an adverse opinion on internal controls from our independent registered public accounting firm. In addition, we may identify additional material weaknesses in the future. Any additional failures of internal controls could have a material adverse effect on our results of operations and harm our reputation.

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

As of December 31, 2012, our co-founder and chairman of the Board, Mr. Ji, beneficially owned 3,002,299 shares of common stock or approximately14.0% of our outstanding shares of common stock. Mr. Ji is an affiliate as defined in Rule 144 under the Securities Act of 1933, as amended, or the Securities Act, due to the large size of his shareholding in us and his positions with us as our chairman. Rule 144 defines an affiliate of a company as a person that, directly or indirectly, through one or more intermediaries, controls or is controlled by, or is under common control with, our company. Mr. Ji has, and may continue to have, significant influence in determining the outcome of any corporate transactions or other matters submitted to our shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. He may not act in the best interests of our other shareholders. In addition, without the consent of Mr. Ji, we could be prevented from entering into transactions that could be beneficial to us. This concentration of ownership may also discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our common stock. These actions may be taken even if they are opposed by our other shareholders.

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

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

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

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

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

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

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

Stockholders should have no expectation of any dividends.

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

ITEM 2. PROPERTIES

Our principal executive offices are located at 19th Floor, Building B, Van Metropolis, No. 35 Tangyan Road, Hi-Tech Zone, Xi'an, 710065, Shaanxi Province, PRC. Our property consists of approximately 1,686 square meters of office space, the annual rent for which is $211,965.

We have additional properties located in Lantian County, the districts of Baqiao, Lintong and Gaoxin in the city of Xi'an, and the cities of Jiyuan, Kaifung and Pindingshan, in Henan Province. We own a 120km high-pressure underground pipeline network and two citygate stations (terminals) with accompanying buildings and equipment. We lease the main office building where we are headquartered and all of our CNG fueling station sites. In order to secure sufficient CNG supply, our VIE also own three compressor stations in Shaanxi and Hubei Province to support our stations. As of December 31, 2012, our VIE owned and operated 20 CNG fueling stations in Shaanxi province, 10 CNG fueling stations in Henan Province and 1 CNG fueling station in Hubei Province.

As of December 31, 2012, our VIE owned 33 trucks and 53 tankers that were used to transport natural gas.

In December, 2009, XXNGC formed a wholly owned subsidiary, Hubei Xilan Natural Gas, Co., that maintains an office in the No. 478 of Hongneng Mansion, Jianshe Avenue, Jianghan District, Wuhan City, Hubei Province, China. The office is approximately 900 square meters in area, with annual rental payment of $51,419. We have additional properties located in the cities of Yichang, Yidu and Huangshi, in Hubei Province, with total annual rent of $8,951.

In October 2008, we acquired Lingbao Yuxi Natural Gas, Co., Ltd. through Xi'an Xilan Natural Gas Co., Ltd. Lingbao Yuxi Natural Gas maintains an office located at Changan Rd. W, Lingbao, Henan Province, with annual rent of $6,344.

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

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

On February 29, 2008, we entered into a 62-month lease agreement in connection with an office located on the 22nd Floor, 370 Lexington Avenue, New York, New York. The monthly rent of this office in 2012 was $7,845.

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

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

ITEM 3. LEGAL PROCEEDINGS

a) On May 14, 2012, the Securities and Exchange Commission ("SEC") filed a Complaint (the "Complaint") in the U.S. District Court for the Southern District of New York against Qinan Ji and the Company, captioned Securities and Exchange Commission v. China Natural Gas, Inc. and Qinan Ji (12 CV 3824) (the "SEC Action"). The SEC Action alleged that the Company violated Section 17(a)(2) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B) and 14(a) of the Securities Exchange Act of 1934 ("Exchange Act") (as well as certain rules promulgated under such sections), and that Mr. Ji violated Section 17(a) of the Securities Act, Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5) and 14(a) of the Exchange Act (as well as certain rules promulgated under such sections), Section 304 of the Sarbanes Oxley Act of 2002 and aiding and abetting certain of the Company's alleged violations.

The SEC Action further alleged among other things that, in January 2010, the Company made two-short term loans totaling $14.3 million ($9.9 million to Taoxiang Wang and $4.4 million to a real estate company called Shaanxi Juntai Housing Purchase Co. Ltd. ("Juntai")) and disclosed them in its periodic reports as loans made to unrelated third parties. The SEC Action alleged that the true and undisclosed purpose of the loans was to benefit a company called Xi'an Demaoxing Real Estate Co., Ltd. ("Demaoxing"), and that Demaoxing was 90% owned by Mr. Ji's son and 10% owned by Mr. Ji's nephew. The SEC Action further alleged that Taoxiang Wang was a sham borrower selected to conceal Demaoxing's receipt of the loan proceeds and that Juntai was Demaoxing's business partner and borrowed the money to undertake a joint real estate project with Demaoxing.

As of the date hereof, the Company and the staff of the SEC have agreed in principle to a settlement of the SEC Action. Pursuant to such agreement in principle, without admitting or denying any allegations against it, the Company would offer to consent to the entry of a court order that: (a) permanently restrains and enjoins the Company from future violations of Section 17(a)(2) of the Securities Act and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 14a-9 thereunder; and (b) orders the Company to pay an aggregate civil penalty in the amount of $815,000 pursuant to Section 20(d) of the Securities Act and Section 21(d)(3) of the Exchange Act.

b) On May 22, 2012, Kousa, Mallano and Steinmetz, shareholders in the Company ("Delaware Plaintiffs"), filed a Shareholder Class Action and Derivative Complaint ("Delaware Complaint") against the Company and certain members of the Company's Board ("Delaware Director Defendants") in the Court of Chancery of the State of Delaware. The Delaware Complaint alleges a direct class action claim for breach of fiduciary duty against the Delaware Director Defendants, a derivative claim for breach of fiduciary duty against the Delaware Director Defendants, and a separate derivative claim for breach of fiduciary duty against Ji. The Delaware Complaint alleges that the Delaware Director Defendants breached their fiduciary duties to the Company and its shareholders by preserving Ji's control over the Company despite his alleged wrongdoing and the threatened delisting of the Company's shares by NASDAQ, thereby causing the Company's shares to be delisted. The Delaware Complaint separately alleges that Ji engaged in self-dealing and other conduct that breached his fiduciary duties to the Company and its shareholders. The Delaware Complaint seeks certification of a class action, authorization to proceed as a derivative action, and unspecified money damages, including attorneys' fees and costs. The claims are directed against the individual defendants and not against the Company.

On July 30, 2012, Ji filed a motion to dismiss the Delaware Complaint. On August 14, 2012, the Company and the remaining Delaware Director Defendants filed a motion to stay or dismiss the Delaware Complaint. The parties agreed, with the approval of the Court, to bifurcate briefing on the motion to stay and the motions to dismiss. On October 16, 2012, after briefing and oral argument, the Chancery Court stayed the separate derivative claim against Ji pending the outcome of the SEC investigation and Federal Securities Action, but denied the motion to stay as to the other counts in the Delaware Complaint against the Delaware Director Defendants and directed the parties to proceed with briefing on the motions to dismiss without prejudice to the Plaintiffs' right to amend the Delaware Complaint. The Court also stayed all discovery pending the outcome of the motions to dismiss. On November 2, 2012, the Court approved a stipulation among the parties providing that the Plaintiffs would file an amended complaint no later than 30 days after the proposed settlement of the SEC Action is approved by the U.S. District Court, setting the time within which the defendants must answer or move in response to the amended complaint and a briefing schedule in the event that they file a motion, and vacating that portion of the Court's order directing the defendants to proceed with briefing on the motions to dismiss the Delaware Complaint.

As a result of the October 16, 2012 Order and the November 2, 2012 Stipulation and Order, the case is effectively stayed pending the filing of an amended complaint by the Plaintiffs. As of the date of this letter, the Plaintiffs have yet to file an amended complaint.

c) On February 8, 2013, an Involuntary Petition for bankruptcy, entitled In re China Natural Gas, Inc. (Case No. 13-10419), was filed against the Company by three creditors of the Company, namely Abax Lotus Ltd., Abax Nai Xin A Ltd., and Lake Street Fund LP (the "Petitioners"). The petition was filed in the United States Bankruptcy Court, Southern District of New York. The Petitioners have claimed in the Involuntary Petition that they have debts totaling $42,218,956.88 as a result of the Company's failure to make payments on the 5% Guaranteed Senior Notes issued in 2008.

As previously disclosed in the Current Reports on Form 8-K filed by the Company with the Securities and Exchange Commission (the "SEC") on December 31, 2007 and January 29, 2008, the Company entered into a Securities Purchase Agreement with Abax Lotus Ltd. (the "Investor") on December 30, 2007 which was amended on January 29, 2008 (the "SPA"). Pursuant to the SPA, the Company issued to the Investor 5% Guaranteed Senior Notes due 2014 (the "Senior Notes") in aggregate principal amount of RMB 145,000,000 (approximately US$20,000,000) on January 29, 2008. Also, as previously disclosed in the Current Report on Form 8-K filed by the Company with the SEC on March 12, 2008, also pursuant to the SPA, the Investor exercised its option to purchase an additional RMB145,000,000 in aggregate principal amount of Senior Notes. The Senior Notes were issued in connection with the Indenture dated as of January 29, 2008 (the "Indenture"). The aggregate principal amount of the Senior Notes at issuance was RMB290,000,000 (approximately US$40,000,000). In addition, the Company agreed to issue to the Investor seven-year warrants (the "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 adjustment) pursuant to the Warrant Agreement dated January 29, 2008 (the "Warrant Agreement") by and among the Warrant Agent and Warrant Registrar as a holder of the Warrants (as defined therein).

Also as previously disclosed in the Company's Current Report on Form 8-K filed with the SEC on September 11, 2012, the holders of a majority of the Senior Notes (the "Holders") notified the Company on August 21, 2012 (the "Default Notice") that the Company was in default of the Senior Notes for failure to make the interest payment due and a mandatory redemption of the Senior Notes on July 30, 2012 (the "Default"). In the notice, the Holders also demanded that the Company make all payments due as of July 30, 2012 under the Senior Notes to avoid acceleration of all payments under the Senior Notes and foreclosure of collaterals pledged to secure the Senior Notes.

On September 5, 2012, the Company received another notice from the Holders that the Holders elected to exercise their right to accelerated payment of the Senior Notes as a result of the continued Default (the "Acceleration Notice"). The immediate acceleration of all amounts owing under the Senior Notes totals approximately RMB249,450,516.

Further, on September 10, 2012, the Company received a demand notice from the Holders' legal counsel on behalf of the Holder for the payment of all amounts owing under the Senior Notes (the "Demand Notice") within 15 days from the date of the Demand Notice. The Demand Notice stated that if the Company failed to meet the demand, the Holders intend to pursue all of its legal rights under the transaction documents, including, without limitation:

Requiring the Trustee to initiate suit in the courts of New York with respect to the Company's failure to pay the entire amount due to the Holders under the Senior Notes;

Initiating involuntary bankruptcy proceedings with respect to the Company under the U.S. Federal Bankruptcy Code;

Initiating arbitration in Hong Kong against the Company for breaches of the Company's obligations under the SPA;

Exercising its rights under the Warrant Agreement to require the redemption of all Warrants held by it at the Redemption Price (as defined therein); and

All other rights under the transaction documents relating to the Senior Notes in relation to the Default, which may include, foreclosing on the security interest in 65% of all outstanding equity interest of the Company's wholly owned subsidiary, Shaanxi Xilan Natural Gas Equipment Co., Ltd., and all funds in the account where the proceeds from the Senior Notes were deposited.

In addition to the demands disclosed above, the Holders have also asserted that by virtue of the Default the Company is obliged to redeem the Warrants and pay to the Holders $17.5 million. The Company disputes the amount allegedly owed, and has been in negotiation with the Holders but has not able to come to a resolution with the Holders. As disclosed above, on February 8, 2013, the Holders initiated involuntary bankruptcy proceedings with respect to the Company under the U.S. Federal Bankruptcy Code. The Company intends to oppose the petition.

d) Vandevelde v. China Natural Gas, Inc., et al. (Case No. 1:10CV00728, United States District Court for the District of Delaware). As previously disclosed, on August 26, 2010, an individual investor filed a putative class action complaint against the Company and certain of its current and former officers and directors alleging that the defendants violated the U.S. securities laws. The Court appointed another individual investor as lead plaintiff, and he then filed an amended complaint. The Company filed a motion to dismiss which, on July 6, 2012, the Court granted in its entirety. In its order, the Court also granted the plaintiffs leave to amend their complaint. In the second amended complaint, the plaintiffs allege that, in violation of Section 10(b) of the Securities Exchange Act of 1934 (and Rule 10b-5 thereunder), the defendants made false or misleading statements in the Company's Annual Reports on Form 10-K for the years ended December 31, 2009, and December 31, 2010, and in various quarterly reports, by purportedly failing to disclose a series of loans and related party transactions. The second amended complaint also asserts claims against certain of the Company's current and former officers and directors for violations of Section 20(a) of the Securities Exchange Act of 1934. The suit seeks unspecified monetary damages. On September 25, 2012, the Company filed a motion to dismiss the second amended complaint. On February 26, 2013, the Company notified the Court that certain of the Company's creditors had filed an involuntary petition for bankruptcy and that, under the U.S. Bankruptcy Code, the filing of that petition operates as an automatic stay of the suit. The Company cannot at this time provide any assurance that the outcome of this suit will not be materially adverse to its financial condition, consolidated results of operations, cash flows or business prospects.

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

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II

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

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

The following table sets forth, for the indicated periods, the high and low sales prices for our common stock, as reported on NASDAQ and OTC Markets, for the years ended December 31, 2012 and 2011, respectively. The quotations represent inter-dealer prices without retail markup, markdown or commission, and may not necessarily represent actual transactions.

	COMMON STOCK MARKET PRICE	
	HIGH	LOW
FISCAL YEAR ENDED DECEMBER 31, 2012:		
Fourth Quarter	$ 1.00	$ 0.40
Third Quarter	$ 1.20	$ 0.75
Second Quarter	$ 1.91	$ 1.00
First Quarter	$ 1.93	$ 0.61
FISCAL YEAR ENDED DECEMBER 31, 2011:		
Fourth Quarter	$ 1.93	$ 1.93
Third Quarter (trading was halted on September 21, 2011)	$ 3.95	$ 1.90

Second Quarter	$ 6.10	$ 2.44
First Quarter	$ 6.27	$ 5.00

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

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

*$100 invested on 12/31/07 in stock or index, including reinvestment of dividends.

Fiscal year ending December 31.

	12/07	12/08	12/09	12/10	12/11	12/12
China Natural Gas, Inc.	100	43.48	80.58	39.93	13.99	3.48
S&P Smallcap 600	100	68.01	84.18	105.21	105.04	120.61

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

	2012	2011	2010	2009	2008
Return on equity	5.6 %	8.5 %	11.0%	17.5%	24.7%

Holders

As of March 23, 2013, there were approximately 26 holders of record of our common stock.

Dividends

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

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

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

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

future.

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

Securities Authorized for Issuance under Equity Compensation Plan

There has been no common stock authorized for issuance with respect to any equity compensation plan as of the fiscal year ended December 31, 2012.

Recent Sales of Unregistered Securities

We did not sell any equity securities that were not registered under the Securities Act of 1933, as amended, during the year ended December 31, 2012.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

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

Forward-Looking Statements

This Annual Report contains statements that are forward-looking and, as such, are not historical facts. Rather, these statements constitute projections, forecasts and forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of performance. They involve known and unknown risks, uncertainties, assumptions and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by these statements. Such statements can be identified by the fact that they do not relate strictly to historical or current facts. These statements use words such as “believe,” “expect,” “should,” “strive,” “plan,” “intend,” “esti “anticipate” or similar expressions. When the Company discusses its strategies or plans, it is making projections, forecasts or forward-looking statements. Actual results and stockholders’ value will be affected by a variety of risks and factors, including, without limitation, the recent crisis in worldwide financial markets, international, national and local economic conditions, merger, acquisition and business combination risks, financing risks, geo-political risks, and acts of terror or war. Many of the risks and factors that will determine these results and stockholder values are beyond the Company’s ability to control or predict. These statements are necessarily based upon various assumptions involving judgment with respect to the future. You should carefully read the risk factor disclosure contained in “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2012, where many of the important factors currently known to management that could cause actual results to differ materially from those in our forward-looking statements are discussed.

All such forward-looking statements speak only as of the date of this Annual Report. We are under no obligation to, nor do we intend to, release publicly any updates or revisions to any forward-looking statements contained herein to

reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Overview

We are an integrated natural gas operator in the People's Republic of China (referred to herein as China or the PRC), primarily involved in distribution of compressed natural gas, or CNG, through the CNG fueling stations owned by our variable interest entity, or VIE, Xi'an Xilan Natural Gas Co., Ltd. (referred to as XXNGC). As of December 31, 2012 our VIE owned and operated 31 CNG fueling stations, including 20 CNG fueling stations in Shaanxi Province, 10 CNG fueling stations in Henan Province and 1 CNG fueling station in Hubei Province. Our VIE owns our CNG fueling stations while we lease the land upon which our VIE-owned CNG fueling stations operate. For the year ended December 31, 2012, we sold 142,449,576 cubic meters of CNG through our fueling stations, compared to 162,752,780 cubic meters for the year ended December 31, 2011. Our VIE and its subsidiary, Lingbao Yuxi Natural Gas Co. Ltd. ("LYNG"), also install natural gas pipelines for, and distribute and sell piped natural gas to, residential and commercial customers in the city of Xi'an in Shaanxi Province, including Lantian County, and the districts of Lintong and Baqiao, and in the city of Lingbao in Henan Province, through a high pressure pipeline network of approximately 120 kilometers.

In addition, we have expanded into liquefied natural gas ("LNG") business and generate significant revenue from the LNG business. Our first LNG production facility, Shaanxi Jingbian Liquefied Natural Gas Co. Ltd. ("JBLNG"), located in Jingbian County, Shaanxi Province, commenced commercial production and sales on July 16, 2011. As of December 31, 2012, we had begun construction of 11 LNG fueling stations in Shaanxi, Henan and Hubei Provinces. Our VIE, XXNGC signed a contract with Zhangjiagang CIMC Sanctum Cryogenic Equipment Co., Ltd to buy 50 smart semi-trailers, seven of which have begun operations as of December 31, 2012.

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

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

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

- continue to expand our CNG business into Hubei Province by construction of new stations.

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

Current Operations

We currently operate five main business lines:

- distribution and sales of CNG through our VIE-owned CNG fueling stations serving hybrid (natural gas/gasoline) powered vehicles. As of December 31, 2012, our VIE owned and operated 31 fueling stations in total;

- installation, distribution and sales of piped natural gas to residential and commercial customers through our VIE-owned pipelines. We distributed and sold piped natural gas to approximately 122,020 residential customers as of December 31, 2012;

- production and sales of LNG through our LNG production facility in Jingbian County, Shaanxi Province. Revenues from commercial production and sales of LNG started on July 16, 2011. We have seven semi-trailers in operation serving LNG powered vehicles as of December 31, 2012.

- distribution and sales of gasoline through our VIE-owned CNG fueling stations for gasoline and hybrid (natural gas/gasoline) powered vehicles (two of our VIE-owned CNG fueling stations were selling gasoline as of December 31, 2012); and

- conversion of gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles at our automobile conversion workshops.

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

We had total revenues of $145,281,288 and $124,221,526 for the years ended December 31, 2012 and 2011, respectively. We had net income of $11,037,269 and $15,261,932 for the years ended December 31, 2012 and 2011, respectively.

Recent Developments

LNG Business

As of December 31, 2012, we had invested $68.6 million in Phase I of the LNG project located in Jingbian Country, Shaanxi Province and expected to invest approximately an additional $0.1 million to satisfy installment payments to contractors. We commenced test runs of Phase I of the LNG plant during 2010 and, in December 2010, we conducted and completed further test runs, including testing the operation of various components and equipments of the plant. We completed production preparation and trial production in June 2011. On July 16, 2011, we completed most of the construction of Phase I of the LNG plant and began commercial production and sale of LNG. Phase I of the LNG plant has a processing capacity of 500,000 cubic meters of LNG per day, or approximately 150 million cubic meters of LNG per year. Customers of our LNG business mainly include city gas companies supplying industrial, commercial and residential pipeline end users, such as ENN Energy Holdings Ltd., Kunlun Energy Company Ltd. and Shanxi Guoyun Liquefied Natural Gas Ltd.. The launch of the LNG plant is an important part of our integration strategies, which include strategic plans to develop our own network of LNG fueling stations in Shaanxi, Henan and Hubei Provinces.

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

In addition, as of December 31, 2012, we had invested $49.4 million for the construction of phases II and III of Jingbian LNG plant. We estimate that a further aggregate investment of $192.8 million will need to be made through December 2015 to finance the construction of Phase II and III of the LNG plant, which, upon completion, will have a processing capacity of 3,000,000 cubic meters of LNG per day, or approximately 900 million cubic meters of LNG per year. The expected completion date of Phase II and III of the LNG plant is December 2015.

On September 2, 2010, we announced the completion of our first LNG fueling station. The station is located in Hongqing District, Xi'an, and we believe it is the first LNG fueling station in Shaanxi Province. The LNG fueling station is in operation and developing the potential LNG market. As of December 31, 2012, 11 LNG fueling stations were under construction in various locations in Shaanxi and Henan Provinces, and our VIE, XXNGC signed a contract with Zhangjiagang CIMC Sanctum Cryogenic Equipment Co., Ltd to buy 50 smart semi-trailers, seven of which have begun operations as of December 31, 2012.

We successfully completed the regular maintenance of our Jingbian LNG factory which spanned a period of 28 days. The factory resumed full operational on August 12, 2012.

Hubei Province and Yangtze River

As of December 31, 2012, we had made certain progress in the expansion of both our CNG and LNG businesses into Hubei Province. In April 2010, we received the approval from local government authorities in Hubei Province to build LNG fueling stations, both inland and in harbors, and reserve LNG stations, along the Yangtze River. We are currently going through necessary procedures to prepare for the building of these LNG stations.

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

near railways and arterial highways. We believe that the Makou acquisition laid the foundation for expanding our CNG business into Hubei Province.

On June 28, 2011, our VIE, XXNGC, entered into an Equity Transfer Agreement (the "Transfer Agreement") with five individual shareholders of Xiantao City Jinhua Gas and Oil Co., Ltd. ("XTJH"). Pursuant to the Transfer Agreement, XXNGC acquired a 58.5284% ownership of XTJH for a total purchase price of approximately $1,905,099 (RMB 12,290,964). During the first quarter of 2012, we completed the acquisition of XTJH, and have our own fueling station available locally, which increases our revenue and share in the local market.

As of December 31, 2012, we also engaged in developing market demand for our natural gas products along the Yangtze River. By leveraging our automobile conversion know-how, we are developing conversion technologies and operations to modify river vessels so that they can be powered by a mixture of LNG and diesel. In August 2010, a tugboat, modified by us to operate on a mixture consisting of 70% LNG and 30% diesel, completed its maiden voyage on the Yangtze River. We believe it was the first time that an LNG-powered ship navigated China's domestic waterways.

