



DISCOVERING TOMORROW'S BLUE CHIPS TODAY™

**VISIBILITY  
RESEARCH NOTE**

**ANALYST**

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**MARKET DATA**

TICKER	CHNG
FISCAL YEAR	DECEMBER
SECTOR	OIL & GAS SERVICES
RECENT PRICE	\$7.11
MARKET CAP	\$150.6M
52-WEEK HIGH - LOW	\$18.00 - \$7.00
PRICE/EARNINGS (TTM)	7.1X
PRICE/BOOK (MRQ)	1.0X
PRICE/SALES (TTM)	1.6X
SHARES OUTSTANDING	21.2M
FLOAT	15.4M
AVG DAILY VOLUME (3 MOS)	314,514
INSIDER OWNERSHIP	22.3%

As of May 11, 2010

**FINANCIAL DATA**

REVENUE (TTM)	\$81.9M
REV (TTM) PER SHARE	\$4.41
QRTL REV GRWTH (YOY)	4.5%
GROSS PROFIT (TTM)	\$39.6M
OPERATING MARGIN (TTM)	29.1%
EBITDA (TTM)	\$29.5M
NET INCOME (TTM)	\$18.6M
DILUTED EPS (TTM)	\$1.00
QRTL EPS GRWTH (YOY)	-35.7%
CASH & EQUIV (MRQ)	\$30.2M
CASH (MRQ) PER SHARE	\$1.42
TOTAL DEBT/EQUITY	36.8%
BOOK VALUE PER SHARE	\$6.99
ROE (TTM)	16.7%
ROA (TTM)	11.4%



**China Natural Gas, Inc.**  
(NasdaqGM: CHNG)

MAY 12, 2010

**LNG PLANT ON TRACK FOR JUNE 30 COMPLETION; FY11 GUIDANCE GIVEN**

**Construction of LNG facility progresses toward June 30 completion date.**

According to management, the Company's Jingbian County liquefied natural gas (LNG) plant in Shaanxi Province, China is set to complete construction by June 30, 2010. Test runs are scheduled to start at the beginning of 3Q10. Recently released images (taken May 4, 2010) of the plant's construction progress are shown below.



While we continue to believe a June 30 completion date is aggressively optimistic given the pipe and instrumentation installation yet to be completed at the Jingbian site, management reiterated to us that the Company is doing everything necessary and will meet its stated timetable for completion. Additionally, we now have capacity utilization targets from the Company. CHNG management expects the LNG facility to be operating at 30% of capacity in 3Q10 and 50% of capacity in 4Q10. Plant production capacity is expected to be 500 thousand cubic meters per day or 150 million cubic meters in total.

CHNG has laid out long-term plans for the distribution of LNG to end customers via a highway and harbor system of refueling stations (see RedChip's April 23, 2010 update report), however in the short-term the Company will rely on a wholesale sales strategy. Immediate customers will be utilities and negotiations



are in process.

**CNG expansion growth reduced.** In our March 11, 2010 update report we reported the Company's ambitious growth plans to acquire or build 40 additional compressed natural gas (CNG) refueling stations in 2010. It turns out those growth plans were in fact overly ambitious as CHNG added just one additional CNG station in the first quarter bringing the Company's total number of fueling stations to 37. CHNG now guides toward 8-10 company owned stations and four joint venture stations added in 2010 (the Company has a 51%/49% JV with CNPC Kunlun Natural Gas Co.).

## 1Q10 FINANCIAL RESULTS

1st Quarter Summary						
	1Q10 Actual Results	YOY % Change	1Q10 RedChip estimates	% Diff. vs RedChip estimates	1Q10 Consensus Estimates	% Diff. vs Consensus Estimates
Revenue	19.4	4.5%	23.9	-18.9%	21.6	-10.3%
Gross Profit	9.1	-5.5%	11.5	-20.6%	10.5	-13.3%
Gross Margin	47.0%	-9.6%	48.0%	-2.1%	48.6%	-3.4%
Operating Income	4.4	-22.0%	7.6	-41.9%	6.4	-31.4%
Operating Margin	22.7%	-25.4%	31.6%	-28.3%	29.6%	-23.5%
Net Income	4.0	-4.8%	5.8	-31.4%	5.6	-28.6%
Net Margin	20.7%	-8.9%	24.4%	-15.4%	25.9%	-20.3%
EPS	0.19	-35.6%	0.27	-31.5%	0.26	-28.2%

*in US\$ millions, except percentage and EPS data*

Revenue in the first quarter of 2010 (1Q10) increased 4.5% to \$19.4 million from \$18.5 million in the first quarter of 2009 but 10.6% lower than fourth quarter's revenue of \$21.7 million, driven by sales from two new fueling stations added in third quarter 2009 and first quarter 2010, respectively, as well as an increase in the number of residential and commercial pipeline customers to 110,713 as of March 31, 2010 from 98,754 as of March 31, 2009. Sequential results were affected by the Chinese New Year in the first quarter.

