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VISIBILITY INITIAL REPORT



China Natural Gas, Inc.
(NasdaqGM: CHNG)

JANUARY 25, 2010 | TARGET PRICE: \$15.00 | RATING: BUY

ANALYST

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MARKET DATA

TICKER	CHNG
FISCAL YEAR	DECEMBER
SECTOR	OIL & GAS
RECENT PRICE	\$2.81
TARGET PRICE	\$13.50
MARKET CAP	\$85.0M
52-WEEK HIGH - LOW	\$3.60 - \$0.50
PRICE/EARNINGS (TTM)	5.5X
PRICE/BOOK (MRQ)	1.1X
PRICE/SALES (TTM)	0.6X
SHARES OUTSTANDING	30.2M
FLOAT	12.8M
AVG DAILY VOLUME (3 MOS)	116,498
INSIDER OWNERSHIP	55.6%

As of January 6, 2010

FINANCIAL DATA

REVENUE (TTM)	\$140.5M
REV (TTM) PER SHARE	\$4.65
QRTL REV GRWTH YOY	5.3%
GROSS PROFIT (TTM)	\$33.8M
OPERATING MARGIN (TTM)	15.5%
EBITDA	\$21.7M
NET INCOME (TTM)	\$15.4M
DILUTED EPS (TTM)	\$0.58
QRTL EPS GRWTH (YOY)	-0.2%
CASH & EQUIV (MRQ)	\$4.2M
CASH (MRQ) PER SHARE	\$0.14
TOTAL DEBT/EQUITY	56.4%
BOOK VALUE PER SHARE	\$2.56
ROE (TTM)	22.2%
ROA (TTM)	13.4%

China Natural Gas Inc (“CHNG” or the “Company”) is a clean tech company providing natural gas for transportation use in China. The Company purchases natural gas from producers and sells compressed natural gas (CNG) for transportation vehicles through their 36 company owned refueling stations. CHNG also sells piped natural gas (PNG) to commercial and residential customers for heating and cooling systems. The Company is constructing a plant to produce liquefied natural gas (LNG) beginning in May 2010. The Company is located in Xi’an City in the western Shaanxi Province, China.

INVESTMENT RATIONALE

- Pure Play on booming natural gas segment in China which is growing at 20% driven by a change in Government policy from low cost, dirty coal to clean burning and environmentally healthier natural gas. Domestic economy is booming especially in the larger cities.
- **Established and lucrative business model.** CHNG realizes a 52% gross margin on their CNG business and 45% on residential gas sales. CHNG operates 24 stations in Shaanxi Province (where they are located) and 12 in Henan Province (adjacent Province). They have a 120 km high pressure pipeline that connects from a nearby trunk pipeline that brings the gas to Xi’an and then they have compression stations and a small fleet of trucks that bring the CNG to their refueling stations. They operate on very low inventory since most customers prepay for their products.
- **Strategic location.** Xi’an is a strategic location for two reasons: it is adjacent to the Ordos Basin one of the largest oil and gas fields in China and it is connected to a series of high speed highways connecting to the prosperous eastern mega cities around the Pearl River Delta (50 million people around Guangzhou) and Yangtze River Delta (30 million population centered around Shanghai).
- **Outstanding Growth Projects under way.** The LNG Project and joint venture with China National Petroleum Company are very significant and can generate \$100 million of additional revenue over the next few years. LNG Project. CHNG plan to invest \$45 million and distribute the LNG using modern trucks to wealthier cities towards the east. The

Project has a 3 year payback according to the Company and at capacity will generate \$72 million in sales at an estimated 25+% gross margin. The project is planned to launch May, 2010. Joint Venture with China National Petroleum Company (CNPC). CNPC is a large State owned enterprise (10% public share holders traded NYSE: CNPC), is the largest oil and gas company in China and has 75% of the PRC gas production. The JV will expand the CNG refueling stations across the country. CNPC has 51% and CHNG has 49% of the JV.

- Sales driven by new CNG stations and LNG Project. Despite the recession 2010 should be a strong year.
- The Company raised \$54 million in a secondary stock offering in September 2009.
- **NASDAQ listing and independent Board of Directors.** The independent directors are very high quality businessmen including former City politicians and members of the Communist Party, officers of other NASDAQ listed companies and international bankers.