Shaanxi and Henan Provinces

During the first quarter of 2011, we closed one CNG fueling station in Shaanxi Province due to changes in market conditions, in October, 2011, we closed another CNG fueling station in Shaanxi Province because the district will be demolished for urban redevelopment, in March 2012, we acquired one CNG fueling station in Hubei Province, in April 2012, we closed one fueling station in Shaanxi Province due to the construction of main subway lines in Xi'an, in May 2012, we ceased operations of two fueling stations in Henan province due to adverse market conditions, we closed three fueling stations in September 2012, and one fueling station in October 2012 in Shaanxi Province due to the change of the Company's strategy to reduce the scale of our CNG fueling stations, and focus on establishing of LNG fueling stations. During the third quarter of 2012, we disposed all the buildings, equipment, and other fixed assets of five CNG fueling stations. As a result, as of December 31, 2012, XXNGC and its subsidiary operated 20 CNG fueling stations in Shaanxi Province, 10 CNG fueling stations in Henan Province and one CNG fueling station in Hubei Province. Four gasoline fueling stations were closed in November and December 2010, due to changes in market conditions in their respective local areas. During the first quarter of 2011, we reopened one of the previously closed gasoline fueling stations and during the second quarter of 2011, we closed another station. During the fourth quarter of 2011, we closed another two of our gasoline fueling stations due to changes in market situations. In March 2012, we acquired one station in Hubei Province. In December 2012, we closed one gasoline fueling stations due to changes in market situations. As of December 31, 2012, we operated two gasoline fueling stations.

Factors Affecting Our Results of Operations

Significant factors affecting our results of operations are:

Successful launch and development of our LNG business. On July 16, 2011, we completed most of the construction of Phase I of our LNG plant in Jingbian County, Shaanxi Province and began commercial production and sale of LNG. Phase I of the LNG plant has a processing capacity of 500,000 cubic meters of LNG per day, or approximately 150 million cubic meters of LNG per year. Revenues from the completed Phase I of the LNG plant have been realized during the third quarter of 2011. In addition, Phases II and III of the LNG plant are planned to be completed by December 2015, adding processing capacity of 3,000,000 cubic meters of LNG per day, or approximately 900 million cubic meters of LNG per year. As of December 31, 2012, 11 LNG fueling stations were under construction in various locations in Shaanxi and Henan Provinces, and our VIE, XXNGC signed a contract to buy 50 smart semi-trailers, seven of which have begun operations as of December 31, 2012..

Regulation of natural gas prices in the PRC. The prices at which we purchase our natural gas supplies and sell CNG and pipeline natural gas products are strictly regulated by the PRC central government, including the National Development and Reform Commission, or the NDRC. Local pricing administrations have the discretion to set natural gas prices within the price range set by the PRC central government. In addition, natural gas procurement and sales prices are not uniform across China and may vary from province to province. Accordingly, our results of operations

and, in particular, our revenue, cost of revenue and gross profit and gross margin are affected significantly by factors that are outside of our control, including the regulation of natural gas products both on the national and local levels. As we expand our natural gas business into other provinces, we expect our results of operations to continue to be affected significantly by the regulations over natural gas prices in the PRC.

Government policies encouraging the adoption of cleaner burning fuels. Our results of operations for the periods covered by this report have benefited from environmental regulations and programs in the PRC that promote the use of cleaner burning fuels, including natural gas, for vehicles. As an enterprise engaged in the natural gas industry, our VIE, XXNGC, benefits from a reduced income tax rate of 15% compared to the standard 25% enterprise income tax rate in the PRC. And one of XXNGC's subsidiaries, JBLNG is subject to a reduced tax rate of 15% beginning on January 1, 2013. In addition, the PRC government has encouraged companies to invest in and build the necessary transportation, distribution and sales infrastructure for natural gas in various policy pronouncements, such as by officially including CNG/gasoline hybrid vehicles in the PRC's "encouraged development" category. The government encourages conversion of private cars from gasoline-fueled to CNG-fueled in Xi'an city beginning in February 2013. These policies have benefitted our results of operations by encouraging the demand for our natural gas products and also by lowering our expenses. As we intend to continue to expand into the LNG business, and our LNG plant in Jingbian has commenced commercial production and sale, we anticipate that our results of operations will continue to be affected by government policies encouraging the adoption of cleaner burning fuels and the increased adoption of CNG and LNG technologies.

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

Taxation

United States

We are incorporated in the State of Delaware and are subject to the tax laws of the United States. We incurred a net operating loss for income tax purposes for the year ended December 31, 2012 and the estimated net operating loss carry-forwards for United States income tax purposes amounted to $12,707,708 as of December 31, 2012, which may be available to reduce future years' taxable income. These carry-forwards will expire, if not utilized, through 2032. Our management believes that the realization of the benefits arising from these net operating loss carry-forwards appears to be uncertain due to our limited operating history and continuing losses for United States income tax purposes. Accordingly, we have provided a 100% valuation allowance at December 31, 2012.

According to the laws of the State of Delaware, we are required to pay annual franchise tax to the state government based on the number of the authorized shares and the amount of total assets. We paid $169,299 for annual franchise tax of 2011, and the outstanding annual franchise tax of 2012 is expected to be paid in September 2013.

The PRC

Our subsidiary, VIE and its subsidiaries operate in the PRC. Starting January 1, 2008, pursuant to the tax laws of the PRC, general enterprises are subject to income tax at an effective rate of 25%. Based on certain income tax regulations

adopted in 2001 to encourage the development of certain industries, including the natural gas industry, in the western regions of the PRC such as Shaanxi Province, XXNGC and one of its subsidiaries, Jingbian Xilan LNG Co., Ltd (referred to as SJLNG, a wholly owned subsidiary of XXNGC), are subject to a reduced tax rate of 15%. Accordingly, except for income from XXNGC and SJLNG, which are subject to the reduced tax rate of 15%, income from Shaanxi Xilan Natural Gas Equipment Co., Ltd. (referred to as SXNGE, a wholly foreign owned enterprise), Xi'an Xilan Auto Body Shop Co., Ltd. (referred to as XXABC, a wholly owned subsidiary of XXNGC), Henan Xilan Natural Gas Co., Ltd. (referred to as HXNGC, a wholly owned subsidiary of XXNGC), Lingbao Yuxi Natural Gas Co., Ltd (referred to as Lingbao Yuxi, a wholly owned subsidiary of XXNGC), Hubei Xilan Natural Gas Co., Ltd. (referred to as HBXNGC, a wholly owned subsidiary of XXNGC), Hanchuan Makou Yuntong Compressed Natural Gas Co., Ltd. (referred to as Makou, a wholly owned subsidiary of HBXNGC) and Xiantao City Jinhua Gas and Oil Co., Ltd. (referred to as XTJH, a holding subsidiary of HBXNGC) are subject to the 25% PRC income tax rate. Our effective income tax rate for the years ended December 31, 2012 and 2011 were approximately 22.6% and 24.0% , respectively.

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

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

RESULTS OF OPERATIONS

The following table sets forth certain information regarding our results of operations for the years ended December 31, 2012 and 2011.

	Years Ended December 31,	
	2012	2011
Revenue		
Natural gas	$132,255,499	$106,178,398
Gasoline	2,782,062	5,998,022
Installation and other	10,243,727	12,045,106
	145,281,288	124,221,526
Cost of revenue		
Natural gas	88,790,622	65,062,505
Gasoline	2,626,569	5,756,960
Installation and other	4,327,203	5,183,985
	95,744,394	76,003,450
Gross profit	49,536,894	48,218,076
Operating expenses		
Selling	22,266,885	17,377,703
General and administrative	7,456,049	9,984,565
	29,722,934	27,362,268
Income from operations	19,813,960	20,855,808

Non-operating income (expense):		
Interest income	68,472	42,290
Interest expense	(1,248,842)	(771,916)
Loss on disposal of fixed assets	(4,020,260)	
Other income (expense), net	144,464	126,100
Change in fair value of warrants	4	252,062
Foreign currency exchange loss	(499,575)	(430,723)
	(5,555,737)	(782,187)
Income before income tax	14,258,223	20,073,621
Provision for income tax	3,220,954	4,811,689
Net income	11,037,269	15,261,932
Less: Income (loss) attributable to noncontrolling interests	(163,245)	-
Net income	11,200,514	15,261,932
Other comprehensive income		
Foreign currency translation gain	1,459,438	4,150,348
Comprehensive income	$12,659,952	$19,412,280

Year Ended December 31, 2012 Compared to Year Ended December 31, 2011

Sales Revenues

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

	Years Ended December 31,		Increase (decrease) in dollar amount	Increase (decrease) in percentage
	2012	2011		
Natural gas from fueling stations	$70,017,870	$77,996,838	$(7,978,968)	(10.2)%
Natural gas from pipelines	7,782,473	7,852,525	(70,052)	(0.9)%
Liquefied natural gas	54,455,156	20,329,035	34,126,121	167.9 %
Gasoline	2,782,062	5,998,022	(3,215,960)	(53.6)%
Installation	8,338,666	10,061,088	(1,722,422)	(17.1)%
Automobile conversion	1,905,061	1,984,018	(78,957)	(4.0)%
Total	$145,281,288	$124,221,526	$21,059,762	17.0 %

Overall. Total revenue for the year ended December 31, 2012 increased to $145,281,288 from $124,221,526 for the year ended December 31, 2011, an increase of $21,059,762 or 17.0%, due to the reasons discussed below. We sold 321,602,154 cubic meters of natural gas, including 166,949,569 cubic meters of CNG and 154,652,585 cubic meters (96,646.6 tons) of LNG, during the year ended December 31, 2012, compared to 246,729,831cubic meters of natural gas, including 188,850,630 cubic meters of CNG and 57,879,201 cubic meters (35,519.9 tons) of LNG during the year ended December 31, 2011. For the year ended December 31, 2012, 92.9% of our revenues was generated from the sale of natural gas and gasoline, and the remaining 7.1% was generated from our installation and auto conversion services.

Natural Gas from Fueling Stations. Natural gas revenue from our fueling stations decreased by 10.2%, or $7,978,968, to $70,017,870 for the year ended December 31, 2012, from $77,996,838 for the year ended December 31, 2011, and contributed 48.2% of our total revenue for the year ended December 31, 2012, which was the largest contributor to revenue among our major business lines. During the year ended December 31, 2012, we sold 142,449,576 cubic meters of CNG, compared to 162,752,780 cubic meters during the year ended December 31, 2011, through our fueling stations. The main reason for the decrease in sales was due to the closure of three fueling stations in the second quarter

of 2012, three fueling stations in the third quarter of 2012 and one fueling station in the fourth quarter of 2012. The average unit selling price per cubic meter of CNG remained stable at $0.50 (RMB 3.13) during the years ended December 31, 2012 and 2011, net of VAT. With respect to average sales revenue and volume per station, in the year ended December 31, 2012, we sold approximately $2,029,503 or 4,128,973 cubic meters of CNG per station, respectively, compared to approximately $2,066,141 or 4,311,332 cubic meters, respectively, in the year ended December 31, 2011. The reason for the decline in per station sales was primarily due to the construction of main subway lines in Xi’an, which caused certain bus routes to deviate from our stations and resulted in decreased sales. The subway construction is expected to be completed by 2019.

Natural Gas from Pipelines. Natural gas revenue from our pipelines decreased by 0.9%, or $70,052, to $7,782,473 for the year ended December 31, 2012, from $7,852,525 for the year ended December 31, 2011, and contributed 5.4% of our total revenue for the year ended December 31, 2012. As of December 31, 2012, we had 122,020 pipeline customers, an increase of 5,230 customers from 116,790 customers as of December 31, 2011. We sold 24,499,993 cubic meters of natural gas through our pipelines for the year ended December 31, 2012, compared to 26,097,850 cubic meters for the year ended December 31, 2011, a decrease of 6.1%, primarily due to the lost of a major commercial customer in Xi'an.

Liquefied Natural Gas. Revenue from LNG increased by 167.9%, or $34,126,121, to $54,455,156 for the year ended December 31, 2012, from $20,329,035 for the year ended December 31, 2011, and contributed 37.5% of our total revenues for the year ended December 31, 2012. We sold 154,652,585 cubic meters (96,646.6 tons) of LNG for the year ended December 31, 2012, compared to 57,879,201 cubic meters (35,519.9 tons) during the year ended December 31, 2011, as our LNG production facility in Jingbian County, Shaanxi Province started operations in July 2011. The average unit selling price per cubic meter decreased by 2.2%, from $0.35 (RMB 2.27), net of VAT, in the year ended December 31, 2011, to $0.35 (RMB 2.22), during the year ended December 31, 2012.

Gasoline. Revenue from gasoline sales decreased by 53.6% or $3,215,960 to $2,782,062 for the year ended December 31, 2012, from $5,998,022 for the year ended December 31, 2011, and contributed 1.9% of our total revenue for the year ended December 31, 2012. The decrease was primarily attributable to the sales volume decrease of 58.8% from 6,368,498 liters to 2,624,155 liters, because of the closure of two gasoline fueling stations during the fourth quarter of 2011 and one gasoline fueling stations during the fourth quarter of 2012 due to the low gross margin of gasoline. The average unit sales price of gasoline increased by 12.6%, from $0.94 (RMB 6.08) per liter, net of VAT, in the year ended December 31, 2011 to $1.06 (RMB 6.68) per liter in the year ended December 31, 2012, compensating for the significant decrease in sales volume to a certain degree.

Installation Services. Revenue from installation services decreased by 17.1% or $1,722,422 to $8,338,666, for the year ended December 31, 2012 from $10,061,088 for the year ended December 31, 2011, and contributed 5.7% of our total revenue for the year ended December 31, 2012. We believe the decrease was primarily due to a slowdown in the property market, which led to a decrease in demand for installation services. Revenue from our five largest customers accounted for 10.7%, 6.0%, 5.1%, 4.8% and 4.2%, respectively, of our total installation revenue for the year ended December 31, 2012.

Automobile Conversion Services. Revenue from our automobile conversion division decreased by 4.0% or $78,957 to $1,905,061 for the year ended December 31, 2012, from $1,984,018 for the year ended December 31, 2011, mainly due to the decrease of customers, and contributed 1.3% of our total revenue for the year ended December 31, 2012.

Cost of Revenue

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

	Years Ended December 31,		Increase (decrease) in dollar amount	Increase (decrease) in percentage
	2012	2011		
Natural gas from fueling stations	$38,568,615	$43,784,390	$ (5,215,775)	(11.9)%
Natural gas from pipelines	5,934,887	6,014,860	(79,973)	(1.3)%
Liquefied natural gas	44,287,120	15,263,255	29,023,865	190.2 %
Gasoline	2,626,569	5,756,960	(3,130,391)	(54.4)%
Installation	3,148,623	3,955,852	(807,229)	(20.4)%
Automobile conversion	1,178,580	1,228,133	(49,553)	(4.0)%
Total	$95,744,394	$76,003,450	$ 19,740,944	26.0 %

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

Our cost of revenue for the year ended December 31, 2012 was $95,744,394, an increase of $19,740,944 or 26.0% from $76,003,450 for the year ended December 31, 2011, mainly attributable to the increase of costs of revenue of natural gas sold through our Liquefied natural gas. As a comparison, our total revenues increased by 17.0% for the year ended December 31, 2012 from the year ended December 31, 2011.

Natural Gas from Fueling Stations. Cost of revenue of natural gas sold through our fueling stations decreased by 11.9%, or $5,215,775 to $38,568,615 for the year ended December 31, 2012, from $43,784,390 for the year ended December 31, 2011, mainly due to the decrease in sales volume. The average procurement costs per cubic meter of our natural gas for our fueling stations decreased slightly from $0.27 (RMB 1.74), net of VAT, for the year ended December 31, 2011, to $0.27 (RMB 1.69), net of VAT, for the year ended December 31, 2012. The average procurement cost remained materially below the natural gas retail price of $0.50 (RMB 3.13) per cubic meter, net of VAT, for the year ended December 31, 2012.

Natural Gas from Pipelines. Cost of revenue of our natural gas sold through our pipelines decreased by 1.3% or $79,973 to $5,934,887 for the year ended December 31, 2012, from $6,014,860 for the year ended December 31, 2011. The decrease was primarily due to the decrease in sales volume.

Liquefied Natural Gas. Cost of revenue from LNG was $44,287,120 for the year ended December 31, 2012, an increase of $29,023,865 or 190.2% from $15,263,255 for the year ended December 31, 2011, as our LNG production facility in Jingbian County, Shaanxi Province started operations in July 2011. The average cost of revenue per cubic meter increased from $0.26 (RMB 1.70), net of VAT, for the year ended December 31, 2011 to $0.29 (RMB 1.81) during the year ended December 31, 2012, primarily due to the increase of our procurement price from $0.21 (RMB 1.355) to $0.24 (RMB 1.4905) beginning on November 1, 2012.

Gasoline. Cost of gasoline revenue decreased by 54.4% or $3,130,391 to $2,626,569 for the year ended December 31, 2012, from $5,756,960 for the year ended December 31, 2011. The decrease of cost of gasoline revenue was primarily due to the closure of two gasoline fueling stations of ours during the fourth quarter of 2011 and one gasoline fueling stations during the fourth quarter of 2012. The average procurement cost per liter increased from $0.90 (RMB 5.82), net of VAT, for the year ended December 31, 2011 to $1.00 (RMB 6.31), net of VAT, for the year ended December 31, 2012.

Installation Services. Cost of revenue from our installation services decreased by 20.4% or $807,229 to $3,148,623 for the year ended December 31, 2012 from $3,955,852 for the year ended December 31, 2011, primarily as a result of the decrease in the number of our installation customers.

Automobile Conversion Services. Cost of our automobile conversion revenue decreased by 4.0% or $49,553 to $1,178,580 for the year ended December 31, 2012 from $1,228,133 for the year ended December 31, 2011, which is consistent with the decrease in sales revenue.

Gross Profit

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

	Years Ended December 31,		Increase (decrease) in dollar amount	Increase (decrease) in percentage
	2012	2011		
Natural gas from fueling stations	$31,449,255	$34,212,448	$(2,763,193)	(8.1)%
Natural gas from pipelines	1,847,586	1,837,665	9,921	0.5 %
Liquefied natural gas	10,168,036	5,065,780	5,102,256	100.7 %
Gasoline	155,493	241,062	(85,569)	(35.5)%
Installation	5,190,043	6,105,236	(915,193)	(15.0)%
Automobile conversion	726,481	755,885	(29,404)	(3.9)%
Total	$49,536,894	$48,218,076	$1,318,818	2.7 %

We earned a gross profit of $49,536,894 for the year ended December 31, 2012, an increase of $1,318,818 or 2.7%, from $48,218,076 for the year ended December 31, 2011. The increase in gross profit was primarily attributable to the increase in revenue from LNG, offset by the decrease in natural gas revenue from our fueling stations.

Gross Margin

Gross margin for natural gas sold through our fueling stations increased from 43.9% for the year ended December 31, 2011 to 44.9% for the year ended December 31, 2012, primarily due to lower purchasing cost of natural gas.

Gross margin for natural gas sold through pipelines was 23.7% for the year ended December 31, 2012, increased slightly from 23.4% for the year ended December 31, 2011.

Gross margin for our LNG business was 18.7% for the year ended December 31, 2012, decreased from 24.9% for the year ended December 31, 2011, primarily attributable to the increase in of procurement price of LNG. This gross margin is lower than that of CNG sold through fueling stations, because till December 31, 2012, we had been selling the greatest part of LNG to industrial customers at wholesale price. We expect that the gross margin of LNG sales will be improved as seven semi-trailers began operations in the fourth quarter of 2012, selling LNG to vehicles at retail price, with a gross margin of 23.5%.

Gross margin for gasoline sales increased from 4.0% for the year ended December 31, 2011 to 5.6% for the year ended December 31, 2012, primarily due our average sales price of gasoline had increased at a greater rate than that of our average purchasing costs of gasoline.

Gross margin for our installation business increased to 62.2% for the year ended December 31, 2012, from 60.7% for the year ended December 31, 2011.

Gross margin for our automobile conversion business remained stable at 38.1% for the year ended December 31, 2012 and 2011.

Our total gross margin decreased from 38.8% for the year ended December 31, 2011 to 34.1% for the year ended December 31, 2012, primarily due to the current lower gross margin level of our LNG business, as compared to the gross margins of those business lines making greatest contribution to revenue.

Operating Expenses

We incurred operating expenses of $29,722,934 for the year ended December 31, 2012, an increase of $2,360,666 or 8.6%, from $27,362,268 for the year ended December 31, 2011.

Selling expenses increased by $4,889,182 or 28.1% to $22,266,885 for the year ended December 31, 2012, from $17,377,703 for the year ended December 31, 2011, primarily due to the increase of $1,902,249 in transportation expense and $1,748,415 in depreciation mainly associated with our LNG business, which started in July 2011. Transportation cost during the year ended December 31, 2012 was approximately $3,039 per million cubic meters of natural gas, compared to $3,605 per million cubic meters of natural gas for the year ended December 31, 2011.

General and administrative expenses decreased by $2,528,516 or 25.3% from $9,984,565 for the year ended December 31, 2011 to $7,456,049 for the year ended December 31, 2012, primarily attributable to the decrease of $2,512,741 in legal and consulting fees.

Income from Operations and Operating Margin

Income from operations decreased by $1,041,848, or 5.0%, to $19,813,960 for the year ended December 31, 2012 from $20,855,808 for the year ended December 31, 2011, primarily attributable to the decrease in gross profit of natural gas and increase in selling expenses as discussed above. Our operating margin for the year ended December 31, 2012 was 13.6%, as compared to 16.8% for the year ended December 31, 2011.

Non-Operating Income (Expense)

Non-operating expense was $5,555,737 for the year ended December 31, 2012, as compared to non-operating expense of $782,187 for the year ended December 31, 2011, primarily due to the loss of $4,020,260 on disposal of five fueling stations during the third quarter of 2012.

Provision for Income Tax

Income tax was $3,220,954 for the year ended December 31, 2012, as compared to $4,811,689 for the year ended December 31, 2011.

Net income

Net income was $11,037,269 for the year ended December 31, 2012, compared to $15,261,932 for the year ended December 31, 2011.

Liquidity and Capital Resources

Historically, our primary sources of liquidity consisted of cash generated from our operations, debt financing and proceeds from equity offerings. Our principal uses of cash have been, and are expected to continue to be, working capital for operational purposes, as well as for satisfying capital investment, such as constructing our LNG plant in Jingbian County, Shaanxi Province and other projects. Due to accelerated repayment of the Abax Senior Notes, 25% of the principal of the loan from SPDB, and the short-term loans from Mr. Hao Qu, all of which are payable within one year from December 31, 2012, our current liabilities were larger than current assets as of December 31, 2012, resulting in negative working capital. On May 17, 2012, May 18, 2012, November 1, 2012, February 16, 2013 and March 28, 2013, we entered into agreements with Mr. Hao Qu to extend the maturity dates of certain borrowing totaling $2.68 million to 2013 and 2014. We will continue to obtain new short-term bank loans to finance our working capital, and long term loans to fund our capital expenditure projects, if necessary.