Sales of natural gas grew 3.5% year-over-year to \$15.5 million, from \$15.0 million in the first quarter of 2009. Gasoline revenue in the first quarter of 2010 increased 25.1% to \$1.5 million, from \$1.2 million in the prior year's period, mainly attributable to the increase of international oil price.

Installation and services revenue grew 1.1% year-over-year to \$2.41 million, from \$2.39 million a year ago. Sales of natural gas, gasoline, and installation and other services contributed 80%, 8%, and 12% of total revenue in 1Q10, respectively.

Gross profit in 1Q10 contracted 5.6% to \$9.1 million, from \$9.6 million in the prior year's same period. Gross margin was 47.0%, compared to 52.0% a year ago. Gross profit and gross margin decreased primarily due to increased procurement cost in Henan Province (CHNG bought coal bed methane gas in Henan Province rather than natural gas as prices increased from 1 RMB/M3 in 2009 to 1.4-1.5 RMB/M3 vs. retail sales price of 3.2 RMB/M3). The Company expects these costs to be stable going forward.

As of March 31, 2010, the Company had \$30.2 million of cash and cash equivalents on hand compared to \$48.2 million of cash and cash equivalents as of December 31, 2009. The decrease was primarily attributable to the construction of the LNG plant, additions of fueling stations, and market development initiatives in Henan and Hubei Province.



Two loans were outstanding on March 31, 2010 totaling \$14.2 million. One has been repaid as of April 27, 2010 and the other is expected to be repaid soon. The loan outstanding is to Shanxi Jun Tai Housing Purchase Ltd. and is due on January 10, 2011 with an estimated annual interest of 5.84%.

### ***OUTLOOK***

CHNG provided guidance for 2011 on its first quarter earnings call. Revenue is expected to grow 20-25% to \$97-101 million while net income is estimated to grow 17-22% excluding non-cash, non-operating costs to \$22-23 million (EPS \$1.02-\$1.06 non-GAAP basis).

### ***INVESTMENT CONCLUSION***

Nothing has changed our long-term outlook on CHNG. They are strong financially, have major expansion plans, a partnership with a State-owned oil and gas company (China National Petroleum), aggressive but viable business development plans and are making monthly progress updates. Most importantly they are in a business that is supported by the Chinese Government. Government support of clean fuels such as natural gas in utility plants (it replaces coal) and in vehicles hybrid engines (CNG to gasoline) are strong, established and growing.

Operating cash flow is strong at \$4 million in 1Q10 and construction costs on the Company's LNG facility should be winding down leaving a reserve cash balance of at least \$30 million. We believe this is adequate for their business development activities as well as ongoing acquisitions, but we will watch operating costs and margins closely.

We are reevaluating our short-term projections and will present our updated estimates model in our forthcoming research update.



### Analyst Certification

The analysts contributing to this report do not hold any shares of CHNG. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts' personal views as to the subject securities and issuers. RedChip Companies Inc. certifies that no part of the analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst authoring this report.

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RedChip Visibility Coverage Universe		
Rating	Number of Covered Companies	Percentage of Universe
Strong Buy	2	11.1%
Buy	12	66.7%
Speculative Buy	4	22.2%
Hold	0	0.0%
Sell	0	0.0%

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#### STRONG BUY

The current price reflects a substantial discount from the market and from its peers, and the company does not possess significant financial risk within its risk category. Future growth potential is undervalued relative to the company's stock price. The analyst believes the stock at current levels represents a compelling opportunity for capital gains over the time period to its target price.

#### BUY

The current price reflects a discount from the market and from its peers, and the company does not possess significant financial risk within its risk category. The analyst believes the stock at current levels will provide an opportunity for capital gains over the period of its target price. Several factors can indicate an undervaluation of the company's shares.

#### SPECULATIVE BUY

The current price appears to offer potential gains though risk is considerably higher given its risk category. There may be insufficient historical data or clear-cut prospects to warrant a "Buy," but the analyst believes that the long run prospects of the Company are positive. The analyst believes its risk reward ratio advocates purchase of the stock. In the short term, the stock may be subject to high volatility and continue to trade at a discount to its market.

#### HOLD

The analyst is unable to assign a buy rating due to a number of specified factors noted in the report. These include the stock being fairly valued relative to its peers and the market, or the company may have risks that make it potentially unsuitable for investment within its risk category. Similarly there are no currently known compelling factors that would warrant selling. The analyst will remain neutral pending developments.

#### SELL

The analyst believes that the Company is overvalued based on its current status. The future of the Company's operations may be questionable and there is an extreme level of investment risk relative to reward given its risk category. An investment in the company may produce below market returns and/or deficits.

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