Company History. The Company was incorporated in Delaware in 1999 as Bullet Environmental Systems. After a name change to Covent Enterprises, Covent issued 4 million shares to Xi'an Xiling Natural Gas Co. Ltd (XXNGC) in December 2005. Various subsidiaries were subsequently formed in China. CHNG operates as a US based holding company for these subsidiaries. Control of the operations in China is managed by contracts and ownership as noted in the chart below.

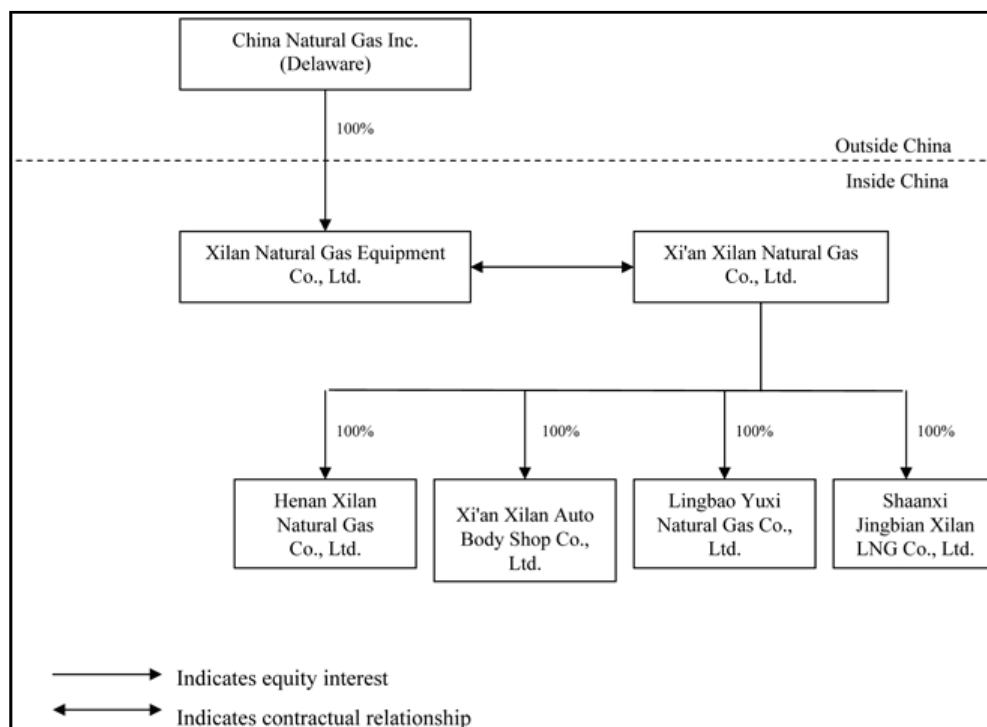


Figure 1 Organization Chart

Financial Results. Q3 '09 revenues were up 9.4% vs. '08 primarily due to CNG sales being flat and installation services increasing over 100%. Gross profit increased only 2.4% YoY due to higher cost of

coal bed methane gas purchases for refueling and CNG sales. Operating expenses increased 24.9% due to higher sales, general and administrative costs as well as higher depreciation charges. Consequently net income declined 9.4% vs. '08 and EPS declined 17.1 % due to the increased shares outstanding from the September 2009 secondary offering of 6,583,750 shares including over allotments. As of 9/30/09 there were 21,183,904 basic common shares outstanding. This was not a strong quarter and when compared to the 2Q'09 indicates some concern that growth assumptions need to be carefully considered.

For the 9 months year to date revenue is still a strong 20.4% positive and gross profit is up 27.5%. The higher operating expenses and dilution result in only 7.1% EPS growth. However, the impact of the capital raise will be seen over the next two years and this snapshot is just a point in time.

	3Q09 vs. 3Q08	3Q09 vs. 2Q09	9 mo '09 vs. '08
Revenue	9.40%	-3.00%	20.40%
Gross Profit	2.40%	-5.50%	27.50%
Operating Expenses	24.90%	9.00%	42.60%
Net Income	-9.50%	20.30%	10.90%
EPS	-17.10%	11.50%	7.10%

Business. CHNG sells PNG to residential, commercial and industrial users. In addition, the Company charges for the costs to install connections to their pipeline. The Company also sells and installs CNG conversion kits that enable the vehicle to run on either CNG or petroleum fuels (gasoline or diesel) so are truly 'hybrid' vehicles.