As of December 31, 2012, we had $10,857,456 of cash and cash equivalents on hand, compared to $9,622,883 of cash and cash equivalents as of December 31, 2011. The increase was primarily attributable to the cash provided by operating activities.

Net cash provided by operating activities was $29,678,803 for the year ended December 31, 2012, compared to net cash provided by operating activities of $24,479,256 for the year ended December 31, 2011.The increase was primarily due to the decrease in prepaid expense and accounts receivable, increase in accrued interest, and adjustments for non-cash expense items, including depreciation and amortization expenses, offset mainly by the decrease in accounts payable and increase in advances to suppliers.

Net cash used in investing activities decreased from $20,403,058 for the year ended December 31, 2011 to $20,167,580 for the year ended December 31, 2012, due to decrease in additions to construction in progress related to our LNG plant.

Net cash used in financing activities was $8,091,334 for the year ended December 31, 2012, primarily due to the repayment of the principals of the Abax Senior Notes and of the long term loan from SPDB. Net cash used in financing activities was $3,858,314 for the year ended December 31, 2011, primarily due to the repayment of the principals of the Abax Senior Notes and of the long term loan from SPDB, offset by the proceeds from the related party borrowings, including the short-term borrowings from Mr. Hao Qu, a former senior management member and a shareholder of the Company, and the short-term borrowings from our joint venture company, Henan CNPC Kunlun Xilan Compressed Natural Gas Co., Ltd,.

Based on our past performance and current expectations, we believe our cash and cash equivalents, as well as cash generated from operations, will satisfy only a small part of our working capital needs. Our independent certified public accountant has indicated in its report on our financial statements for the year ended December 31, 2012 regarding our ability to continue as a going concern. Key to this determination is our default on a senior note payable where the creditors have filed for involuntary bankruptcy and that we have a working capital deficit of current liabilities exceeding current assets by $54,750,409. We will try to obtain new short-term bank loans to finance our working capital and to satisfy other liquidity requirements associated with our operations. As for capital expenditures, we will evaluate the availability of long-term bank loans or strategic investment, and negotiate possible debt restructuring of the Senior Notes with Abax. We also intend to oppose the involuntary petition for bankruptcy filed by Abax.

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

Off-Balance Sheet Arrangements

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

Capital Expenditures

Our planned capital expenditures as of December 31, 2012 were approximately $215.4 million through December 2015, the majority of which were to be incurred in connection with Phase II and III of the LNG facility in Jingbian County, Shaanxi Province, the construction of additional fueling stations and compressor stations, and the expansion of our operations in Hubei Province. We expect to fund the planned capital expenditures mainly through cash flows from operations as well as through potential bank loans or other forms of borrowing.

Outstanding Indebtedness

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

We are required to make mandatory prepayments on the Senior Notes on certain dates and we are subject to customary covenants for financings of this type, including restrictions on the incurrence of liens, payment of dividends and disposition of properties as well as being obligated to maintain certain financial ratios. On August 5, 2011, the Company paid the first balance due equal to 8.3333% of the principal amount outstanding. The second repayment for 8.3333% of the principal of the Senior Notes was due on January 30, 2012. After negotiations with Abax, the note-holders agreed that the Company could make the payment on or before March 9, 2012. On March 7, 2012, the Company paid $4,946,541 to Abax, including $3,838,949 of the principal due on January 30, 2011 in full (with foreign currency exchange loss of $505,615), plus accrued interest of $1,079,176, as well as penalty interest of $28,416. Abax issued a waiver to exempt the Company from any other consequences of the late payment. The repayment of 16.6666% of the principal of the notes payable plus accrued interest of the period from January 29, 2012 to July 30, 2012 was due on July 30, 2012. And the repayment of 16.6666% of the principal of the notes payable plus accrued interest of the period from July 31, 2012 to January 30, 2013 was due on January 30, 2013. The company did not make these payments at the time they were due and the payments remain unpaid.

On September 11, 2012, the holders of a majority of the Senior Notes (the "Holders") notified the Company on August 21, 2012 (the "Default Notice") that the Company was in default of the Senior Notes for failure to make the interest payment due and a mandatory redemption of the Senior Notes on July 30, 2012 (the "Default"). In the notice, the Holders also demanded that the Company make all payments due as of July 30, 2012 under the Senior Notes to avoid acceleration of all payments under the Senior Notes and foreclosure of collaterals pledged to secure the Senior Notes.

On September 5, 2012, the Company received another notice from the Holders that the Holders elected to exercise their right to accelerated payment of the Senior Notes as a result of the continued Default (the "Acceleration Notice"). The immediate acceleration of all amounts owing under the Senior Notes totals approximately RMB249,450,516.

Further, on September 10, 2012, the Company received a demand notice from the Holders' legal counsel on behalf of the Holder for the payment of all amounts owing under the Senior Notes (the "Demand Notice") within 15 days from the date of the Demand Notice. The Demand Notice stated that if the Company failed to meet the demand, the Holders intend to pursue all of its legal rights under the transaction documents, including, without limitation:

requiring the Trustee to initiate suit in the courts of New York with respect to the Company's failure to pay the entire amount due to the Holders under the Senior Notes;

Initiating involuntary bankruptcy proceedings with respect to the Company under the U.S. Federal Bankruptcy Code;

Initiating arbitration in Hong Kong against the Company for breaches of the Company's obligations under the SPA;

exercising its rights under the Warrant Agreement to require the redemption of all Warrants held by it at the Redemption Price (as defined therein); and

all other rights under the transaction documents relating to the Senior Notes in relation to the Default, which may include, foreclosing on the security interest in 65% of all outstanding equity interest of the Company's wholly owned subsidiary, Shaanxi Xilan Natural Gas Equipment Co., Ltd., and all funds in the account where the proceeds from the Senior Notes were deposited.

In addition to the demands disclosed above, the Holders have also asserted that by virtue of the Default the Company is obliged to redeem the Warrants and pay to the Holders $17.5 million.

The Company disputes the amount allegedly owed, and has been in negotiation with the Holders but has not able to come to a resolution with the Holders.

On February 8, 2013, an Involuntary Petition for bankruptcy, entitled In re China Natural Gas, Inc. (Case No. 13-10419), was filed against China Natural Gas, Inc. (the "Company") by three creditors of the Company, namely Abax Lotus Ltd., Abax Nai Xin A Ltd., and Lake Street Fund LP (the “Petitioners”). The petition was filed in the United States Bankruptcy Court, Southern District of New York. The Petitioners have claimed in the Involuntary Petition that they have debts totaling $42,218,956.88 as a result of the Company’s failure to make payments on the 5% Guaranteed Senior Notes issued in 2008. The Company intends to oppose the petition.

Long-Term Loan

On February 26, 2010, JBLNG entered into a fixed assets loan contract with SPDB, pursuant to which the SPDB agreed to lend $18,564,000 to JBLNG. SPDB transferred $13,923,000 and $4,641,000 to JBLNG on March 17 and May 28, 2010, respectively. The applicable interest rate of this loan is the standard three- to five-year rate issued by the People’s Bank of China’s, 5.76% for the first year and subject to adjustment commencing the second year. As the People’s Bank of China adjusted the standard interest rate several times in 2011 and 2010, beginning January 1, 2012 the interest rate of these loans had been adjusted to 6.90%. As the People’s Bank of China lowered the standard interest rate twice in June and July 2012, beginning January 1, 2013 the interest rate of these loans is 6.40%. The repayment term was amended in October 2011. According to the amended contract, the loan period is 58 months from the date of effectiveness of the contract, and will be repaid twice a year, with the last repayment no later than December 5, 2014. The loan is guaranteed by XXNGC and secured by XXNGC’s equipment and vehicles located within PRC. Pursuant to the long-term loan agreement with Pudong Development Bank Xi’an Branch, the Company repaid the principal of $775,000 (RMB 5,000,000), $3,875,000 (RMB 25,000,000), $793,000 (RMB 5,000,000), $3,965,000 (RMB 25,000,000) and $1,586,000 (RMB 10,000,000) to the SPDB on October 10, 2011, December 31, 2011, March 5, 2012, December 5, 2012 and March 5, 2013, respectively.

If the default of the Senior Notes is not resolved, the Company may be deemed to be in default on its fixed asset loan from Shanghai Pudong Development Bank ("SPDB") as the Holders initiate involuntary bankruptcy proceedings with respect to the Company and the Company does not obtain prior written approval from SPDB. The default of the loan with SPDB may result in full or partial acceleration of the repayment of the loan.

Contractual Obligations

Our contractual obligations are as follows:

		Payments due by period			
Contractual obligations	Total	Less than 1 year	1-3 Years	3-5 years	More than 5 years
	(in thousands)				
Long-term debt obligations(1)	$38,352	$38,352	$-	$-	$-
Operating lease obligations(2)	40,135	1,827	4,361	4,157	29,790
Purchase obligations (3)	9,156	9,156	-	-	-
Other long-term liabilities reflected on balance sheet (4)	17,500	17,500	-	-	-
Related party debt (5)	2,680	2,680	-	-	-
Long-term loan	9,522	4,761	4,761	-	-
Total	$117,345	$74,276	$9,122	$4,157	$29,790

(1) Please refer to Note 6 to our consolidated financial statements for the year ended December 31, 2012.

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

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

(4) The $17.5 million reflects derivative liability related to the embedded put option in the 1,450,000 warrants we issued to Abax in January 2008. Abax is entitled to require us to purchase back the portion of warrants not exercised upon expiration.

(5) The $2.68 million reflects related party debt to Mr. Hao Qu, a former employee of XXNGC and shareholder of the Company.

Natural Gas Purchase Commitments

We have existing long-term natural gas purchase agreements with our major suppliers. As of December 31, 2012, we maintained long-term natural gas purchase agreements with one of our vendors, Qinshui Lanyan Coal Bed Methane Co., Ltd. (“Qinshui Lanyan”) which expires on December 31, 2015. We do not expect any issues or difficulties in renewing our supply contracts with the vendor going forward.

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

Foreign Currency Translations

Our reporting currency is the U.S. dollar ("USD"). The functional currency of XXNGC and XXNGC's PRC subsidiaries and, therefore, our functional currency, is the RMB. The results of operations and financial position of XXNGC and XXNGC's PRC subsidiaries are translated to USD using the period end exchange rates as to assets and liabilities and weighted average exchange rates as to revenues, expenses and cash flows. Capital accounts are translated at their historical exchange rates when the capital transaction occurred. The resulting currency translation adjustments are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity.

The balance sheet amounts, with the exception of equity, were translated at the December 31, 2012 exchange rate of RMB 6.30 to $1.00 as compared to RMB 6.35 to $1.00 at December 31, 2011. The equity accounts were stated at their historical rate. The average translation rates applied to income and cash flow statement amounts for the years ended December 31, 2012 and 2011 were RMB 6.31 and RMB 6.45 to $1.00, respectively.

Critical Accounting Policies

Our discussion and analysis of our financial position and results of operations contained in this Form 10-K is based on our consolidated financial statements, contained elsewhere herein. The preparation of these financial statements in conformity with generally accepted accounting principles requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. There have been no material changes in the development of our accounting estimates or the assumptions underlying those estimates, or the accounting policies that we disclosed as our Critical Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2012.

Use of Estimates and assumptions

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting estimates reflected in the Company's consolidated financial statements include revenue recognition, allowance for doubtful accounts, inventory obsolescence, warrants liability and useful lives of property and equipment. Actual results could differ from those estimates.

Consolidation of Variable Interest Entity

In accordance with the accounting standard regarding consolidations, VIEs are entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders lack adequate decision-making ability. Any VIE with which the Company is involved must be evaluated to determine the primary beneficiary of the risks and rewards of the VIE. Management makes ongoing reassessments of whether the Company is the primary beneficiary of XXNGC.

Property and Equipment

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

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

Construction in Progress

Construction in progress consists of (1) the costs for constructing CNG fueling stations, the liquefied natural gas, or LNG, project in Jingbian County, and the natural gas infrastructure project in Xi'an International Port District and (2) other construction in progress costs, including technology licensing fees, equipment purchases, land use rights requisition cost, capitalized interest and other construction fees. No depreciation is provided for construction in progress until such time as the assets are completed and placed into service. Interest incurred during construction is capitalized into construction in progress. All other interest is expensed as incurred.

Revenue Recognition

Revenue is recognized when services are rendered to customers and when a formal arrangement exists, the price is fixed or determinable, the delivery is completed, no other significant obligations of ours exist and collectability is reasonably assured. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as unearned revenue. Revenue from gas and gasoline sales is recognized when gas and gasoline is pumped through pipelines to the end users. Revenue from installation of pipelines is recorded when the contract is completed and accepted by the customers. Construction contracts are usually completed within one to two months. Revenue from repairing and modifying vehicles is recorded when services are rendered to and accepted by the customers.

Fair Value of Financial Instruments

The accounting standards regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy for disclosures of fair value measurement, and provide disclosure requirements for fair value measures. The carrying amounts reported in the consolidated balance sheets for current receivables and payables qualify as financial instruments. Management concluded the carrying values are a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization and, if applicable, their stated interest rate approximates current rates available. The three levels are defined as follows:

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

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

·Level 3 inputs to the valuation methodology are unobservable.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Depending on the product and the terms of the transaction, the fair value of our notes payable and derivative liabilities were modeled using a series of techniques, including closed-form analytic formula, such as the Black-Scholes option-pricing model, which does not entail material subjectivity because the methodology employed does not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets.

A contract that would otherwise meet the definition of a derivative but is both (a) indexed to the company's own stock and (b) classified in stockholders' equity in the balance sheet would not be considered a derivative financial instrument. There is a two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the exception. Changes in the fair value of warrants are recognized in the income statement.

Income Taxes

Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of temporary differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. At December 31, 2012 and December 31, 2011, there were no significant book to tax differences except for warrants liability and stock based compensation. An uncertain tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the year incurred. No significant penalties or interest relating to income taxes have been incurred during the years ended December 31, 2012 and 2011.

Long-Lived Assets

We evaluate the carrying value of long-lived assets to be held and used whenever events or changes in circumstances indicate that the assets might be impaired. Impairment losses are recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal.

RECENT ACCOUNTING PRONOUNCEMENTS

See *"Note 3. Summary of Significant Accounting Policies"* in *"Item 1. Financial Statements"* herein for a discussion of the new accounting pronouncements adopted in this Annual Report on Form 10-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

There are no reportable disagreements with our current independent auditors, WWC, P.C.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the reporting period covered by this Report, and under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we conducted an evaluation of our disclosure controls and procedures that were in effect at the end of the period covered by this report. Disclosure controls and procedures is defined under Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as those controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

During management's evaluation of the effectiveness of internal control over financial reporting in connection with this annual report for the year ended December 31, 2012, management concluded that the Company continues to have the following material weakness in its internal control over financial reporting for the year ended December 31, 2012:

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

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

- The Company failed to communicate to the Board of Directors the Wang Loan and the loan made to JunTai Hosing Purchase Ltd. and had entered into the Loans without approval of the Board of Directors.

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

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

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

- The Company did not obtain the Board of Director's resolution prior to sign a contract with Zhangjiagang CIMC Sanctum Cryogenic Equipment Co., Ltd to buy 50 smart semi-trailer for $10,131,200 (RMB 64 million).

- The Company did not obtain the Board of Director's resolution prior to close five stations and dispose these fixed assets.

Based on their evaluation (and considering the material weaknesses previously identified and discussed in our internal control over financial reporting, Item 9A, Controls and Procedures, in our Annual Report on Form 10-K for the year ended December 31, 2011), our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures at December 31, 2012 were not effective.

Management's Remediation Initiatives

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

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

2) The Company appointed Mr. Shuwen Kang to replace Mr. Qinan Ji as Chief Executive Officer of the Company. Mr. Shuwen Kang is familiar with the Company's management and operations and has extensive experience in the natural gas industry and we believe he is qualified and competent to serve effectively as the Company's CEO.

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

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

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

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

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

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

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

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

Changes in Internal Control over Financial Reporting

Other than the remediation measures described above, there was no change in our internal control over financial reporting during the year ended December 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth information regarding our directors and executive officers.

Name	Position with our Company	Age	Director Since
Qinan Ji	Chairman	56	2005
Zhiqiang Wang	Director	73	2006
Yang Xiang Dong(1)	Director	47	2008
Frank Waung	Director	47	2010
Lawrence W. Leighton	Director	79	2008
Shuwen Kang(2)	Chief Executive Officer	63	2011
Zhaoyang Qiao(3)	Chief Financial Officer	39	2012

(1) In past filings with the Securities and Exchange Commission ("SEC"), we have referred to Mr. Yang by his English name, Donald Yang.

(2) Mr. Kang was appointed as the Company's Chief Executive Officer on October 4, 2011. Mr. Ji resigned as Chief Executive Officer of the Company at the request of the Board of Directors on the same date.

(3) Bode Xu resigned as our Chief Financial Officer effective on May 2, 2012. Zhaoyang Qiao replaced Mr. Xu as the Company's Chief Financial Officer.

Qinan Ji has been a member and Chairman of the Board of Directors of China Natual Gas since 2005. In 1996, he founded the Anxian Hotel in Weinan City in Shaanxi Province. In 2001, he formed Xi'an Sunway Technology and Industry Co., Ltd. He has more than 20 years experience in the energy and petroleum industries in operational, administrative, management and government relation roles. He received a Bachelors of Economic Management from Northwestern University (Shaanxi). The Board selected Mr. Ji to serve as a director because of his knowledge of the Company's affairs as well as his knowledge of and experience in the energy and petroleum industries in the People's Republic of China.

Zhiqiang Wang has been the Vice Chairman of the Board of Directors of the Company since 2006. From 2002 until his retirement in 2004, Mr. Wang was the Chief Executive Officer of Xi'an Municipal Government Construction Company where he was in charge of the city's major construction projects. Mr. Wang was the former head of energy industry regulations from 1992 to 2002 as well as the Vice Mayor of the city of Xi'an, China's largest western city with a population of 8 million, in which position he was in charge of regulating and licensing the city's energy and natural gas businesses. Mr. Wang graduated from the Northwestern University of Politics and Law in China in 1962. The Board selected Mr. Wang to serve as a director because of his knowledge of the Company's affairs and the regulatory landscape applicable to the Company in the People's Republic of China, as well as his experience with overseeing major construction projects.

Yang Xiang Dong has been a member of our Board of Directors since August 2008. Mr. Yang is a founding partner and president of Abax Global Capital ("***AGC***"), a leading Hong Kong based asset management firm focused on Asian public and private investments especially in Greater China. He has held this position since March 2007. From 2000 to 2007, Mr. Yang was a Managing Director responsible for Merrill Lynch's Hong Kong and China Debt Capital Markets division. Mr. Yang also served as a director for Sinoenergy Corporation, until September 25, 2010 when Sinoenergy Corporation underwent a change of control and delisted from NASDAQ. Mr. Yang holds a MBA degree from Wharton School of Business and a BA degree from Nankai University in China. Abax Lotus Ltd., an affiliate of AGC, was the sole investor in the Company's $40 million note financing which closed in January 2008. Mr. Yang was initially nominated to the Board by Abax Lotus Ltd. pursuant to the investor rights agreement we entered into with Abax Lotus Ltd. in 2008 in connection with the notes financing. See "*Certain Relationships and Related Transactions, and Director Independence*". The Board selected Mr. Yang to serve as a director because of his knowledge of the Company's affairs and his expertise with respect to the international capital and credit markets.

Frank Waung has been a member of our Board of Directors since November 2010. Mr. Waung has served as the Chief Financial Officer of China Pharma Holdings, Inc. since April 28, 2009. China Pharma Holdings, Inc., a China-based manufacturer of pharmaceuticals and nutritional supplements, is listed on the NYSE AMEX market. Prior to his employment with China Pharma Holdings, Inc., Mr. Waung worked for Hickey Freihofner Capital as an investment banker with a focus on China matters from 2008. Prior to 2008, Mr. Waung worked for Dellacamera Capital Management as a special situations analyst in 2007. Mr. Waung acted as a senior market economist in Cowen & Co. from 2000 to 2003 and as a convertible securities trader from 2003 to 2006. He worked for Credit Suisse First Boston as a quantitative marketer from 1994 to 1998. Mr. Waung received his bachelor's degree from University of California in 1988 and received his master's degree in business administration from the Wharton School of the University of Pennsylvania in 1994. The Board selected Mr. Waung to serve as a director because of his knowledge of the Company's affairs and his understanding of financial reporting and internal control over financial reporting.

Lawrence W. Leighton has been a member of our Board of Directors since August 2008. Mr. Leighton has had an extensive 45-year international investment banking career. Beginning at what became Lehman Brothers, he advised on financing for the Mexican Government and leading Mexican corporations. As Director of Strategic Planning for the consumer products company, Norton Simon Inc., he initiated and executed the acquisition of Avis Rent-a-Car. Subsequently, he was a Limited Partner of Bear Stearns & Co., a Managing Director of the investment bank of Chase Manhattan Bank and then President and Chief Executive Officer of the U.S. investment bank of Credit Agricole, the major French Bank. Among his transactions have been advising Pernod Ricard, the major European beverage company, on its acquisitions in the United States; and advising Verizon, the major U.S. telecom company, on its dispositions of certain European operations. Since 1997, Mr. Leighton has been a Managing Director of Bentley Associates, an investment banking firm. Mr. Leighton received his BSE degree in engineering from Princeton University and an MBA degree from Harvard Business School. He holds a commercial pilot's license with instrument rating. Mr. Leighton is currently a director of China XD Plastics Company Limited, a NASDAQ listed company. The Board selected Mr. Leighton to serve as a director because of his knowledge of the Company's affairs as well as his expertise with respect to the international capital and credit markets.

Shuwen Kang is our Chief Executive Officer. Mr. Kang was vice president of XXNGC, the variable interest entity of one of the Company's major subsidiaries, and is in charge of XXNGC's business operations, prior to being appointed as Chief Executive Officer. From 2006 to 2010, Mr. Kang served as senior counsel to XXNGC, responsible for making strategic and business development plans for the Company. Mr. Kang has extensive experience in the operations and management of the Company and in the natural gas industry in general. Mr. Kang holds an associate degree in Party and Government Management from the Party School of the Shaanxi Provincial Committee of the Communist Party of China.

Zhaoyang Qiao is our Chief Financial Officer. Mr. Qiao brings over a decade of experience in accounting. Mr. Qiao was Financial Manager responsible for the preparation of the Company's financial statements under US GAAP and carrying out reforms for Sarbanes-Oxley requirements from December 2009 to May 2012. Prior to joining the Company, from September 2006 through September 2009, he served as International Financial Supervisor for Fujitsu (Xian) System Engine Co., Ltd., which is a Fortune 500 company primarily engaged in communication equipment, IT equipment and software development. Prior to his employment at Fujitsu Mr. Qiao was an accountant at Xian Janssen Pharmaceutical Co. from July 1998 through September 2006. Mr. Qiao received his bachelor's degree in Accounting from Shaanxi Finance and Economics College in 1998.

There are no family relationships, or other arrangements or understandings between or among any of the directors, executive officers or other person pursuant to which such person was selected to serve as a director or officer.

CORPORATE GOVERNANCE

Director Independence

The Board of Directors has determined that, other than Qinan Ji, our Chairman, and Yang Xiang Dong, each of the current members of the Board is “independent” in accordance with the applicable SEC rules and listing standards of the NASDAQ Stock Market as currently in effect.

Executive Sessions

Non-management directors meet in executive session without management present each time the Board holds its regularly scheduled meetings. The director to preside during the executive sessions is determined at the beginning of the meeting.

Meetings of the Board of Directors and Committees

The Board of Directors of the Company held three meetings and acted by unanimous written consent in lieu of a meeting one time during the fiscal year ended December 31, 2012. The Board has an Audit Committee, a Compensation Committee and a Governance and Nominating Committee. During the last fiscal year, each of our directors attended at least 75% of the total number of meetings of the Board and its committees on which such director served.

The following table sets forth the three standing committees of the Board, the members of each committee during the last fiscal year and the number of meetings held by each committee.

Director	Audit Committee	Compensation Committee	Governance and Nominating Committee

Qinan Ji			
Zhiqiang Wang	X	X	Chair
Yang Xiang Dong			
Frank Waung	Chair	X	X
Lawrence W. Leighton	X	Chair	X
Number of Meetings held in 2012	2	0	1

Audit Committee

The members of the Audit Committee are Messrs. Waung (Chair), Wang and Leighton. Each of the members of the Audit Committee is “independent” for purposes of the NASDAQ listing standards as they apply to audit committee members. The Board has determined that Mr. Waung qualifies as an “audit committee financial expert” under the rules of the SEC. The Audit Committee’s written charter can be found in the “Investor Relations” area of our website at www.naturalgaschina.com.

The functions of the Audit Committee include reviewing our significant accounting policies, reviewing the financial, investment and risk management policies applicable to our business operations, retaining our independent auditors, reviewing their independence, reviewing and approving the planned scope of our internal audit, reviewing and approving any fee arrangements with our auditors, overseeing their audit work, reviewing and pre-approving any non-audit services that may be performed by them, reviewing our financial results, audited financial statements and any related public disclosures, reviewing and approving any related party transactions and establishing procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters. Also, the Audit Committee enforces and interprets our Code of Ethics. The Audit Committee held two meetings during the fiscal year ended December 31, 2012.

Compensation Committee

The members of the Compensation Committee are Messrs. Leighton (Chair), Wang and Waung. Each of the members of the Compensation Committee is "independent" for purposes of the NASDAQ listing standards. The Compensation Committee's written charter can be found in the "Investor Relations" area of our website at www.naturalgaschina.com.

The functions of the Compensation Committee include reviewing and approving our compensation strategy, reviewing and approving the individual elements of total compensation for the Chief Executive Officer and all other officers, approving stock option grants to directors and officers, granting stock options to all employees, amending the provisions of our stock option or other equity incentive plans, overseeing the operation of any employee benefit plans, ensuring that our annual incentive compensation plan is administered in a manner consistent with our compensation plan, approving separation packages and severance benefits to officers to the extent that the packages are outside the ordinary plan limits and reviewing and approving all reports and summaries of compensation policies and decisions as may be appropriate for operational purposes or as may be required under applicable law. The Compensation Committee did not hold any meetings during the fiscal year ended December 31, 2012.

For more information on the responsibilities and activities of the Compensation Committee, including the committee's processes for determining executive compensation, see "*Compensation Discussion and Analysis*" and the Compensation Committee's report.

Governance and Nominating Committee

The members of the Governance and Nominating Committee are Messrs. Wang (Chair), Waung and Leighton. Each of the members of the Governance and Nominating Committee is "independent" for purposes of the NASDAQ listing standards. The Governance and Nominating Committee's written charter can be found in the "Investor Relations" area of our website at www.naturalgaschina.com.

The functions of the Governance and Nominating Committee include identifying, reviewing, and recommending candidates for appointment and nomination for election to the board of directors, reviewing the appropriate skills and characteristics in the composition of the board of directors and periodically reviewing our corporate governance policies. The Governance and Nominating Committee held one meeting during the fiscal year ended December 31, 2012.

Selection of Board Nominees

The Governance and Nominating Committee reviews the qualifications of potential director candidates in accordance with its charter. The Governance and Nominating Committee's consideration of a candidate as a director includes assessment of the individual's understanding of our business, the individual's professional and educational background, skills and abilities, and potential time commitment and whether such characteristics are consistent with criteria established by the Governance and Nominating Committee from time to time. To provide such a contribution to the Company, a director must generally possess one or more of the following, in addition to personal and professional integrity:

§ experience in corporate management;

§ experience with complex business organizations;

§ experience as a board member or officer of another publicly held company;

§ diversity of expertise, experience in substantive matters related to the Company's business and professional experience as compared to existing members of our Board and other nominees; and

§ practical and mature business judgment.

The Governance and Nominating Committee may also adopt such procedures and criteria as it considers advisable for the assessment of director candidates. Other than the foregoing, there are no stated minimum criteria for director nominees. The Governance and Nominating Committee does however recognize that at least one member of the Board should meet the criteria for an "audit committee financial expert" as defined by SEC rules, and that at least a majority of the members of the Board must meet the definition of "independent director" under NASDAQ listing rules, and the Governance and Nominating Committee, and the Board, is committed to considering candidates for the Board regardless of gender, ethnicity and national origin. We believe that the considerations and the flexibility of our nomination process have created on our Board diversity of a type that is effective for our Company because our current Board members have a wide variety of business experiences and expertise, including in substantive matters related to our business, and our Board includes professionals from the People's Republic of China and the United States and members with experience in the private and public service sectors as well as in the energy, petroleum, construction, banking and finance and technology industries.

Stockholder Nominations

The Governance and Nominating Committee considers and makes recommendations to the Board regarding any stockholder recommendations for candidates to serve on the Board. However, it has not adopted a formal process for that consideration because it believes that the informal consideration process has been adequate given the historical absence of stockholder proposals. The Governance and Nominating Committee will review periodically whether a more formal policy should be adopted.

The Governance and Nominating Committee will consider all stockholder recommendations for candidates for the Board, which should be sent to the Nominating and Governance Committee, c/o Secretary, China Natural Gas, Inc., 19th Floor, Building B, Van Metropolis, 35 Tang Yan Road, Hi-Tech Zone, Xi'an, 710065, Shaanxi Province, People's Republic of China.

A stockholder's notice to our Secretary with respect to persons that the stockholder proposes to directly nominate as a director must set forth as to each individual whom the stockholder proposes to nominate, all information relating to the person that is required to be disclosed in solicitations of proxies for the election of directors or is otherwise required, pursuant to Regulation 14A (or any successor provisions) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), including their name, age, business address, residence address, principal occupation or employment, the number of shares of our common stock beneficially owned by such candidate, and the written consent of such person to be named in the proxy statement as a nominee and to serve as a director if elected. In order to submit a proposal, a stockholder must meet the eligibility criteria for stockholder proposals set forth in Regulation 14A under the Exchange Act. In addition, a stockholder nomination must meet the general requirements for stockholder proposals discussed in "*Stockholder Proposals for 2013 Annual Meeting*".

The Governance and Nominating Committee will evaluate recommendations for director nominees submitted by directors, management or qualifying stockholders in the same manner, using the criteria stated above. All directors and director nominees will be required to submit a completed directors' and officers' questionnaire as part of the nominating process. The process may also include interviews and additional background and reference checks for non-incumbent nominees, at the discretion of the Governance and Nominating Committee.

Communications with Directors

Stockholders may communicate with any of the Company's directors, including the chair of any of the committees of the Board or the non-management directors as a group by writing to them c/o Secretary, China Natural Gas, Inc., 19th Floor, Building B, Van Metropolis, 35 Tang Yan Road, Hi-Tech Zone, Xi'an, 710065, Shaanxi Province, People's Republic of China. Please specify to whom your correspondence should be directed. The Secretary will promptly forward all correspondence to the Board or any specific committee member, as indicated in the correspondence, except for junk mail, mass mailings, job inquiries, surveys, business solicitations or advertisements, or patently offensive or otherwise inappropriate material. The Secretary may forward certain correspondence, such as product-related or service-related inquiries, elsewhere within the Company for review and possible response.

Code of Ethics

Our Board has adopted a Code of Ethics that applies to all officers, directors and employees of our Company. A copy of our Code of Ethics is available in the "Investor Relations" area of our website at www.naturalgaschina.com. Any substantive amendment or waiver of the Code of Ethics may be made only by the Board upon a recommendation of the Audit Committee, and will be disclosed on our website.

Board Leadership Structure and Role in Risk Management

Our Board may select either a combined Chief Executive Officer and Chairman or a Chairman who does not also serve as Chief Executive Officer. Currently, our Chief Executive Officer does not serve as Chairman. The Board believes this leadership structure is best for the Company at the current time because it achieves independent oversight and management accountability through executive sessions of the independent directors and through a Board composed of a majority of independent directors.

The Board is actively involved in oversight of risks that could affect the Company. This oversight is conducted primarily through committees of the Board, as disclosed in the descriptions of each of the committees above, but the full Board has retained responsibility for general oversight of risks. The Board satisfies this responsibility through reports by each committee chair regarding the committee's considerations and actions, as well as through regular reports directly from officers responsible for oversight of particular risks within the Company.

Further, the Board continually evaluates its oversight role, the Company's internal controls and management accountability to determine whether changes to its role or Company policies or procedures are appropriate. For example, as disclosed in this annual report on Form 10-K, during management's evaluation of the effectiveness of the Company's internal control over financial reporting, management identified certain material weaknesses in the Company's internal control over financial reporting. In response to the identified material weaknesses and to strengthen the Company's internal control over financial reporting, the Company has taken certain remediation initiatives, including the following remediation initiatives that reflect the exercise, as well as an expansion, of the Board and the Audit Committee oversight responsibilities:

§ the Board and the Audit Committee held meetings promptly after being notified of the material weaknesses in internal controls to address such weaknesses, and determined to meet regularly specifically for the purpose of monitoring and discussing with management the remediation of such weaknesses; and

§

the Board and the Audit Committee adopted a written internal authorization policy establishing approval procedures for various corporate actions. The policy lists various operational, administrative and financial corporate events and actions and for each such event and action, identifies whether prior approval or discussion with particular executive officers, the Board or legal counsel is required. The policy also sets quantitative limits on specific types of transactions that management may approve without Board approval. After adopting such policy, the Audit Committee and Board discussed the policy with management.

Involvement in Certain Legal Proceedings

None of our directors, executive officers, significant employee or control persons have been involved in any legal proceeding listed in Item 401(f) of Regulation S-K in the past 10 years.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our executive officers and directors and persons who beneficially own more than 10% of our common stock to file initial reports of beneficial ownership and reports of changes in such ownership with the SEC. Such persons are required by rules promulgated by the SEC to furnish us with copies of all Section 16(a) forms they file.

Based solely on our review of these forms and written representations from certain reporting persons, we believe that during the fiscal year ended December 31, 2012, all Section 16(a) filing requirements applicable to our executive officers, directors and persons who own more than 10% of our common stock have been timely satisfied, except for our CEO Shuwen Kang and our CFO Zhaoyang Qiao who did not file the required Form 3s.

ITEM 11. EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Overview

This Compensation Discussion and Analysis describes the material elements of compensation awarded to, earned by, or paid to our Chief Executive Officer and Chief Financial Officer (collectively the "named executive officers"). This Compensation Discussion and Analysis focuses on the information contained in the below tables and narrative discussion. The Compensation Committee of the Board oversees the design and administration of our executive compensation program.

Compensation Philosophy and Objectives

We believe executive compensation programs impact all employees by setting general levels of compensation and helping to create an environment of goals, rewards and expectations. We also believe that the compensation cost for our employees is an investment in human capital to secure certain knowledge and performance capabilities necessary for our business.

The objectives of our executive compensation program are to recruit, hire, retain, motivate and reward the most talented and dedicated executives possible. In determining what constitutes appropriate and competitive compensation for each named executive officer, our Compensation Committee takes into account many factors, including: the total portfolio of responsibilities assumed by the executive officer; the skills, knowledge, experience and competencies required for the position; internal comparability of a position as compared to other similar positions within our Company; our desire to pay at market or competitive levels based on current economic and business factors, including regional and industry-wide compensation practices and trends; individual performance; and contributions to the financial performance of the Company by the executive officer. Our Compensation Committee also considers factors of corporate performance including our sales, revenue, income from operations and income before income tax, as well as the current overall economic situation when setting compensation levels.

Our compensation program is designed to reward named executive officers for their contributions to our growth and profitability.

Compensation Committee's Processes and Procedures for Consideration and Determination of Executive and Director Compensation

The Board has delegated authority to the Compensation Committee to review and make recommendations with respect to compensation matters and oversee all of our compensation policies and procedures, including the administration and interpretation of our 2009 Employee Stock Option and Stock Award Plan and director compensation, but the Board has retained the authority to approve and take final action on all executive compensation awards. The Board has delegated to Mr. Kang the authority to make grants of options under our 2009 Employee Stock Option and Stock Award Plan to non-officer level employees, subject to final approval by the Compensation Committee. The Compensation Committee and Mr. Kang have not been empowered by the Board to delegate the authority granted to them with respect to compensation matters to other persons.

At the beginning of each fiscal year, our Compensation Committee reviews our compensation program to assess the adequacy and competitiveness of our compensation programs and to determine whether any adjustments should be made to the program as a whole or with respect to particular executive officers, taking into the account the factors described above as well as changes in job responsibility and any fluctuations in cost of living. In connection with this review and determination, the Compensation Committee solicits appropriate input from Mr. Kang, our Chief Executive Officer, regarding base salary and other forms of compensation for our other executive officers. Mr. Kang makes recommendations to the Compensation Committee based upon his annual performance review and consultation with each other executive officer. The Compensation Committee aims to make final recommendations with respect to any adjustments prior to the end of the first quarter.

Neither the Compensation Committee nor management has engaged the services of a compensation consultant in determining or recommending the amount or form of executive or director compensation.

Elements of Compensation

The Compensation Committee is committed to a strong, positive link between our short-term and long-term objectives and our compensation practices. The executive compensation program for our named executive officers is intended to be composed of three basic components: base salary, discretionary bonus and long-term incentive compensation in the form of stock options.

Base Salary

Base salary compensation for our named executive officers is generally established by the terms of employment agreements between the Company and the named executive officer. The level of base salary is intended to provide appropriate base pay to our named executive officers taking into account their responsibilities, level of experience, individual performance and internal equity considerations. The Compensation Committee takes into account both Company and individual performance in setting base salary levels. The Company has recognized that to attract talented employees from secure positions at other more stable or mature companies, we must be able to pay competitive base salaries (while also supplementing the salaries with cash and equity incentive compensation). The Compensation Committee annually reviews the salaries of our named executive officers. Our Compensation Committee believes that any increases in base salary should be based upon a favorable evaluation of individual performance, which is evaluated by assessing factors such as the functioning of that executive's team within the corporate structure, success in furthering the corporate strategy and goals and individual management skills, responsibilities and anticipated workload.

Bonus

Bonuses and eligibility for a discretionary bonus are also established by the terms of employment agreements between the Company and the named executive officer, although the Compensation Committee may award a discretionary bonus to any named executive officers to reward outstanding personal achievement during the year. The actual amount of discretionary bonus paid is determined following a review of each executive's individual performance and contribution to our short-term strategic goals as well as the Company's performance and achievement of such goals, but is not tied to pre-established individual or Company performance criteria. Bonuses other than discretionary bonuses are payable upon a term of service and, therefore, incentivize continued employment with the Company. Pursuant to his employment agreement, Mr. Kang was entitled to receive a bonus of RMB 50,000 upon completing 12 months of service in 2012. However, he did not receive the bonus due to the Company's failure to achieve the strategic

goals of 2012.

Long Term Incentive Compensation—Stock Options

We intend to utilize stock options as the primary vehicle for payment of long-term compensation to our named executive officers over the next several years. Our 2009 Employee Stock Option and Stock Award Plan authorizes the Compensation Committee to grant stock options to our named executive officers with time-based vesting or vesting based on achievement of performance conditions, including goals related to profits or loss, revenue or profit growth or loss reduction, profit or loss related return ratios, other balance sheet or income statement targets or ratios, market share, project completion, operational or productivity efficiency gains, cash flow, share price appreciation or total stockholder return. Such goals may be stated in absolute terms or relative to comparison companies.

The Compensation Committee believes that stock options are a necessary part of compensation packages granted to named executive officers because it believes: they help attract and retain employees; the value received by the recipient of a stock option is based on the growth of our stock price, thereby creating and enhancing incentives to increase our stock price and maximize stockholder value; and they create a balance with shorter term incentives such as base salary and bonuses.

In determining the number and vesting schedule or vesting schedule of stock options granted to named executive officers and other employees, the Compensation Committee will generally take into account the individual’s position, tenure with the Company, scope of responsibility, value of stock options in relation to the other elements of the individual’s total compensation and, where applicable, the need to attract and retain the individual for his or her current position. The Compensation Committee makes its determination of whether to grant stock options during its annual review of our compensation programs as well as at the time a new executive officer is hired.

In 2009, Mr. Ji received options to purchase 146,000 shares of common stock, with an exercise price of $4.90. The options awarded to Mr. Ji vest evenly over four years beginning on April 1, 2010.

Tax and Accounting Information

For 2012 and continuing thereafter, the Compensation Committee has considered and will continue to consider the impact of the requirement under Financial Accounting Standards Board, Accounting Standards Codification, Topic 718, *Compensation-Stock Compensation* ("***FASB ASC Topic 718***"), that we record as an expense in our financial statements, at the time stock options are granted, the fair value of the options over their vesting period. In addition, the Compensation Committee will examine the tax impact on employees and the potential tax deductions to the Company with respect to the exercise of stock option grants. However, although it will consider the tax implications of its compensation decisions, the Compensation Committee believes its primary focus should be to attract, retain, and motivate high caliber executives and to align the executives' interests with those of our stockholders. We do not pay or reimburse any named executive officers for any taxes due upon exercise of a stock option.

COMPENSATION COMMITTEE

Lawrence W. Leighton (Chair)

Frank Waung

Zhiqiang Wang

The foregoing Report of the Compensation Committee shall not be deemed to be "soliciting material" or to be "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent that the Company specifically incorporates such information by reference in such filing.

Summary Compensation Table

The following table sets forth information regarding compensation awarded or paid to, or earned by, our named executive officers and principal financial officers during the year ended December 31, 2012, 2011 and 2010. No other executive officer of our Company had total compensation exceeding $100,000 during the year ended December 31, 2012.

Name and Principal Position	Year	Salary ($)	Bonus ($)	Options ($) (3)	All Other Compensation ($)	Total ($)
Shuwen Kang (1)	2012	95,160	-	-	-	95,160
Chief Executive Officer	2011	23,250				23,250
Qinan Ji(1)	2011	90,000	-	-	-	90,000
Former Chief Executive Officer						
Zhaoyang Qiao(2)	2012	21,147	-	-	-	21,147
Chief Financial Officer						
Bode Xu (2)	2012	31,720	-	-	-	31,720
Former Chief Financial Officer	2011	93,000	-	-	-	93,000

(1) Mr. Kang was appointed as the Company's Chief Executive Officer on October 4, 2011. Mr. Qinan Ji resigned as Chief Executive Officer of the Company at the request of the Board of Directors on the same date,.

(2) Mr. Xu was appointed as our Chief Financial Officer on December 20, 2010 and resigned from the position effective May 2, 2012 and Mr. Qiao was appointed as the Company's Chief Financial Officer on that date

(3) The dollar amount reflected in this column is equal to the aggregate grant date fair value of such options computed in accordance with FASB ASC Topic *718, Compensation-Stock Compensation*. See Note 10 to our consolidated financial statements included in our Annual Report for an explanation of all assumptions made by us in determining the values of our option awards.

Employment Agreements

Our employment agreements are intended to comply with the current Labor Contract Law of the People's Republic of China. Our employment agreements are typically valid for one year and are renewable if both the Company and the employee decide to renew the employment agreement afterwards. In determining whether to renew an employment agreement, our Company considers primarily individual performance of that executive and our corporate performance including our sales, revenue, growth and the current overall economic situation.

On October 4, 2011, our Chairman, Mr. Kang, entered into a one year employment agreement with the Company, which has been extended for an additional one year period. Under the terms of the agreement, Mr. Kang was entitled to a base salary of RMB 650,000 after-tax annually and receiving 12 pays each year, equal to a monthly salary of RMB 50,000, plus RMB 50,000 when Executive works for the entire 12 months.

On May 2, 2012, our Chief Financial Officer, Mr. Qiao, entered into a one year employment agreement with the Company. Under the terms of the agreement, Mr. Qiao's annual base salary would be RMB 200,000.

Grants of Plan-Based Awards

We did not grant any plan-based awards to our executive officers during the year ended December 31, 2012.

Outstanding Equity Awards at Fiscal Year End

The following table discloses certain information regarding all outstanding option awards for each of our named executive officers as of December 31, 2012 We have not granted any equity awards to any named executive officer other than the option awards set forth in the table below.

Name and Principal Position	Grant Date	Number of Securities Underlying Unexercised Options (#)	Number of Securities Underlying Unexercised Options (#)	Option Exercise Price	Option Expiration Date

		Exercisable	Unexercisable (1)		
Qinan Ji					
	April 1, 2009	36,500	36,500	$4.90	April 1, 2015
Chairman and Chief Executive Officer					

(1) The options awarded to Mr. Ji vest evenly over four years beginning on April 1, 2010.
(2) Mr. Ji resigned as the CEO on October 4, 2011.

Option Exercises and Stock Vested

Our executives did not exercise any stock options or hold any stock awards that vested during the year ended December 31, 2012.

Severance and Change of Control Agreements

We do not have any agreements or arrangements providing for payments to an executive officer in connection with any termination of the officer's employment or change of control of our Company.

Non-Employee Director Compensation

The Compensation Committee of the Board of Directors, which is comprised of Messrs. Leighton, Waung and Wang, are responsible for evaluating compensation levels and compensation programs for our Board of Directors and for making recommendations to the Board of Directors regarding appropriate compensation awards for directors.

The compensation program for non-employee directors is designed to attract, retain and motivate experienced non-employee directors, to optimize long-term stockholder value and reward members of the Board based on the extent of their participation on the Board and its committees. Generally, the Compensation Committee makes an annual recommendation regarding the structure of the non-employee director compensation program, considering the factors described above as well as information regarding director compensation programs for other comparable companies.

During the year ended December 31, 2012, Messrs. Leighton, Waung and Yang were entitled to receive a director fee of $4,000 per month. Zhiqiang Wang received an annual director fee of $5,710. Each of our non-employee directors was reimbursed for reasonable expenses incurred in attending Board and committee meetings. Our Chairman, Mr. Ji is entitled to a base salary of $120,000, 80% of which is payable monthly and 20% of which will be payable upon completion of one year of service, and a bonus of $60,000 upon completion of one year of service.

The following table sets forth all compensation paid to our non-employee directors during the fiscal year ended December 31, 2012.

Name	Fees Earned or Paid in Cash ($)	Option Awards ($)	All Other Compensation	Total (S)
Qinan Ji	78,697 (1)	-	-	78,697
Zhiqiang Wang	5,710	-	-	5,710
Yang Xiang Dong	24,000	-	-	24,000
Frank Waung	44,000	-	-	44,000
Lawrence W. Leighton	40,000	-	-	40,000

(1) Mr. Ji voluntarily received 65% of his base salary, and did not receive the bonus of $60,000 due to the Company's failure to achieve the strategic goals.

Compensation Policies and Risk Management

We do not believe that risks arising from our compensation policies and practices for our employees are reasonably likely to have a material adverse effect on the Company.

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

The following table sets forth information regarding the beneficial ownership of our common stock on March 23, 2013, by (i) those persons known by management of the Company to beneficially own 5% or more of our common stock, (ii) each director and director-nominee, (iii) our named executive officers (pursuant to Regulation SK-402(a)(3)), and (iv) all of our named executive officers and directors of the Company as a group.

Name and Address of Beneficial Owner[1]	**Common Stock Amount and Nature of Beneficial Ownership[2]**	**Percent of Class**
Qinan Ji[3] Chairman	3,002,299	13.99%
Zhiqiang Wang Director	2,500	*
Yang Xiang Dong[4] Director	1,451,250	6.76 %
Frank Waung Director	—	*
Lawrence Leighton Director	1,250	*
Chaoyang Qiao	10,000	*
Directors, executive officers and named executive officers as a group	***4,467,299***	***20.82%***
Wellington Management Company, LLP[7] 75 State Street Boston, MA 02109	1,908,775	8.90 %
Xi'an Sunway Technology & Industry Co., Ltd.[3] Tang Xing Shu Ma Building, Suite 418 Tang Xing Road Xi'an, Shaanxi Province, People's Republic of China	1,437,683	6.70 %
Abax Lotus Ltd.[4] c/o Abax Global Capital (Hong Kong) Limited Suite 6708, 67/F Two International Finance Center 8 Finance Street, Central, Hong Kong	1,450,000	6.76 %

*Represents beneficial ownership of less than 1% of the outstanding shares of our common stock.

(1) Unless otherwise indicated, the address for each director, director-nominee and officer is c/o China Natural Gas, Inc., 19th Floor, Building B, Van Metropolis, 35 Tang Yan Road, Hi-Tech Zone, Xi'an, 710065, Shaanxi Province, People's Republic of China. Unless otherwise indicated, we believe that all persons named in the table have sole voting and investment power with respect to all shares of common stock beneficially owned by them. The information in this table is based on statements in filings with the SEC, or other reliable information available to the Company.

(2) Beneficial ownership of shares and percentage ownership are determined in accordance with the rules of the SEC. In calculating the number of shares beneficially owned by an individual or entity and the percentage ownership of that individual or entity, shares underlying options or warrants held by that individual or entity that are either currently exercisable or exercisable within 60 days from March 23, 2013 are deemed outstanding. For each individual and group, percentage ownership is calculated by dividing the number of shares beneficially owned by such person or group by the sum of the 21,458,654 shares of common stock outstanding on March 23, 2013 plus the number of shares of common stock that such person or group had the right to acquire on or within 60 days after March 23, 2013. The Company is not aware of any pledge of common stock that could result in a change of control of the Company.

(3) Mr. Ji beneficially owns 3,002,299 shares of common stock as follows: (i) Mr. Ji is the direct owner of record of 1,564,616 shares of common stock and options to purchase up to 36,500 shares of which are currently exercisable and has sole voting and investment power over such shares, and (ii) Mr. Ji shares voting and investment power over 1,437,683 shares of common stock that are directly owned of record by Xi'an Sunway Technology & Industry Co., Ltd. ("***Xi'an Sunway***"), a company formed under the laws of the People's Republic of China, due to Mr. Ji's ownership of 42.1% of the outstanding equity of Xi'an Sunway. Mr. Ji disclaims any beneficial ownership in the 1,078,262 shares of common stock that are directly owned of record by Xi'an Sunway Technology & Industry Co., Ltd., except to the extent of his pecuniary interest therein.

(4) Mr. Yang beneficially owns 1,451,250 shares of common stock as follows: (i) Mr. Yang is the direct owner of record of options to purchase 1,250 shares of common stock that are currently exercisable and has sole voting and investment power over such options, and (ii) Mr. Yang shares voting and investment power over warrants to purchase 1,450,000 shares of common stock, which are directly owned of record by Abax Lotus Ltd., a Cayman Islands company ("***Abax***") and are currently exercisable (the "***Abax Warrants***"). Based solely on the information set forth in the Schedule 13D filed with the SEC on February 6, 2008, Mr. Yang shares voting and investment power over the Abax Warrants with Abax, Abax Global Opportunities Fund, a Cayman Islands company (the "***Fund***"), Abax Arhat Fund, a Cayman Islands company ("***Arhat***") and 50% owner of the Fund, Abax Upland Fund LLC, a Delaware limited liability company ("***Upland***") and 50% owner of the Fund, Abax Global Capital, a Cayman Islands company and the sole shareholder of Arhat ("***Arhat Shareholder***"), Abax Claremont Ltd., a Cayman Islands company and the managing member of Upland ("***Upland Managing Member***") and Christopher Chung-Yi Hsu, who, along with Mr. Yang, are the controlling members of Arhat Sharehoder and Upland Managing Member.

(7) Based solely on information set forth in the Schedule 13G filed with the SEC on February 14, 2013, Wellington Management Company, LLP, in its capacity as investment adviser, may be deemed to share voting and investment power over these shares.

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

Although we have not adopted formal procedures for the review, approval or ratification of transactions with related persons, we adhere to a general policy that such transactions should only be entered into if they are on terms that, on the whole, are no more favorable, or no less favorable, than those available from unaffiliated third parties and their approval is in accordance with applicable law. Such transactions require the review and approval of the Audit Committee under its charter. The related party transactions discussed below were approved by the full Board and not separately approved by the Audit Committee because the transactions arose in connection with agreements approved by the Board prior to the adoption of the Audit Committee's charter.

We have entered into the following transactions with Abax Lotus Ltd. ("***Abax***"). Yang Xiang Dong, who became a director on our Board on August 7, 2008 pursuant to the investor rights agreement discussed below, and who has been nominated for election at the Annual Meeting, is a controlling shareholder, executive officer and director of Abax.

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

In connection with the Purchase Agreement, on January 29, 2008, we entered into:

§ an indenture with DB Trustees (Hong Kong) Limited, as trustee (the "***Trustee***"), pursuant to which the Senior Notes were issued (the "***Indenture***");

§ a warrant agreement with Deutsche Bank AG, Hong Kong Branch, as warrant agent, pursuant to which the Abax Warrants were issued;

§ an investors rights agreement with Abax, pursuant to which, among other things, Abax had the right to nominate a director for election to the Board so long as Abax held at least 10% of the outstanding shares of common stock on an as-converted, fully diluted basis. Abax no longer holds such amount of our common stock and therefore no longer has a director nomination right.

§ a registration rights agreement with Abax, pursuant to which we agreed to filed a registration statement to register the resale of the shares of common stock issuable upon exercise of the Abax Warrants. We filed a registration statement on Form S-1 (File No. 149719), which was declared effective by the SEC on May 6, 2008, to register the resale of the shares of common stock issuable upon exercise of the Abax Warrants.

§ an information rights agreement with Abax, pursuant to which Abax has the right to receive certain information regarding the Company.

§ an onshore share pledge agreement with DB Trustees (Hong Kong) Limited, as pledgee, pursuant to which we granted to DB Trustees (Hong Kong) Limited, on behalf of the holders of the Senior Notes, a pledge on 65% of our equity interests in Shaanxi Xilan Natural Gas Co., Ltd., a wholly foreign owned enterprise organized and existing under the laws of the People's Republic of China and a wholly-owned subsidiary of the Company; and

§ an account pledge and security agreement with DB Trustees (Hong Kong) Limited, as collateral agent, pursuant to which we granted to DB Trustees (Hong Kong) Limited a security interest in the account where the proceeds from our sale of the Senior Notes were deposited.

The Senior Notes will mature on January 30, 2014 and have borne interest at a rate of 5.0% per annum since issuance. On the dates set forth in the table below, we will be required make prepayments of the corresponding percentage of principal amount (or such lesser principal amount as shall then be outstanding) in respect of the aggregate outstanding principal amount of the Senior Notes:

Date	**Prepayment Amount Percentage of Principal Amount**
July 30, 2011 (paid on August 5, 2011)	8.3333%
January 30, 2012 (paid on March 7, 2012)	8.3333%
July 30, 2012	16.6667%
January 30, 2013	16.6667%
July 30, 2013	25.0000%

The second repayment for 8.3333% of the principal of the Senior Notes was due on January 30, 2012. After negotiation with Abax, the note-holders agreed that the Company could make the payment on or before March 9, 2012. On March 7, 2012, the Company paid the principal due on January 30, 2012 in full plus accrued interest for the period from July 30, 2011 to January 29, 2012, as well as a penalty interest of $28,416 for the period from February 6, 2012 to March 7, 2012. Abax issued a waiver to exempt the Company from any other consequences of the late payment.

The repayment of 16.6666% of the principal of the notes payable plus accrued interest of the period from January 29, 2012 to July 30, 2012 was due on July 30, 2012. And the repayment of 16.6666% of the principal of the notes payable plus accrued interest of the period from July 31, 2012 to January 30, 2013 was due on January 30, 2013. The company did not make these payments at the time they were due and the payments remain unpaid.

On September 11, 2012, the holders of a majority of the Senior Notes (the “Holders”) notified the Company on August 21, 2012 (the “Default Notice”) that the Company was in default of the Senior Notes for failure to make the interest payment due and a mandatory redemption of the Senior Notes on July 30, 2012 (the “Default”). In the notice, the Holders also demanded that the Company make all payments due as of July 30, 2012 under the Senior Notes to avoid acceleration of all payments under the Senior Notes and foreclosure of collaterals pledged to secure the Senior Notes.

On September 5, 2012, the Company received another notice from the Holders that the Holders elected to exercise their right to accelerated payment of the Senior Notes as a result of the continued Default (the “Acceleration Notice”). The immediate acceleration of all amounts owing under the Senior Notes totals approximately RMB249,450,516.

Further, on September 10, 2012, the Company received a demand notice from the Holders’ legal counsel on behalf of the Holder for the payment of all amounts owing under the Senior Notes (the “Demand Notice”) within 15 days from the date of the Demand Notice. The Demand Notice stated that if the Company failed to meet the demand, the Holders intend to pursue all of its legal rights under the transaction documents, including, without limitation:

requiring the Trustee to initiate suit in the courts of New York with respect to the Company’s failure to pay the entire amount due to the Holders under the Senior Notes;

Initiating involuntary bankruptcy proceedings with respect to the Company under the U.S. Federal Bankruptcy Code;

Initiating arbitration in Hong Kong against the Company for breaches of the Company’s obligations under the SPA;

exercising its rights under the Warrant Agreement to require the redemption of all Warrants held by it at the Redemption Price (as defined therein); and

all other rights under the transaction documents relating to the Senior Notes in relation to the Default, which may include, foreclosing on the security interest in 65% of all outstanding equity interest of the Company's wholly owned subsidiary, Shaanxi Xilan Natural Gas Equipment Co., Ltd., and all funds in the account where the proceeds from the Senior Notes were deposited.

In addition to the demands disclosed above, the Holders have also asserted that by virtue of the Default the Company is obliged to redeem the Warrants and pay to the Holders $17.5 million.

The Company disputes the amount allegedly owed, and has been in negotiation with the Holders but has not able to come to a resolution with the Holders.

On February 8, 2013, an Involuntary Petition for bankruptcy, entitled In re China Natural Gas, Inc. (Case No. 13-10419), was filed against China Natural Gas, Inc. (the "Company") by three creditors of the Company, namely Abax Lotus Ltd., Abax Nai Xin A Ltd., and Lake Street Fund LP (the "Petitioners"). The petition was filed in the United States Bankruptcy Court, Southern District of New York. The Petitioners have claimed in the Involuntary Petition that they have debts totaling $42,218,956.88 as a result of the Company's failure to make payments on the 5% Guaranteed Senior Notes issued in 2008. The Company intends to oppose the petition.

The Abax Warrants are presently exercisable and have an exercise price of $7.3652 per share, although Abax has not exercised any of the Abax Warrants. If Abax does not exercise the Abax Warrants prior to their expiration date, January 29, 2015, Abax can require us to repurchase the Abax Warrants for $17,500,000.

Additional details of the above transactions as well as the terms of the Senior Notes and the Abax Warrants are set forth in our Current Report on Form 8-K, filed with the SEC on January 1, 2008 and Note 6 to the consolidated financial statements contained in this Annual Report on Form 10-K, which are incorporated herein by reference.

As of December 31, 2012, the aggregate amount in principal of Senior Notes outstanding was $38,352,498, which reflects the largest amount in principal outstanding during the fiscal year ended December 31, 2012.

Other than as discussed above, there have been no transactions since the beginning of our fiscal year ended December 31, 2012, and there are no current proposed transactions, in which we were or will be a participant and the amount involved exceeds $120,000, and in which any related person had or will have a direct or indirect material interest.

Director Independence

The Board of Directors has determined that, other than Qinan Ji, our Chairman, and Yang Xiang Dong, each of the current members of the Board is “independent” in accordance with the applicable SEC rules and listing standards of the NASDAQ Stock Market as currently in effect.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Background

WWC, P.C. audited our consolidated financial statements for the fiscal year ended December 31, 2012. WWC is a registered public accounting firm with the Public Company Accounting Oversight Board (“PCAOB”), as required by the Sarbanes-Oxley Act of 2002 and the rules of the PCAOB. The Audit Committee, in its discretion, may direct the appointment of different independent auditors to audit our consolidated financial statements for the fiscal year ending December 31, 2013 at any time during the year if the Audit Committee determines that such a change would be in the Company’s and its stockholders’ best interests.

The audit report of WWC on the consolidated financial statements of the Company as of and for the year ended December 31, 2012, as restated, did not contain an adverse opinion or a disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope or accounting principles.

During the fiscal years ended December 31, 2012, there were: (i) no disagreements between the Company and WWC on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of WWC, would have caused WWC to make reference to the subject matter of the disagreement in their reports on the Company's financial statements for such year, and (ii) no reportable events within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K.

Prior to becoming the Company's independent accounting firm on June 7, 2012, the Company did not consult with WWC on (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that may be rendered on the Company's financial statements, and WWC did not provide either in a written report or oral advice to the Company that was an important factor considered by the Company in reaching a decision as to any accounting, auditing, or financial reporting issue; or (ii) the subject of any disagreement, as defined in Item 304 (a)(1)(v) of Regulation S-K and the related instructions, or a reportable event within the meaning set forth in Item 304 (a)(1)(V) of Regulation S-K.

Independent Auditors' Fees and Services

The following is a summary of the fees billed to us by our independent auditors for the fiscal years ended December 31, 2012 and 2011:

Fee Category	2012	2011
Audit Fees (1)	$100,000	$320,000
Audit Related Fees	-	-
Tax Fees (2)	$5,000	$10,000
All Other Fees	-	-
Total Fees	$105,000	$330,000

(1) Audit fees consist of fees billed for professional services rendered for the audit of our consolidated annual financial statements, internal control over financial reporting and the review of the interim consolidated financial statements included in quarterly reports and services that are normally provided by our independent auditors in connection with statutory and regulatory filings or engagements, and attest services. Audit fees for 2012 were paid to WWC. Audit fees for 2011 were paid to Friedman, LLP.

(2) Tax fees include the fees billed for professional services rendered in connection with the preparation of the Company's corporate and state tax returns. Tax fees for 2012 were paid to WWC. Tax fees for 2011 were paid to Friedman, LLP.

Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm

The Audit Committee has policies and procedures regarding the pre-approval of the performance by WWC of audit and non-audit services. WWC may not perform any service unless the approval of the Audit Committee is obtained prior to the performance of the services, except as may otherwise be provided by law or regulation. All services described above were approved by the Audit Committee.

PART V

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Exhibits:

Number	Description of Exhibit
1.1	Underwriting Agreement, dated September 2, 2009 (incorporated by reference to same Exhibit 1.1 filed with the Registrant's Form 8-K filed on September 3, 2009).
2.1	Form of Equity Ownership Transfer Agreement (incorporated by reference to same exhibit filed with the Registrant's Form 8-K filed on December 31, 2008).
3.1	Articles of Incorporation, dated March 31, 1999 (incorporated by reference to same exhibit filed with the Company's Form 10SB Registration Statement filed September 15, 2000, SEC file no. 000-31539); Certificate of Amendment to the Articles of Incorporation, dated May 25, 2000 (incorporated by reference to same exhibit filed with the Registrant's Form 10SB Registration Statement filed September 15, 2000, SEC

	file no. 000-31539); Certificate of Amendment to the Articles of Incorporation, dated October 26, 2007 (incorporated by reference to Exhibit 4 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File No. 001-34373); Certificate of Amendment to the Articles of Incorporation, dated April 20, 2009 (incorporated herein by reference to Exhibit 5 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File no. 001-34373).
3.2	Registrant's Amended and Restated By-Laws, dated June 14, 2006 (incorporated by reference to Exhibit 3.1 filed with the Registrant's Form 8-K filed June 16, 2006, SEC file no. 000-31539); Amended and Restated By-Laws, dated September 24, 2008 (incorporated by reference to Exhibit 7 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File No. 001-34373).
3.3	Certificate of Ownership and Merger, dated February 14, 2002 (incorporated by reference to Exhibit 2 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File No. 001-34373).

3.4	Certificate of Ownership, dated December 12, 2005 (incorporated by reference to Exhibit 3 to the Registrant's Registration Statement on Form 8-A12B filed June 3, 2009, SEC File No. 001-34373).
4.1	Registrant’s 2009 Employee Stock Option and Stock Award Plan (incorporated by reference to Exhibit 4.1 to the Registrant’s Registration Statement on Form S-8 (333-166422) filed April 30, 2010); Registrant’s 2009 Employee Stock Option and Stock Award Plan – Award Agreement (incorporated by reference to Exhibit 10.2 to the Registrant’s Form 10-Q filed July 20, 2009).
10.1	Share Purchase Agreement made as of December 6, 2005 among Coventure International Inc., Xi’an Xilan Natural Gas Co., Ltd. and each of Xilan's shareholders (incorporated by reference to the exhibits to Registrant’s Form 8-K filed on December 9, 2005).
10.2	Return to Treasury Agreement between Coventure International Inc. and John Hromyk, dated December 6, 2005 (incorporated by reference to the exhibits to Registrant’s Form 8-K filed on December 9, 2005).
10.3	Purchase Agreement made as of December 20, 2005 between China Natural Gas, Inc. and John Hromyk (incorporated by reference to the exhibit to Registrant’s Form 8-K filed on December 23, 2005).
10.4	Form of Securities Purchase Agreement (incorporated by reference to the exhibits to Registrant’s Form 8-K filed on January 12, 2006).
10.5	Form of Warrant (incorporated by reference to the exhibits to Registrant’s Form 8-K filed on January 12, 2006).
10.6	Form of Registration Rights Agreement (incorporated by reference to the exhibits to Registrant’s Form 8-K filed on January 12, 2006).
10.7	CNG Product Purchase and Sale Agreement between Xi’an Xilan Natural Gas Co., Ltd. and Zhengzhou Zhongyou Hengran Petroleum Gas Co., Ltd. made as of July 20, 2006, (translated from the original Mandarin) (incorporated by reference to the exhibits to Registrant’s Form 10-KSB filed on April 17, 2007).
10.8	Securities Purchase Agreement, dated August 2, 2007, between the Company and the Investors named therein (incorporated by reference to the exhibits to Registrant’s Form 8-K filed on August 8, 2007).
10.9	Registration Rights Agreement, dated August 2, 2007, between the Company and the Investors named therein (incorporated by reference to the exhibits to Registrant’s Form 8-K filed on August 8, 2007).
10.10	Consulting Services Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi’an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant’s Form 10-QSB filed on August 20, 2007).
10.11	Operating Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi’an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant’s Form 10-QSB filed on August 20, 2007).
10.12	Equity Pledge Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi’an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant’s Form 10-QSB filed on August 20, 2007).

10.13	Option Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi'an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant's Form 10-QSB filed on August 20, 2007).
10.14	Proxy Agreement, dated August 17, 2007, between Shaanxi Xilan Natural Gas Equipment Co., Ltd. and Xi'an Xilan Natural Gas Co., Ltd. (incorporated by reference to the exhibits to Registrant's Form 10-QSB filed on August 20, 2007).

10.15	Securities Purchase Agreement, dated December 30, 2007, between the Company and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.16	Amendment to Securities Purchase Agreement, dated January 29, 2008, between the Company and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.17	Indenture, dated January 29, 2008, by and among the Company and DB Trustees (Hong Kong) Limited, as trustee, relating to the 5.00% Guaranteed Senior Notes due 2014 (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.18	Warrant Agreement, dated January 29, 2008, by and among the Company, Mr. Qinan Ji, Deutsche Bank AG, Hong Kong Branch as Warrant Agent and Deutsche Bank Luxembourg S.A. as Warrant Agent (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.19	Equity Registration Rights Agreement, dated January 29, 2008, by and between the Company and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.20	Investor Rights Agreement, dated January 29, 2008, by and among the Company, its subsidiaries, Mr. Qinan Ji, and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.21	Information Rights Agreement, dated January 29, 2008, between the Company and Abax Lotus Ltd. (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.22	Onshore Share Pledge Agreement, dated January 29, 2008, between the Company and DB Trustees (Hong Kong) Limited, as security agent (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.23	Account Pledge and Security Agreement, dated January 29, 2008, by and between the Company and DB Trustees (Hong Kong) Limited as Security Agent (incorporated by reference to the exhibits to Registrant's Form 8-K filed on January 31, 2008).
10.24	Natural Gas Purchase Agreement entered by and between Xi' An Xilan Natural Gas Co., Ltd. and China Petroleum Co., Ltd., Changqing Branch, dated July 30, 2006 (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.25	Natural Gas Purchase Agreement entered by and between Jiyuan Yuhai Natural Gas Co., Ltd. and Xi' An Xilan Natural Gas Co., Ltd. dated, February 28, 2008 (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.26	Natural Gas Supply Agreement between Jincheng Ming Shi Natural Gas Co., Ltd., Jinan Branch and Xi' An Xilan Natural Gas Co., Ltd. dated March 20, 2008 (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.27	Natural Gas Purchase Agreement entered by and between Shaanxi Natural Gas Co., Ltd. and Xi' An Xilan Natural Gas Co., Ltd., dated July 17, 2008 (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).

10.28	Independent Director Agreement dated January 1, 2008, by and between China Natural Gas., Inc. and Zhiqiang Wang (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).

10.29	Independent Director Agreement dated July 1, 2008, by and between China Natural Gas., Inc. and Carl Yeung (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.30	Independent Director Agreement dated August 5, 2008, by and between China Natural Gas., Inc. and Lawrence W. Leighton (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.31	Employment Agreement, dated October 10, 2008, by and between China Natural Gas., Inc. and Richard Peidong Wu (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009).
10.32	Employment Agreement, dated May 10, 2005, by and between China Natural Gas., Inc. and Qinan Ji (incorporated herein by reference to the exhibits to the Registrant's Form 10-K/A filed on July 20, 2009); Employment Agreement, dated January 1, 2009, by and between China Natural Gas., Inc. and Qinan Ji (incorporated herein by reference to the Exhibit 10.4 to the Registrant's Form 10-Q/A filed on July 20, 2009); Employment Agreement dated January 1, 2010, by and between the Company and Qinan Ji (incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K filed on November 9, 2010).
10.33	Equity Ownership Transfer Agreement, dated October 2, 2008, by and between Xi'an Xilan Natural Gas Co., Ltd., Zhihe Zhang and Lingjun Hu (incorporated by reference to the Registrant's Form 8-K filed on December 31, 2008).
10.34	Joint Venture Agreement dated July 22, 2009 by and between Xi'an Xilan Natural Gas Co., Ltd. and China National Petroleum Corporation Kunlun Natural Gas Co., Ltd. (incorporated by reference to the Registrant's Form 8-K filed on July 28, 2009).
10.35	Strategic Cooperation Framework Agreement dated as of July 6, 2009 by and between Xi'an Xilan Natural Gas Co., Ltd. and China National Petroleum Corporation Kunlun Natural Gas Co., Ltd. (incorporated by reference to the Registrant's Form 8-K filed on July 8, 2009).
10.36	Employment Agreement dated December 20, 2010 between the Company and Shaocheng Xu (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on December 23, 2010).
10.37	Independent Director Agreement dated November 25, 2010 between the Company and Frank Waung (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on November 26, 2010).
10.38	Waiver dated February 4, 2009, executed by DB Trustees (Hong Kong) Limited, as trustee under the Indenture governing the Company's 5.0% Guaranteed Senior Notes due 2014 (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on November 9, 2010).
10.39	Waiver dated August 14, 2009, by and among the Company and the holders of the Company's 5.0% Guaranteed Senior Notes due 2014 signatory thereto (incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed on November 9, 2010).
10.40	Loan Contract of Fixed Asset dated February 26, 2010, by the between Jingbian Xi'an Xilan Liquefied Natural Gas Co. Ltd. and Xi'an Branch Shanghai Pudong Development Bank (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on August 13, 2010).

10.41	Mortgage Contract of Movables dated February 26, 2010, by and between Xi'an Xilan Natural Gas Co. Ltd. and Xi'an Branch Shanghai Pudong Development Bank (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q filed on August 13, 2010).

10.42	Contract of Guarantee dated February 26, 2010, by and between Xi'an Xilan Natural Gas Co. Ltd. and Xi'an Branch Shanghai Pudong Development Bank (incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q filed on August 13, 2010).
10.43	Employment Agreement of Veronica Chen dated May 1, 2009 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed on July 20, 2009).
10.44	Supply Agreement between CNP Changqing Oil Field Branch Company dated November 25, 2010 and Jingbian LNG Company (incorporated by reference to Exhibit 99.1 to the Registrant's Form 8-K filed on December 1, 2010).
10.45	Coal Bed Methane Purchase Agreement entered by and between Henan Xilan Natural Gas Co., Ltd. and Qinshui Lanyan Coal Bed Methane Co., Ltd. dated January 12, 2009 (Incorporated by reference to the Company's Form 10-K filed March 14, 2011)
10.46	Natural Gas Supply Agreement between Huojia Hualong Petrochemical Co., Ltd., and Xi' An Xilan Natural Gas Co., Ltd. dated November 16, 2009 (Incorporated by reference to the Company's Form 10-K filed March 14, 2011)
10.47	Employment Agreement dated as of May 2, 2012 between the Company and Zhaoyang Qiao (Incorporated by reference to the Company's Form 8-K filed May 8, 2012)
10.48*	Employment Agreement dated as of September 30, 2011 between the Company and Shuwen Kang.
14.1	Code of Ethics adopted by the Company on June 14, 2006 (incorporated by reference to the exhibits to Registrant's Form 8-K filed on June 16, 2006).
21.1	List of Subsidiaries (incorporated by reference to the exhibits to Registrant's Form 10-K/A filed on December 28, 2011)
31.1*	Certification of Principal Executive Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended.
31.2*	Certification of Principal Financial Officer pursuant to Rule 13a-14 and Rule 15d 14(a), promulgated under the Securities and Exchange Act of 1934, as amended.
32.1*	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer).
32.2*	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer).
101*	Interactive Data File

* Filed herewith.

SIGNATURES

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

Date: April 1, 2013

CHINA NATURAL GAS, INC.

/s/ Shuwen Kang
Name: Shuwen Kang
Title: Chief Executive Officer
(Principal Executive Officer)

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

/s/ Shuwen Kang Shuwen Kang	President and Chief Executive Officer (Principal Executive Officer)	April 1, 2013
/s/ Qinan Ji Qinan Ji	Chairman of the Board of Directors	April 1, 2013
/s/ Zhiqiang Wang Zhiqiang Wang	Director	April 1, 2013
Yang Xiang Dong	Director	

/s/ Zhaoyang Qiao Zhaoyang Qiao	Chief Financial Officer (Principal Financial and Accounting Officer)	April 1, 2013
/s/ Frank Waung Frank Waung	Director	April 1, 2013
/s/ Lawrence Leighton Lawrence Leighton	Director	April 1, 2013

CHINA NATURAL GAS, INC.

AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of China Natural Gas, Inc.

We have audited the accompanying balance sheets of China Natural Gas, Inc. as of December 31, 2012, and the related statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the two year period ended December 31, 2012 and 2011. China Natural Gas, Inc.'s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of China Natural Gas, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has defaulted on a senior note payable where the creditors have filed for involuntary bankruptcy and has a working capital deficit, all of which raise substantial doubt about its ability to continue as a going concern. Management's plans in regards to these matters are also described in Note 2. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

San Mateo, California WWC, Professional Corporation

March 15, 2013 Certified Public Accountants

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

China Natural Gas, Inc.

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

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

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

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

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company’s annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management’s assessment as of December31, 2011:

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

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

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

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

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

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

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

In our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, China Natural Gas, Inc. has not maintained effective internal control over financial reporting as of December31, 2011, based on the criteria established in *Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).* Also in our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Natural Gas, Inc. as of December 31, 2011, and the results of its operations and its cash flows for each of the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Friedman LLP

New York, New York

April 2, 2012

CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2012 and 2011
(Stated in US Dollars)

	As of December 31,	
	2012	2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$10,857,456	$9,622,883
Accounts receivable, net	2,148,379	2,997,845
Other receivables, net	458,605	540,646
Employee advances	399,031	285,270
Inventories	2,473,933	1,938,754
Advances to suppliers	4,869,606	4,540,139
Prepaid expense and other current assets	3,541,431	4,470,687
Total current assets	24,748,441	24,396,224
Investment in unconsolidated joint ventures	1,587,000	1,574,000
Property and equipment, net	179,515,563	174,097,754
Construction in progress	53,393,933	45,882,320
Deferred financing cost, net	-	517,334
Goodwill	839,806	629,729
Other intangible assets	21,400,924	18,910,244
Prepaid expenses and other assets	7,015,142	10,976,203
TOTAL ASSETS	$288,500,809	$276,983,808
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Senior notes- current maturities	$38,352,498	$9,671,682
Current portion of bank loan payable	4,761,000	4,722,000
Redeemable liabilities - warrants	17,500,000	-
Accounts payable and accrued liabilities	6,756,278	7,694,423
Other payable - related party	1,616,429	787,000
Short-term borrowing - related party	2,679,945	1,359,945
Unearned revenue	3,663,570	4,280,594
Accrued interest	1,936,584	1,029,431
Taxes payable	2,232,546	2,626,271
Total current liabilities	79,498,850	32,171,346
LONG-TERM LIABILITIES:		
Senior notes, net of current portion	-	25,791,151
Bank loan payable, net of current portion	4,761,000	9,444,000
Borrowings - related party	-	1,320,000

Warrants liability	-	17,500,000
Total long-term liabilities	4,761,000	54,055,151
Total liabilities	$84,259,850	$86,226,497
STOCKHOLDERS' EQUITY:		
Preferred stock, par value $0.0001 per share, 5,000,000 authorized, none issued and outstanding	$-	$-
Common stock, par value $0.0001 per share, 45,000,000 authorized, 21,458,654 issued and outstanding at December 31, 2012 and 2011	2,145	2,145
Additional paid-in capital	83,501,637	82,909,485
Accumulated other comprehensive income	21,276,931	19,817,493
Statutory reserves	11,818,087	10,124,710
Retained earnings	87,410,615	77,903,478
Noncontrolling interests	231,544	-
Total stockholders' equity	204,240,959	190,757,311
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$288,500,809	$276,983,808

S**ee Accompanying Notes to the Financial Statements and Accountant’s Report.**

CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011
(Stated in US Dollars)

	Years Ended December 31,	
	2012	2011
Revenue		
Natural gas	$132,255,499	$106,178,398
Gasoline	2,782,062	5,998,022
Installation and other	10,243,727	12,045,106
	145,281,288	124,221,526
Cost of revenue		
Natural gas	88,790,622	65,062,505
Gasoline	2,626,569	5,756,960
Installation and other	4,327,203	5,183,985
	95,744,394	76,003,450
Gross profit	49,536,894	48,218,076
Operating expenses		
Selling	22,266,885	17,377,703
General and administrative	7,456,049	9,984,565
	29,722,934	27,362,268
Income from operations	19,813,960	20,855,808
Non-operating income (expense):		
Interest income	68,472	42,290
Interest expense	(1,248,842)	(771,916)
Loss on disposal of fixed assets	(4,020,260)	-
Other income (expense), net	144,464	126,100
Change in fair value of warrants	4	252,062
Foreign currency exchange loss	(499,575)	(430,723)
	(5,555,737)	(782,187)
Income before income tax	14,258,223	20,073,621
Provision for income tax	3,220,954	4,811,689
Net income	11,037,269	15,261,932
Less: (Income)/loss attributable to noncontrolling interests	(163,245)	-
Net income attributable to China Natural Gas, Inc.	11,200,514	15,261,932

Other comprehensive income		
Foreign currency translation gain	1,459,438	4,150,348
Comprehensive income	$12,659,952	$19,412,280
Weighted average shares outstanding		
Basic	21,458,654	21,418,389
Diluted	21,458,654	21,418,389
Earnings per share		
Basic	$0.52	$0.71
Diluted	$0.52	$0.71

See Accompanying Notes to the Financial Statements and Accountant's Report.

CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011
(Stated in US Dollars)

	Common Stock		Additional	Accumulative Other		Retained Earnings		Total
	Shares	Amount	Paid-in Capital	Comprehensive Income	Non-controlling Interest	Statutory Reserve	Unrestricted	Stockholders' Equity
Balance at 1/1/2011	21,321,904	$2,132	$81,611,763	$15,667,145	$-	$7,918,634	$64,847,622	$170,047,296
Exercise of stock options	136,750	13	670,062	-	-	-	-	670,075
Stock based compensation	-	-	627,660	-	-	-	-	627,660
Cumulative translation adjustment	-	-	-	4,150,348	-	-	-	4,150,348
Net income	-	-	-	-	-	-	15,261,932	15,261,932
Appropriation of retain earnings	-	-	-	-	-	2,206,076	(2,206,076)	-
Balance at 12/31/2011	21,458,654	$2,145	$82,909,485	$19,817,493	$-	$10,124,710	$77,903,478	$190,757,311
Balance at 1/1/2012	21,458,654	$2,145	$82,909,485	$19,817,493	$-	$10,124,710	$77,903,478	$190,757,311
Stock based compensation	-	-	592,152	-	-	-	-	592,152
Purchases of a Noncontrolling interest equity	-	-	-	-	394,789	-	-	394,789
Cumulative translation adjustment	-	-	-	1,459,438	-	-	-	1,459,438
Net income	-	-	-	-	(163,245)	-	11,200,514	11,037,269
Appropriation of retain earnings	-	-	-	-	-	1,693,377	(1,693,377)	-
Balance at 12/31/2012	21,458,654	$2,145	$83,501,637	$21,276,931	$231,544	$11,818,087	$87,410,615	$204,240,959

See Accompanying Notes to the Financial Statements and Accountant's Report.

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CHINA NATURAL GAS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
AS OF DECEMBER 31, 2012 and 2011
(Stated in US Dollars)

	For the Years ended December 31,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	11,037,269	15,261,932
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,025,863	9,600,518
Provision for (recovery of) doubtful accounts	197,942	110,166
Loss (Gain) on disposal of equipment	4,020,260	(3,385)
Stock-based compensation	592,152	627,660
Change in fair value of warrants	(4)	(252,062)
Change in assets and liabilities:		
Accounts receivable	992,933	(1,201,079)
Other receivables	(194,338)	(339,941)
Employee advances	(111,449)	27,679
Inventories	(146,105)	(860,723)
Advances to suppliers	(846,886)	(2,729,776)
Prepaid expense and other current assets	1,407,530	(133,968)
Accounts payable and accrued liabilities	(1,136,395)	2,064,383
Unearned revenue	(651,968)	1,787,063
Accrued interest	907,153	382,903
Taxes payable	(415,154)	137,886
Net cash provided by operating activities	29,678,803	24,479,256
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payment for acquisition of property and equipment	(4,780,369)	(7,314,640)
Proceeds from sales of property and equipment	2,852,712	16,990
Additions to construction in progress	(14,604,880)	(11,769,752)
Prepayment on long-term assets	(1,164,454)	(1,169,313)
Payment for acquisition of business	(656,593)	(976,500)
Payment for intangible assets	(1,813,996)	(189,843)
Net cash used in investing activities	(20,167,580)	(21,403,058)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	-	670,075
Proceeds from short-term borrowing and other payable, related parties	-	3,454,945
Repayment of long -term debt	(4,758,000)	(4,650,000)
Repayment of senior notes	(3,333,334)	(3,333,334)
Net cash (used in) provided by financing activities	(8,091,334)	(3,858,314)

Effect of exchange rate changes on cash and cash equivalents	(185,316)	358,750
NET INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	1,234,573	(423,366)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	9,622,883	10,046,249
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 10,857,456	$ 9,622,883
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid, net of capitalized interest	$ 941,966	$ 742,224
Income taxes paid	$ 3,422,353	$ 4,683,774
Non-cash transactions for investing and financing activities:		
Construction material transferred to construction in progress	$ 67,100	$ 7,396,787
Construction in progress transferred to property and equipment	$ 19,393,132	$ 94,607,146
Construction in progress transferred to intangible assets	$ -	$ 11,676,342
Advances to suppliers transferred to construction in progress	$ -	$ 7,652,350
Other assets transferred to construction in progress	2,754,075	3,070,647
Capitalized interest - amortization of discount of notes payable and issuance costs	$ 6,107,601	$ 4,203,896

See Accompanying Notes to the Financial Statements and Accountant's Report.

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Note 1 - Organization

Organization and Line of Business

China Natural Gas, Inc. (the "Company," "our," "us" or "we") was incorporated in the State of Delaware on March 31, 1999. The Company through its wholly owned subsidiaries and variable interest entity ("VIE"), Xi'an Xilan Natural Gas Co., Ltd. ("XXNGC") and subsidiaries of its VIE, which are located in Hong Kong, Shaanxi Province, Henan Province and Hubei Province in the People's Republic of China ("PRC"), engages in sales and distribution of natural gas and gasoline to commercial, industrial and residential customers through fueling stations and pipelines, construction of pipeline networks, installation of natural gas fittings and parts for end-users, and conversions of gasoline-fueled vehicles to hybrid (natural gas/gasoline) powered vehicles at 0ptmobile conversion sites. The consolidated balance sheets as of December 31, 2012 and 2011 and the consolidated statements of income and comprehensive income for the years ended December 31, 2012 and 2011, and cash flows for the years ended December 31, 2012 and 2011 include the accounts of China Natural Gas, Inc. and subsidiaries and VIE. Our subsidiaries are: Xilan Energy Co. Ltd. ("XEC"), Shaanxi Xilan Natural Gas Equipment Co. Ltd ("SXNGE"), Hubei Xian Natural Gas Co., Ltd ("HBXNG"), Lingbao Yuxi Natural Gas Co. Ltd. ("LYNG"), Shaanxi Jingbian Liquefied Natural Gas Co. Ltd ("JBLNG"), Henan Xilan Natural Gas Co. Ltd ("HXNGC"), Xi'an Xilan 0pt Body Shop Co, Ltd. ("XXABC"), Henan CNPC Kunlun Xilan Compressed Natural Gas Co., Ltd ("JV"), Hanchuan Makou Yuntong Compressed Natural Gas Co., Ltd ("Makou") and Xiantao City Jinhua Gas And Oil Co., Ltd. ("XTJH").

Note 2 – Going Concern Uncertainties

These financial statements have been prepared assuming that Company will continue as a going concern, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future.

As of December 31, 2012, the Company had working capital deficit of current liabilities exceeding current assets by $54,750,409 due to the default of its senior notes payable. Management has taken certain action and continues to implement changes designed to improve the Company's financial results and operating cash flows. The actions involve certain cost-saving initiatives and growing strategies, including (a) reductions in headcount and corporate overhead expenses; and (b) obtainment of new short-term bank loans to finance our working capital, and long-term

loans to fund our capital expenditure projects. Management believes that these actions will enable the Company to improve future profitability and cash flow in its continuing operations through December 31, 2013. As a result, the financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of the Company's ability to continue as a going concern.

Note 3 – Summary of Significant Accounting Policies

Basis of Presentation

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

The consolidated financial statements include all adjustments necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company for the periods presented.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting estimates reflected in the Company’s consolidated financial statements include revenue recognition, allowance for doubtful accounts, inventory obsolescence, construction in progress, warrants liability and useful lives of property and equipment. Actual results could differ from those estimates.

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Principles of Consolidation

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

Consolidation of Variable Interest Entity

VIEs are entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders lack adequate decision-making ability. Any VIE with which the Company is involved must be evaluated to determine the primary beneficiary of the risks and rewards of the VIE. Management makes ongoing reassessments of whether the Company is the primary beneficiary of XXNGC.

On February 21, 2006, the Company formed SXNGE as a wholly foreign owned enterprise ("WFOE") under the laws of the PRC. Through SXNGE, the Company entered into exclusive arrangements with XXNGC and its shareholders that give the Company the ability to substantially influence XXNGC's daily operations and financial affairs and appoint its senior executives. The Company is considered the primary beneficiary of XXNGC and it consolidates its accounts as a VIE. The Company's arrangements with XXNGC consist of the following agreements:

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

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

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

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

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

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

Foreign Currency Translation

Our reporting currency is the U.S. dollar. The functional currency of XXNGC and the Company's and XXNGC's PRC subsidiaries is the Chinese Renminbi ("RMB"). The results of operations and financial position of XXNGC and the Company's and XXNGC's PRC subsidiaries are translated to U.S. dollars using the period end exchange rates as to assets and liabilities and weighted average exchange rates as to revenues, expenses and cash flows. Capital accounts are translated at their historical exchange rates when the capital transaction occurred. The resulting currency translation adjustments are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity.

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The balance sheet amounts, with the exception of equity, were translated at the December 31, 2012 exchange rate of RMB 6.30 to $1.00 as compared to RMB 6.35 to $1.00 at December 31, 2011. The equity accounts were stated at their historical rate. The average translation rates applied to income and cash flow statement amounts for the years ended December 31, 2012 and 2011 were RMB 6.31 and RMB 6.45 to $1.00, respectively.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and demand deposits in accounts maintained with state-owned banks within the PRC, and private sector banks in Hong Kong and the United States. The Company considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents.

The Company maintains balances at financial institutions which, from time to time, may exceed Hong Kong Deposit Protection Board (“HKDPB”) insured limits for the banks located in Hong Kong or may exceed Federal Deposit Insurance Corporation (“FDIC”) insured limits for the banks located in the United States. Balances at financial institutions or state-owned banks within the PRC are not covered by insurance. As of December 31, 2012 and 2011, the Company had total deposits of $10,481,343 and $9,236,515, respectively, without insurance coverage or in excess of HKDPB or FDIC insured limits. The Company has not experienced any losses to date as a result of this policy.

Accounts Receivable

Accounts receivable are presented net of an allowance for doubtful accounts. Management periodically reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of the allowance.

Management considers accounts past due after three months. Delinquent account balances are allowed for when management has determined that the likelihood of collection is not probable. Uncollectible receivables are written off against the allowance for doubtful accounts when identified. The Company recorded allowances for doubtful accounts in the amount of $9,340 and $127,619 as of December 31, 2012 and 2011, respectively.

Employee Advances

From time to time, the Company advances predetermined amounts based upon internal Company policy to certain employees and internal units. As of December 31, 2012 and 2011, the Company had employee advances in the amount of $399,031 and $285,270, respectively.

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Inventories

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

The following are the details of the inventories:

	December 31, 2012	December 31, 2011
Materials and supplies	$2,108,837	$1,529,678
Liquefied natural gas	113,203	298,016
Gasoline	251,893	111,060
	$2,473,933	$1,938,754

Investments in Unconsolidated Joint Ventures

Investee companies that are not required to be consolidated, but over which the Company exercises significant influence, are accounted for under the equity method of accounting. Whether or not the Company exercises significant influence with respect to an investee depends on an evaluation of several factors including, among others, representation on the investee company's board of directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the investee company. Under the equity method of accounting, the Company's share of the earnings or losses of the investee company is reflected in the caption "other income (expense), net" in the consolidated statements of income and comprehensive income.

The Company's investment in unconsolidated joint ventures that are accounted for on the equity method of accounting represents the Company's 49% interest in the JV. The investment in the JV amounted to $1,587,000 and $1,574,000 at December 31, 2012 and 2011, respectively. The JV has not had any operations to date.

The financial position of the JV is summarized below:

	December 31, 2012	December 31, 2011
Current assets	$3,238,776	$3,212,245
Noncurrent assets	-	-
Total assets	3,238,776	3,212,245
Current liabilities	-	-
Noncurrent liabilities	-	-
Equity	3,238,776	3,212,245
Total liabilities and equity	$3,238,776	$3,212,245

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Subsequent to the balance sheet date, February 19, 2013, the JV held a shareholder meeting, decided that we transferred our investment in JV to Shaanxi Jinyuan Investment Co., Ltd for a sale price of $1,507,650 (RMB 9.5 million). The transfer was completed on February 27, 2013, which incurred a loss of $79,350 (RMB 0.5 million).

Property and Equipment

Property and equipment are stated at cost. Expenditures for maintenance and repairs are charged to earnings as incurred while additions, renewals and betterments are capitalized. Depreciation of property and equipment is provided using the straight-line method for all assets with estimated lives as follows:

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

The following are the details of the property and equipment:

	December 31, 2012	December 31, 2011
Office equipment	$936,749	$823,822
Operating equipment	176,463,908	158,183,281
Vehicles	4,228,255	3,540,962
Buildings and improvements	38,557,910	41,713,318
Total property and equipment	220,186,822	204,261,383
Less accumulated depreciation	(40,671,259)	(30,163,629)
Property and equipment, net	$179,515,563	$174,097,754

Depreciation expense for the years ended December 31, 2012 and 2011 was $13,324,491 and $9,286,221, respectively.

Disposal of fixed assets

In an effort to utilize the Company's resource and maximize its operation results, the Company decided to reduce the scale of its CNG fueling station business and expand its fueling station development of LNG. During the third quarter of 2012, the Company closed five CNG fueling stations: 1) Tanan fueling station, 2) Donghuan fueling station, 3) Fenghe fueling station, 4) Tongchuan fueling station, and 5) Yan'an fueling station. These five CNG fueling stations suffered accumulated operation loss for the past few years. Simultaneously, the Company disposed all the buildings, equipment, and other fixed assets attached to them.

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The following are the details of the disposed fixed assets:

	Original value	Accumulated depreciation	Net value	Proceeds from sales	Loss/(gain) on disposal
Tanan Fueling Station	$2,379,000	$732,424	$1,646,576	$746,640	$899,936
Donghuan Fueling Station	1,928,513	589,145	1,339,368	622,200	717,168
Fenghe Fueling Station	1,982,500	614,533	1,367,967	388,875	979,092
Tongchuan Fueling Station	1,744,600	523,160	1,221,440	466,650	754,790
Yan'an Fueling Station	1,903,200	611,051	1,292,149	622,200	669,949
Other equipments	7,613	2,140	5,473	6,147	(674)
	$9,945,426	$3,072,453	$6,872,973	$2,852,712	$4,020,261

Construction in Progress

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

As of December 31, 2012 and 2011, the Company had construction in progress in the amount of $53,393,933 and $45,882,320, respectively. Interest cost capitalized into construction in progress for the years ended December 31, 2012 and 2011 amounted to $7,815,471 and $7,286,405, respectively.

Construction in progress at December 31, 2012 and 2011 is set forth in the table below. The column of “estimated additional cost to complete” reflects the amounts currently estimated by management to be necessary to complete the relevant project. As of December 31, 2012, the Company was not contractually or legally obligated to expend the estimated additional cost to complete these projects, except to the extent reflected in Note 14 – *Commitments and Contingencies* to the consolidated financial statements.

Project Description	Location	December 31, 2012		Commencement date	Expected completion date		Estimated additional cost to complete	
Phase I of LNG Project	Jingbian County, Shaanxi Province, PRC	$ 8,424,350	(1)	December 2006	March 2014	(2)	$ 94,000	(3)
Phases II and III of LNG Project	Jingbian County, Shaanxi Province, PRC	14,660,048	(4)	December 2006	December 2015		192,800,000	(5)
Fangzhi District	Fangzhi District, Xi’an, PRC	8,904,054		October 2010	December 2013		4,120,000	
Sa Pu Mother Station	Henan Province, PRC	1,376,421		July 2008	June 2013		6,100,000	
International Port(6)	International Port District, Xi’an, PRC	9,835,400		May 2009	December 2020		295,300,000	
LNG fueling stations	Shaanxi & Henan Province, PRC	1,646,358		Various	Various		11,050,000	
Other Construction in Progress Costs	PRC	8,547,302		Various	Various		1,200,000	
		$ 53,393,933					$ 510,664,000	

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Project Description	Location	December 31, 2011	Commencement date	Expected completion date	Estimated additional cost to complete
Phase I of LNG Project	Jingbian County, Shaanxi Province, PRC	$ 6,531,004	December 2006	September 2012	$385,359
Phases II and III of LNG Project	Jingbian County, Shaanxi Province, PRC	8,849,299	December 2006	December 2015	198,638,693
Fangzhi District	Fangzhi District, Xi'an, PRC	19,346,484	October 2010	June 2012	1,361,198
Sa Pu Mother Station	Henan Province, PRC	1,090,627	July 2008	June 2013	6,300,000
International Port	International Port District, Xi'an, PRC	5,715,443	May 2009	December 2020	299,400,000
LNG fueling stations	Shaanxi & Henan Province, PRC	899,653	Various	Various	11,692,347
Other Construction in Progress Costs	PRC	3,449,810	Various	Various	3,000,000
		$ 45,882,320			$520,777,597

(1) Includes $5,620,297 of construction cost and $2,804,053 of capitalized interest for Phase I of the LNG Project.

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

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

(4) Includes $9,780,438 of construction cost and $4,879,610 of capitalized interest for Phases II and III of the LNG project.

(5) This amount reflects the estimated costs of Phases II and III of the LNG project from December 31, 2012 to December 31, 2015, including an estimated $178 million of construction costs and $15 million of capitalized interest. Such costs should be able to finance the construction of a facility capable of processing 3 million cubic meters of LNG per day, or approximately 900 million cubic meters of LNG per year.

(6) Xi'an International Port District Committee, a local government agency in the PRC, pursuant to a conditional non-binding agreement, has appointed XXNGC to be the developer of natural gas infrastructure for Xi'an International Port District, a former agricultural area that has been zoned for urbanization. If XXNGC chooses to proceed with the project, it will be responsible for the construction and all costs related thereof a natural gas pipeline network that will service residential, commercial and industrial buildings and users, as well as fueling stations and related infrastructure. The estimated cost of $295,300,000 was based on a third-party feasibility study and management's estimate. The Company is the only natural gas provider in the surrounding area and expects that it would supply natural gas to the International Port District once construction is completed. If the Company decides not to proceed with this project, it expects to be able to obtain a refund from subcontractors of the $9,835,400 invested as of December 31, 2012 or sell the construction-in-progress assets to third parties.

Goodwill

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

of the goodwill impairment test is performed to measure the amount of impairment loss, if any. Under step two, the impairment loss is measured by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

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Long-Lived Assets

We evaluate the carrying value of long-lived assets to be held and used whenever events or changes in circumstances indicate that the assets might be impaired. Impairment losses are recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. Loss on long-lived assets to be disposed of is determined in a similar manner, except that fair market values are reduced for the cost of disposal. Based on our review, no impairment indicators were noted at December 31, 2012.

Fair Value of Financial Instruments

The accounting standards regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy for disclosures of fair value measurement, and provide disclosure requirements for fair value measures. The carrying amounts reported in the consolidated balance sheets for current receivables and payables qualify as financial instruments. Management concluded the carrying values are a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization and, if applicable, their stated interest rate approximates current rates available. The three levels are defined as follows:

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

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

- Level 3 inputs to the valuation methodology are unobservable.

The accounting standard regarding derivatives and hedging specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company’s own stock and (b) classified to stockholders’ equity

in the statement of financial position would not be considered a derivative financial instrument. This Financial Accounting Standards Board's ("FASB") accounting standard also provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the exception.

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These common stock purchase warrants, expired at October 26, 2012, do not trade in an active securities market and, as such, the Company estimates the fair value of these warrants using the Black-Scholes Option Pricing Model, using the following assumptions as of December 31, 2011:

	December 31, 2011	
Annual dividend yield	-	
Expected life (years)	0.82	
Risk-free interest rate	0.10	%
Expected volatility	55	%

The following tables set forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2012 and 2011.

	Carrying Value at December 31, 2012	Fair Value Measurement at December 31, 2012		
		Level 1	Level 2	Level 3
Redeemable liability – warrants	$ 17,500,000	$ -	$ 17,500,000	$ -
Total liability measured at fair value	$ 17,500,000	$ -	$ 17,500,000	$ -

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

Other than the assets and liabilities set forth in the table above, the Company did not identify any other assets or liabilities that are required to be accounted for at fair value on the balance sheet. The carrying value of long-term debt with variable interest rate approximates its fair value based on market rates available to the Company with similar terms (See Notes 6 and 7).

The following is a reconciliation of the beginning and ending balance of warrants liability measured at fair value on a recurring basis as of December 31, 2012 and 2011:

	Fair Value Measurement at December 31, 2012	December 31, 2011
Beginning balance	$ 4	$ 252,066
Change in fair value	(4)	(252,062)
Ending balance	$ -	$ 4

The fair value of the warrants was $0 and $4 as of December 31, 2012 and 2011, respectively, as the warrants expired at October 26, 2012. The Company recognized a gain of $4 and $252,062 for the years ended December 31, 2012 and 2011, respectively, to reflect the change in fair value of the warrants.

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Revenue Recognition

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

Stock-Based Compensations

The Company records and reports stock-based compensation based on a fair-value-based method of accounting for stock-based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from non-employees. Compensation for stock granted to non-employees is determined as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

Income Taxes

FASB’s accounting standard regarding income taxes requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of temporary differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. As at December 31, 2012 and 2011, there were no significant book to tax differences except for warrants liability and stock based compensation. An uncertain tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the year incurred. No significant penalties or interest relating to income taxes have been incurred during the years ended December 31, 2012 and 2011.

XXNGC, the Company's PRC VIE, and XXNGC's subsidiaries operate in the PRC. Pursuant to the tax laws of PRC, general enterprises are subject to income tax at an effective rate of 25%. However, under PRC income tax regulation, any company deemed to be engaged in the natural gas industry in the West Regions of the PRC under such regulation enjoys a favorable income tax rate. Thus, XXNGC's income is subject to a reduced tax rate of 15%. And one of XXNGC's subsidiaries, JBLNG is subject to a reduced income tax rate of 15% beginning on January 1, 2013. Other XXNGC's subsidiaries are not deemed to be engaged in the natural gas industry in the West Regions under PRC income tax regulation and, accordingly, are subject to a 25% income tax rate.

The estimated tax savings as a result of the reduced tax rate enjoyed by XXNGC for the years ended December 31, 2012 and 2011 amounted to approximately $1,447,975 and $2,229,282, respectively. The net effect on earnings per share, had the income tax been applied, would decrease basic and diluted earnings per share for the years ended December 31, 2012 and 2011, from $0.52 to $0.45 and $0.71 to $0.61, respectively.

China Natural Gas, Inc. was incorporated in the United States and has incurred net operating loss for income tax purpose for the period ended December 31, 2012. The estimated net operating loss carry-forwards for United States income tax purposes amounted to $12,707,708 as of December 31, 2012, which may be available to reduce future years' taxable income. These carry-forwards will expire, if not utilized through 2032. Management believes that the realization of the benefits arising from this loss appear to be uncertain due to Company's limited operating history and continuing losses for U.S. income tax purposes. Accordingly, the Company has provided a 100% valuation allowance at December 31, 2012 and 2011 for net deferred tax assets resulting from net operating loss carry forwards, stock based compensation and warrants liability. Management reviews this valuation allowance periodically and makes adjustments as warranted. The valuation allowances were as follows:

	For the years ended December 31,	
Valuation allowance	2012	2011
Balance, beginning of period	$4,222,489	$759,872
Increase	1,063,967	3,462,617
Balance, end of period	$5,286,456	$4,222,489

Provision for income tax is as follow:

	For the years ended December 31,	
	2012	2011
Current	$3,220,954	$4,811,689
Deferred	-	-
	$3,220,954	$4,811,689

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

	For the years ended December 31,	
	2012	2011
Tax expense at statutory rate-US	35.0 %	35.0 %
Changes in valuation allowance-US	(35.0)%	(35.0)%
Foreign income tax rate-PRC	25.0 %	25.0 %
Effect of favorable tax rate	(7.8)%	(8.3)%
Other items (1)	5.4 %	7.3 %
Effective income tax rate	22.6 %	24.0 %

(1) The 5.4% and 7.3% represents $3,039,907 and $5,701,352 in expenses incurred by the Company that are not deductible in the PRC for the years ended December 31, 2012 and 2011, respectively.

The Company has cumulative undistributed earnings of foreign subsidiaries of approximately $73,813,058 as of December 31, 2012, which is included in consolidated retained earnings and will continue to be indefinitely reinvested in international operations. Accordingly, no provision has been made for U.S. deferred taxes related to future repatriation of these earnings, nor is it practicable to estimate the amount of income taxes that would have to be provided if the Company concluded that such earnings will be remitted in the future.

Franchise Tax

According to the laws of the State of Delaware, we are required to pay annual franchise tax to the state government based on the number of the authorized shares.

Basic and Diluted Earnings Per Share

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

Reclassification

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

Recent Accounting Pronouncements

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In July 2012, the FASB issued ASU No. 2012-02, *"Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment" ("ASU 2012-02").* Under the amendments in this Update, an organization has the option first to assess qualitative factors to determine if a quantitative impairment test of the indefinite-lived intangible asset is necessary. If the qualitative assessment reveals that it's more likely than not that the asset is impaired, a calculation of the asset's fair value is required. Otherwise, no quantitative calculation is necessary. The amendments is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Management does not expect the adoption of this standard has a significant effect on the Company's consolidated financial position or results of operations.

In October, 2012, the FASB issued ASU No. 2012-04, *"Technical Corrections and Improvements" ("ASU 2012-04").* The amendments cover a wide range of topics in the FASB ASC. The amendments are incorporated into two sections: a. Technical corrections and improvements. b. Conforming amendments related to fair value measurements.

a. The amendments in the technical corrections and improvements section are categorized as follows:

- Source literature amendments. These amendments are considered necessary due to differences between source literature and the FASB ASC. The amendments primarily carry forward legacy document guidance and/or subsequent amendments into the FASB ASC. Often, either writing style or phrasing in the legacy documents did not directly relate to the FASB ASC format and style so that the meaning of certain guidance might have been unintentionally altered.

- Guidance clarification and reference corrections. These amendments include updated wording or corrected references, or a combination of both.

- Relocated guidance. These amendments primarily move authoritative literature guidance from one location to another location that is deemed more appropriate within the FASB ASC.

b. On the fair value measurements issue, the guidance in ASU 2012-04 identifies when the use of the term "fair value" should be linked to the definition of fair value included in FASB ASC 820, entitled Fair Value Measurement. Most of the amendments are of a nonsubstantive nature. Many of the amendments relate to conforming wording to be consistent with the terminology in FASB ASC 820 for example, references to market value and current market value have been changed to appropriately refer to fair value so that the literature is consistent throughout.

For public entities, the amendments that are subject to the transition guidance is effective for fiscal periods beginning after December 15, 2012. Management does not expect the adoption of this standard has a significant effect on the Company's consolidated financial position or results of operations.

In October, 2012, the FASB issued ASU No. 2012-06, *"Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution" ("ASU 2012-06").* This amendment requires that indemnification assets recognized in accordance with Subtopic 805-20, Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest, as a result of a government-assisted acquisition of a financial institution involving an indemnification agreement should be subsequently measured on the same basis as the asset subject to indemnification. For public and nonpublic entities, the amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2012. Management does not expect the adoption of this standard has a significant effect on the Company's consolidated financial position or results of operations.

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In January 2013, the FASB issued ASU No. 2013-01, *"Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities" ("ASU 2013-01").* The Update clarifies that ordinary trade receivables and receivables are not in the scope of Accounting Standards Update No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. Specifically, Update 2011-11 applies only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in *FASB Accounting Standards Codification*® or subject to a master netting arrangement or similar agreement. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. Management does not expect the adoption of this standard has a significant effect on the Company's consolidated financial position or results of operations.

In February 2013, the FASB issued ASU No. 2013-02, *"Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" ("ASU 2013-02").* The amendments require an organization to:

a. Present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income–but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period.

b. Cross-reference to other disclosures currently required under U.S. GAAP for other reclassification items (that are not required under U.S. GAAP) to be reclassified directly to net income in their entirety in the same reporting period. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is initially transferred to a balance sheet account (e.g., inventory for pension-related amounts) instead of directly to income or expense.

The amendments are effective for reporting periods beginning after December 15, 2012, for public companies. Management does not expect the adoption of this standard has a significant effect on the Company's consolidated financial position or results of operations.

In February 2013, the FASB issued ASU No. 2013-03, *"Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities" ("ASU 2013-03").* The amendment clarifies that the requirement to disclose the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (as Level 1, Level 2, or Level 3) does not apply to private companies and nonpublic not-for-profits for items that are not measured at fair value in the statement of financial position, but for which fair value is disclosed. The amendments are effective upon issuance. Management does not expect the adoption of this standard has a significant effect on the Company's

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In March 2013, the FASB issued ASU No. 2013-04, *"Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date" ("ASU 2013-04").* The update provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this ASU is fixed at the reporting date, except for obligations addressed within existing guidance in US GAAP. The guidance requires an entity to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this ASU also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Management does not expect the adoption of this standard will have a significant effect on the Company's consolidated financial position or results of operations.

In March 2013, the FASB issued ASU No. 2013-05, *"Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity" ("ASU 2013-05").* The ASU clarifies that when a parent entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity, the parent is required to apply the guidance in Accounting Standards Codification 830-30 to release any related cumulative translation adjustment into net income. The ASU provides that the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The amendments take effect prospectively for public companies for fiscal years beginning after December 15, 2013, and interim reporting periods within those years. Management does not expect the adoption of this standard will have a significant effect on the Company's consolidated financial position or results of operations.

Note 4 –Goodwill and Other Intangible Assets

Goodwill is the amount the Company paid to acquire 100% of the equity interests of Makou and 58.5284% of the equity interests of XTJH in excess of the fair value of Makou and XTJH's identifiable assets and liabilities, respectively. Annual impairment testing is performed during the fourth quarter of each year unless events or circumstances indicate earlier impairment testing is required. No impairment loss was recognized during the year ended December 31, 2012.

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

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	December 31, 2012	December 31, 2011
Operating rights	$5,339,474	$5,221,635
Technical license (LNG)	10,072,170	10,527,223
Land use rights	5,971,006	3,147,108
Other	18,274	14,278
Total	$21,400,924	$18,910,244

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

The technical license (LNG) is being amortized over its estimated useful life of 20 years. Amortization expense for the years ended December 31, 2012 and 2011 was $541,659 and $220,000, respectively. Accumulated amortization at December 31, 2012 was $767,834.

The land use rights are being amortized over their estimated useful life of 30 years. For the years ended December 31, 2012 and 2011, amortization expense amounted to $162,369 and $116,701, respectively. As of December 31, 2012, accumulated amortization was approximately $335,770.

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

2013	$704,027
2014	704,027
2015	704,027
2016	693,309
2017	693,309
thereafter	9,565,137
	$13,063,836

Note 5 – Prepaid Expenses and Other Assets

Prepaid expenses and other assets consisted of the following:

	December 31, 2012	December 31, 2011
Prepaid rent – natural gas stations	$501,599	$2,497,681
Prepayment for acquiring land use right	1,269,600	4,596,080
Advances on purchasing equipment and construction in progress	4,286,898	2,297,909
Refundable security deposits	957,045	592,913
Long term investment deposit	-	991,620
Total	$7,015,142	$10,976,203

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Prepaid rent represents prepayments for leasing the land of our fueling stations. In China, land rental usually requires an advancement and then amortized into expense on a straight-line basis over the term of the land lease.

All land in the PRC is government owned. However, the government grants users land use rights. The Company is in the process of negotiating the final purchase price with relevant local government and the land use rights have not yet been granted to the Company. Therefore, the Company did not amortize these amounts for land use rights.

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

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

Long term investment deposit represents for the acquisition of Xiantao City Jinhua Gas and Oil Co., Ltd. ("XTJH") by Xi'an Xilan Natural Gas Co., Ltd. ("XXNGC").

Note 6 –Senior Notes

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

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

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

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The second repayment for 8.3333% of the principal of the Senior Notes was due on January 30, 2012. After negotiation with Abax, the note-holders agreed that the Company could make the payment on or before March 9, 2012. On March 7, 2012, the Company paid the principal due on January 30, 2012 in full plus accrued interest for the period from July 30, 2011 to January 29, 2012, as well as a penalty interest of $28,416 for the period from February 6, 2012 to March 7, 2012. Abax issued a waiver to exempt the Company from any other consequences of the late payment.

The repayment of 16.6666% of the principal of the notes payable plus accrued interest of the period from January 29, 2012 to July 30, 2012 was due on July 30, 2012. And the repayment of 16.6666% of the principal of the notes payable plus accrued interest of the period from July 31, 2012 to January 30, 2013 was due on January 30, 2013. The company did not make these payments at the time they were due and the payments remain unpaid.

On September 5, 2012, the Company received another notice from the Holders that the Holders elected to exercise their right to accelerated payment of the Senior Notes as a result of the continued Default (the “Acceleration Notice”). The immediate acceleration of all amounts owing under the Senior Notes totals approximately RMB249,450,516.

Further, on September 10, 2012, the Company received a demand notice from the Holders’ legal counsel on behalf of the Holder for the payment of all amounts owing under the Senior Notes (the “Demand Notice”) within 15 days from the date of the Demand Notice. The Demand Notice stated that if the Company failed to meet the demand, the Holders intend to pursue all of its legal rights under the transaction documents, including, without limitation:

Requiring the Trustee to initiate suit in the courts of New York with respect to the Company’s failure to pay the entire amount due to the Holders under the Senior Notes;

Initiating involuntary bankruptcy proceedings with respect to the Company under the U.S. Federal Bankruptcy Code;

Initiating arbitration in Hong Kong against the Company for breaches of the Company’s obligations under the SPA;

Exercising its rights under the Warrant Agreement to require the redemption of all Warrants held by it at the Redemption Price (as defined therein); and

All other rights under the transaction documents relating to the Senior Notes in relation to the Default, which may include, foreclosing on the security interest in 65% of all outstanding equity interest of the Company's wholly owned subsidiary, Shaanxi Xilan Natural Gas Equipment Co., Ltd., and all funds in the account where the proceeds from the Senior Notes were deposited.

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In addition to the demands disclosed above, the Holders have also asserted that by virtue of the Default the Company is obliged to redeem the Warrants and pay to the Holders $17.5 million.

The Company disputes the amount allegedly owed, and has been in negotiation with the Holders but has not able to come to a resolution with the Holders.

On September 11, 2012, the holders of a majority of the Senior Notes (the “Holders”) notified the Company on August 21, 2012 (the “Default Notice”) that the Company was in default of the Senior Notes for failure to make the interest payment due and a mandatory redemption of the Senior Notes on July 30, 2012 (the “Default”). In the notice, the Holders also demanded that the Company make all payments due as of July 30, 2012 under the Senior Notes to avoid acceleration of all payments under the Senior Notes and foreclosure of collaterals pledged to secure the Senior Notes.

On February 8, 2013, an Involuntary Petition for Bankruptcy, entitled In re China Natural Gas, Inc. (Case No. 13-10419), was filed against China Natural Gas, Inc. (the "Company") by three creditors of the Company, namely Abax Lotus Ltd., Abax Nai Xin A Ltd., and Lake Street Fund LP (the “Petitioners”). The petition was filed in the United States Bankruptcy Court, Southern District of New York. The Petitioners have claimed in the Involuntary Petition that they have debts totaling $42,218,956.88 as a result of the Company’s failure to make payments on the 5% Guaranteed Senior Notes issued in 2008. The Company intends to oppose the petition.

Senior notes consist of the following:

	December 31, 2012	December 31, 2011
Notes payable	$38,352,498	$41,053,100
Less discount	-	(5,590,267)
	38,352,498	35,462,833
Less current portion	(38,352,498)	(9,671,682)
	$-	$25,791,151

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

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

In connection with the issuance of the Senior Notes, the Company paid $2,122,509 in debt issuance costs, which are being amortized over the life of the Senior Notes. The Company amortized all outstanding amounts of debt issuance costs during the third quarter of 2012. For the years ended December 31, 2012 and 2011, the Company amortized $517,334 and $409,832 of the issuance costs in each of the periods, which were recorded as capitalized interest included in construction in progress.

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The Abax Warrants are presently exercisable and have an exercise price of $7.37 per share, although Abax has not exercised any of the Abax Warrants. The Company reclassified the Warrants to current liabilities as of December 31, 2012.

The Abax Warrants are considered derivative instruments required to be bifurcated from the original security because there is a redemption requirement if the holder does not exercise the Warrants. If Abax does not exercise the Abax Warrants prior to their expiration date of January 29, 2015, Abax can require the Company to repurchase the Abax Warrants for $17,500,000. This amount is shown as a debt discount and is being amortized over the term of the Senior Notes. The Company amortized all outstanding amounts of debt discount during the third quarter of 2012. For the years ended December 31, 2012 and 2011, the Company amortized $5,590,267 and $3,794,064 of the discounts, respectively, which were capitalized into construction in progress.

Note 7 –Bank Loan Payable

The Company’s bank loan payable as of December 31, 2012 consists of:

	December 31, 2012	2011
A loan from Pudong Development Bank Xi’an Branch, due various dates from 2013 to 2014	$9,522,000	$14,166,000
Less current portion	(4,761,000)	(4,722,000)
	$4,761,000	$9,444,000

The loan is secured by XXNGC’s equipment and vehicles located within the PRC. The carrying net value of the assets pledged is $9,976,931 as of December 31, 2012. Interest expense for the years ended December 31, 2012 and 2011 was $941,966 and $1,150,295, respectively (interest rate applied at December 31, 2012 was 6.90%). According to the loan agreement, the interest rate is fixed throughout each single year and will only be adjusted at the beginning of the next year, based on the base interest rate on the same category of loans for the same term published by the People’s Bank of China. XXNGC also entered into a guaranty with the lender to guarantee the repayment of the loans. As a result of the People’s Bank of China lowering the interest rates both in June and July 2012, beginning January 1, 2013 the interest rate of these loans are 6.40%. According to an amendment to the loan agreement with the Bank, which was signed on October 2011, the Company is required to make repayments on the long term loan as follows:

Date	Repayment Percentage		Repayment Amount
October 5, 2011 (paid on October 10, 2011)	4.2	%	$793,500
December 5, 2011 (paid on December 5, 2011)	20.8	%	3,967,500
March 5, 2012 (paid on March 5, 2012)	4.2	%	793,500
December 5, 2012 (paid on December 5, 2012)	20.8	%	3,967,500
March 5, 2013 (paid on March 5, 2013)	8.3	%	1,587,000
December 5, 2013	16.7	%	3,174,000
March 5, 2014	8.3	%	1,587,000
December 5, 2014	16.7	%	3,174,000
	100.0	%	$19,044,000

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If the default of the Senior Notes is not resolved, the Company may be deemed to be in default on its fixed asset loan from Shanghai Pudong Development Bank ("SPDB") as the Holders initiate involuntary bankruptcy proceedings with respect to the Company and the Company does not obtain prior written approval from SPDB. The default of the loan with SPDB may result in full or partial acceleration of the repayment of the loan.

Note 8 – Warrants

No warrants were granted, forfeited or exercised during the years ended December 31, 2012 and 2011, respectively.

The following is a summary of warrants outstanding and exercisable as of December 31, 2012 and 2011:

Warrants Outstanding and Exercisable as of December 31, 2012

Exercise Price	Number	Average Remaining Contractual Life
$ 7.37	1,450,000	2.08
	1,450,000	

Warrants Outstanding and Exercisable as of December 31, 2011

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

Note 9 – Defined Contribution Plan

The Company is required to participate in a defined contribution plan operated by the local municipal government in accordance with PRC law and regulations. The contribution was $608,962 and $676,166 for the years ended December 31, 2012 and 2011, respectively.

Note 10 – Stockholders' Equity

a) Statutory Reserve

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

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

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

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

As of December 31, 2012 and 2011, the remaining amount needed to fulfill the 50% registered capital requirement was approximately $61,974,421 and $63,202,798, respectively.

b) Stock-based Compensation

2009 Stock Option and Stock Award Plan

On March 11, 2009, the Board approved by written consent the China Natural Gas, Inc. 2009 Employee Stock Option and Stock Award Plan (the "Plan"). Pursuant to the Plan, there are currently 1,460,000 shares of common stock of the Company authorized for issuance and the Company has granted 669,900 stock options as of December 31, 2012, of which 274,750 have been exercised and 176,700 have been cancelled and are available for reissuance. Thus, there are currently 966,800 shares of common stock of the Company available for future issuance under the Plan and 218,450 options outstanding. The exercise price for all of the outstanding options is $4.90 per share.

Compensation expense of $592,152 and $627,660 was recorded during the years ended December 31, 2012 and 2011, respectively, relating to options granted under the Plan.

As of December 31, 2012, $148,038 of estimated expense with respect to non-vested stock-based compensation has yet to be recognized and will be recognized in expense over the optionee's remaining weighted average service period of approximately 0.25 year.

The following is a summary of the stock option activity:

	Options		Weighted Average Exercise Price	Aggregate Intrinsic Value
	Outstanding	Exercisable		
Balance, December 31, 2010	359,300	2,750	$ 4.90	$ 219,173
Granted	31,900		4.90	
Forfeited	(36,000)		-	
Exercised	(136,750)		-	
Balance, December 31, 2011	218,450	3,750	$ 4.90	$ -
Granted	-	-		
Forfeited	-			
Exercised	-			
Balance, December 31, 2012	218,450	111,100	4.9	-

The following is a summary of the status of stock options outstanding and exercisable as of December 31, 2012:

Outstanding Options			Exercisable Options		
Exercise Price	Number	Average Remaining Contractual Life	Exercise Price	Number	Average Remaining Contractual Life
$4.90	218,450	2.25 years	$4.90	111,100	2.25 years

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Note 11 – Earnings per Share

The following is a calculation of basic and diluted earnings per common share for the years ended December 31, 2012 and 2011:

	For the years ended December 31,	
	2012	2011
Basic earnings per share		
Net income	$ 11,200,514	$ 15,261,932
Weighted shares outstanding-Basic	21,458,654	21,418,389
Earnings per share-Basic	$ 0.52	$ 0.71
Diluted earnings per share		
Net income	$ 11,200,514	$ 15,261,932
Weighted shares outstanding -Basic	21,458,654	21,418,389
Effect of diluted securities-Warrants	-	-
Effect of diluted securities-Options	-	-
Weighted shares outstanding-Diluted	21,458,654	21,418,389
Earnings per share-Diluted	$ 0.52	$ 0.71

The Company had outstanding warrants of 1,450,000 as of December 31, 2012. For the years ended December 31, 2012, all 1,450,000 outstanding warrants were excluded from the diluted earnings per share calculation as the exercise price was greater than the average stock price during these periods. The Company had outstanding warrants of 1,833,654 as of December 31, 2011. For the years ended December 31, 2011, all 1,833,654 outstanding warrants were excluded from the diluted earnings per share calculation as the exercise price was greater than the average stock price during these periods.

The Company had 218,450 outstanding employee stock options as of December 31, 2012 and 2011. For the years ended December 31, 2012 and 2011, the outstanding options were excluded from the diluted earnings per share

calculation as the exercise price was greater than the average option price during these periods.

Note 12 – Related Party Transactions

a) Other payable - related party

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On February 24, 2011, the Company borrowed $793,500 from the JV for working capital purposes. This payable is due on demand with no interest rate, and is offset to $0 on February 27, 2013, as we transferred our investment in JV to Shaanxi Jinyuan investment Co., Ltd.

As of December 31, 2012, the Company borrowed a total of $822,929 from Mr. Rongxiu Xiang, a manager and shareholder of XTJH, for working capital purposes. This payable is due on demand with no interest rate.

b) Borrowings from related party

As of December 31, 2012, the Company borrowed a total of $2,679,945 from Mr. Hao Qu, a former employee of XXNGC and a shareholder of the Company, for working capital purposes. The loans were originally due in one year and required interest of 4.4075% per year, which is the annual USD lending rate applied by the Bank of China. The principal and interest was required to be paid on specified due dates beginning on February 16, 2012 through October 31, 2012. On May 17, 2012, May 18, 2012, November 1, 2012, February 16, 2013 and March 28, 2013 the Company entered into agreements with Mr. Qu, pursuant to which certain borrowings would be due in 2013 and 2014, rather than in 2012, and would bear a higher rate of interest. The Company has not repaid any principal of the borrowings to date.

Borrowings from Mr. Qu at December 31, 2012, consist of the following:

Short-term maturing on	
February 15, 2013, at 6.2250% (extended to February 15, 2014)	$900,000
March 27, 2013, at 6.2250% (extended to March 27, 2014)	$420,000
May 16, 2013, at 6.2250%	$699,975
May 17, 2013, at 6.2250%	$299,970
October 31, 2013, at 6.2250%	$360,000
	$2,679,945

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

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

Long-term at 6.225% maturing on	
February 15, 2013	$900,000
March 27, 2013	420,000
	$1,320,000

Note 13 –Concentrations

Concentration of natural gas vendors:

	For the years ended December 31,			
	2012		2011	
Numbers of natural gas vendors	4		2	
Percentage of total natural gas purchases	81	%	69	%

As of December 31, 2012 and 2011, the Company had $407,717 and $450,553, respectively, prepayment to its major suppliers.

The Company maintained long-term natural gas purchase agreements with one of its vendors, Qinshui Lanyan Coal Bed Methane Co., Ltd (“Qinshui Lanyan”) as of December 31, 2012. Company’s management reports that it does not expect any issues or difficulty in renewing the supply contracts with these vendors going forward.

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Note 14 – Commitments and Contingencies

Lease Commitments

The Company entered into a series of long-term lease agreements with outside parties to lease land use rights for the Company's CNG fueling stations located in the PRC. The agreements have terms ranging from 10 to 30 years. The Company makes annual prepayments for most of these lease agreements. The Company also entered into five office leases in Xi'an, PRC, one office lease in Wuhan, PRC, one office lease in Yichang, PRC, one office lease in Huangshi, PRC and one office lease in New York, New York, USA. The minimum future payments for leasing land use rights and offices at December 31, 2012 are follows:

Year ending December 31, 2013	1,826,683
Year ending December 31, 2014	2,371,371
Year ending December 31, 2015	1,990,272
Year ending December 31, 2016	1,962,220
Year ending December 31, 2017	2,194,425
Thereafter	29,790,042
Total	$40,135,013

For the years ended December 31, 2012 and 2011, the land use right and office lease expenses were $2,287,613 and $2,013,039, respectively.

Property and Equipment Purchase Commitments

As of December 31, 2012, the Company has purchase commitments totaling $9,156,055 for materials, supplies, services and property and equipment for constructing the LNG plant and other construction projects.

Natural Gas Purchase Commitments

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

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

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Capital Contribution

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

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

VIE Structure

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

The government of the PRC restricts foreign investment in natural gas businesses in China. Accordingly, we operate our business in China through our VIE, XXNGC. XXNGC holds the licenses, approvals and assets necessary to operate our natural gas business in China. We have no equity ownership interest in XXNGC and rely on contractual arrangements with XXNGC and its shareholders that allow us to substantially control and operate XXNGC. These contractual arrangements may not be as effective in providing control over XXNGC as direct ownership would be. For example, XXNGC could fail to take actions required for our business despite its contractual obligation to do so. If

XXNGC fails to perform under its agreements with us, we may have to spend substantial costs and resources to enforce such arrangements and may have to rely on legal remedies under the laws of the PRC, which may not be effective. In addition, we cannot assure you that XXNGC’s shareholders and management would always act in our best interests.

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

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

Individuals Claims to Certain Shares

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

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

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Legal Proceedings

Other than described below, there have been no material developments in the legal proceedings in which we were involved during the year ended December 30, 2012. For a description of previously reported legal proceedings refer to Part I, Item 3, "Legal Proceedings" of the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

On May 14, 2012, the Securities and Exchange Commission ("SEC") filed a Complaint (the "Complaint") in the U.S. District Court for the Southern District of New York against Qinan Ji and the Company, captioned Securities and Exchange Commission v. China Natural Gas, Inc. and Qinan Ji (12 CV 3824) (the "SEC Action"). The SEC Action alleged that the Company violated Section 17(a)(2) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B) and 14(a) of the Securities Exchange Act of 1934 ("Exchange Act") (as well as certain rules promulgated under such sections), and that Mr. Ji violated Section 17(a) of the Securities Act, Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5) and 14(a) of the Exchange Act (as well as certain rules promulgated under such sections), Section 304 of the Sarbanes Oxley Act of 2002 and aiding and abetting certain of the Company's alleged violations.

a) The SEC Action further alleged among other things that, in January 2010, the Company made two-short term loans totaling $14.3 million ($9.9 million to Taoxiang Wang and $4.4 million to a real estate company called Shaanxi Juntai Housing Purchase Co. Ltd. ("Juntai")) and disclosed them in its periodic reports as loans made to unrelated third parties. The SEC Action alleged that the true and undisclosed purpose of the loans was to benefit a company called Xi'an Demaoxing Real Estate Co., Ltd. ("Demaoxing"), and that Demaoxing was 90% owned by Mr. Ji's son and 10% owned by Mr. Ji's nephew. The SEC Action further alleged that Taoxiang Wang was a sham borrower selected to conceal Demaoxing's receipt of the loan proceeds and that Juntai was Demaoxing's business partner and borrowed the money to undertake a joint real estate project with Demaoxing.

As of the date hereof, the Company and the staff of the SEC have agreed in principle to a settlement of the SEC Action. Pursuant to such agreement in principle, without admitting or denying any allegations against it, the Company would offer to consent to the entry of a court order that: (a) permanently restrains and enjoins the Company from future violations of Section 17(a)(2) of the Securities Act and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 14a-9 thereunder; and (b) orders the Company to pay an aggregate civil penalty in the amount of $815,000 pursuant to Section 20(d) of the Securities Act and Section 21(d)(3) of the Exchange Act.

On May 22, 2012, Kousa, Mallano and Steinmetz, shareholders in the Company ("Delaware Plaintiffs"), filed a Shareholder Class Action and Derivative Complaint ("Delaware Complaint") against the Company and certain members of the Company's Board ("Delaware Director Defendants") in the Court of Chancery of the State of Delaware. The Delaware Complaint alleges a direct class action claim for breach of fiduciary duty against the Delaware Director Defendants, a derivative claim for breach of fiduciary duty against the Delaware Director Defendants, and a separate derivative claim for breach of fiduciary duty against Ji. The Delaware Complaint alleges that the Delaware Director Defendants breached their fiduciary duties to the Company and its shareholders by preserving Ji's control over the Company despite his alleged wrongdoing and the threatened delisting of the Company's shares by NASDAQ, thereby causing the Company's shares to be delisted. The Delaware Complaint separately alleges that Ji engaged in self-dealing and other conduct that breached his fiduciary duties to the Company and its shareholders. The Delaware Complaint seeks certification of a class action, authorization to proceed as a derivative action, and unspecified money damages, including attorneys' fees and costs. The claims are directed against the individual defendants and not against the Company.

On July 30, 2012, Ji filed a motion to dismiss the Delaware Complaint. On August 14, 2012, the Company and the
b) remaining Delaware Director Defendants filed a motion to stay or dismiss the Delaware Complaint. The parties agreed, with the approval of the Court, to bifurcate briefing on the motion to stay and the motions to dismiss. On October 16, 2012, after briefing and oral argument, the Chancery Court stayed the separate derivative claim against Ji pending the outcome of the SEC investigation and Federal Securities Action, but denied the motion to stay as to the other counts in the Delaware Complaint against the Delaware Director Defendants and directed the parties to proceed with briefing on the motions to dismiss without prejudice to the Plaintiffs' right to amend the Delaware Complaint. The Court also stayed all discovery pending the outcome of the motions to dismiss. On November 2, 2012, the Court approved a stipulation among the parties providing that the Plaintiffs would file an amended complaint no later than 30 days after the proposed settlement of the SEC Action is approved by the U.S. District Court, setting the time within which the defendants must answer or move in response to the amended complaint and a briefing schedule in the event that they file a motion, and vacating that portion of the Court's order directing the defendants to proceed with briefing on the motions to dismiss the Delaware Complaint.

As a result of the October 16, 2012 Order and the November 2, 2012 Stipulation and Order, the case is effectively stayed pending the filing of an amended complaint by the Plaintiffs. As of the date of this letter, the Plaintiffs have yet to file an amended complaint.

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On February 8, 2013, an Involuntary Petition for bankruptcy, entitled In re China Natural Gas, Inc. (Case No. 13-10419), was filed against the Company by three creditors of the Company, namely Abax Lotus Ltd., Abax Nai Xin A Ltd., and Lake Street Fund LP (the "Petitioners"). The petition was filed in the United States Bankruptcy Court, Southern District of New York. The Petitioners have claimed in the Involuntary Petition that they have debts totaling $42,218,956.88 as a result of the Company's failure to make payments on the 5% Guaranteed Senior Notes issued in 2008.

As previously disclosed in the Current Reports on Form 8-K filed by the Company with the Securities and Exchange Commission (the "SEC") on December 31, 2007 and January 29, 2008, the Company entered into a Securities Purchase Agreement with Abax Lotus Ltd. (the "Investor") on December 30, 2007 which was amended on January 29, 2008 (the "SPA"). Pursuant to the SPA, the Company issued to the Investor 5% Guaranteed Senior Notes due 2014 (the "Senior Notes") in aggregate principal amount of RMB 145,000,000 (approximately US$20,000,000) on January 29, 2008. Also, as previously disclosed in the Current Report on Form 8-K filed by the Company with the SEC on March 12, 2008, also pursuant to the SPA, the Investor exercised its option to purchase an additional RMB145,000,000 in aggregate principal amount of Senior Notes. The Senior Notes were issued in connection with the Indenture dated as of January 29, 2008 (the "Indenture"). The aggregate principal amount of the Senior Notes at issuance was RMB290,000,000 (approximately US$40,000,000). In addition, the Company agreed to issue to the
c) Investor seven-year warrants (the "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 adjustment) pursuant to the Warrant Agreement dated January 29, 2008 (the "Warrant Agreement") by and among the Warrant Agent and Warrant Registrar as a holder of the Warrants (as defined therein).

Also as previously disclosed in the Company's Current Report on Form 8-K filed with the SEC on September 11, 2012, the holders of a majority of the Senior Notes (the "Holders") notified the Company on August 21, 2012 (the "Default Notice") that the Company was in default of the Senior Notes for failure to make the interest payment due and a mandatory redemption of the Senior Notes on July 30, 2012 (the "Default"). In the notice, the Holders also demanded that the Company make all payments due as of July 30, 2012 under the Senior Notes to avoid acceleration of all payments under the Senior Notes and foreclosure of collaterals pledged to secure the Senior Notes.

On September 5, 2012, the Company received another notice from the Holders that the Holders elected to exercise their right to accelerated payment of the Senior Notes as a result of the continued Default (the "Acceleration Notice"). The immediate acceleration of all amounts owing under the Senior Notes totals approximately RMB249,450,516.

Further, on September 10, 2012, the Company received a demand notice from the Holders' legal counsel on behalf of the Holder for the payment of all amounts owing under the Senior Notes (the "Demand Notice") within 15 days from the date of the Demand Notice. The Demand Notice stated that if the Company failed to meet the demand, the Holders intend to pursue all of its legal rights under the transaction documents, including, without limitation:

Requiring the Trustee to initiate suit in the courts of New York with respect to the Company's failure to pay the entire amount due to the Holders under the Senior Notes;

Initiating involuntary bankruptcy proceedings with respect to the Company under the U.S. Federal Bankruptcy Code;

Initiating arbitration in Hong Kong against the Company for breaches of the Company's obligations under the SPA;

Exercising its rights under the Warrant Agreement to require the redemption of all Warrants held by it at the Redemption Price (as defined therein); and

All other rights under the transaction documents relating to the Senior Notes in relation to the Default, which may include, foreclosing on the security interest in 65% of all outstanding equity interest of the Company's wholly owned subsidiary, Shaanxi Xilan Natural Gas Equipment Co., Ltd., and all funds in the account where the proceeds from the Senior Notes were deposited.

In addition to the demands disclosed above, the Holders have also asserted that by virtue of the Default the Company is obliged to redeem the Warrants and pay to the Holders $17.5 million.

The Company disputes the amount allegedly owed, and has been in negotiation with the Holders but has not able to come to a resolution with the Holders. As disclosed above, on February 8, 2013, the Holders initiated involuntary bankruptcy proceedings with respect to the Company under the U.S. Federal Bankruptcy Code. The Company intends to oppose the petition.

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d) Vandevelde v. China Natural Gas, Inc., et al. (Case No. 1:10CV00728, United States District Court for the District of Delaware). As previously disclosed, on August 26, 2010, an individual investor filed a putative class action complaint against the Company and certain of its current and former officers and directors alleging that the defendants violated the U.S. securities laws. The Court appointed another individual investor as lead plaintiff, and he then filed an amended complaint. The Company filed a motion to dismiss which, on July 6, 2012, the Court granted in its entirety. In its order, the Court also granted the plaintiffs leave to amend their complaint. In the second amended complaint, the plaintiffs allege that, in violation of Section 10(b) of the Securities Exchange Act of 1934 (and Rule 10b-5 thereunder), the defendants made false or misleading statements in the Company's Annual Reports on Form 10-K for the years ended December 31, 2009, and December 31, 2010, and in various quarterly reports, by purportedly failing to disclose a series of loans and related party transactions. The second amended complaint also asserts claims against certain of the Company's current and former officers and directors for violations of Section 20(a) of the Securities Exchange Act of 1934. The suit seeks unspecified monetary damages. On September 25, 2012, the Company filed a motion to dismiss the second amended complaint. On February 26, 2013, the Company notified the Court that certain of the Company's creditors had filed an involuntary petition for bankruptcy and that, under the U.S. Bankruptcy Code, the filing of that petition operates as an 0ptmatic stay of the suit. The Company cannot at this time provide any assurance that the outcome of this suit will not be materially adverse to its financial condition, consolidated results of operations, cash flows or business prospects.

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