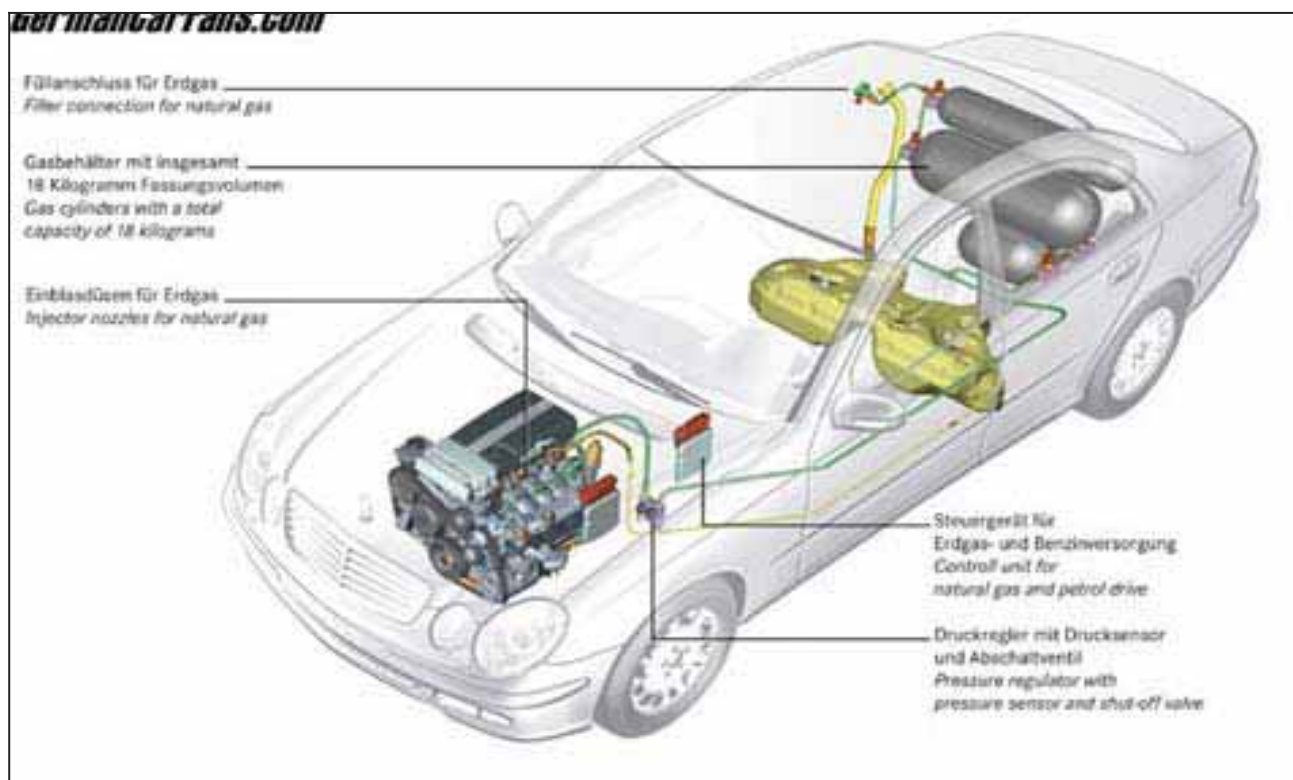


Figure 2 Schematic of Hybrid Vehicle



The refueling station volume is 95% CNG and the remainder is gasoline to cover hybrid vehicles operating on both CNG and gasoline. CNG prices are generally set at 60-75% of the cost of gas (about RMB 4/liter or US\$2.20/gallon) which provides a 90 day payback for the vehicle owner and 60% margin for CHNG.

The economics of refueling stations is excellent: a 2-3 year payback.

USD '000	Shaanxi Province		Henan Province	
	Self-built	Acquired ⁽¹⁾	Self-built	Acquired ⁽¹⁾
Filling Station	\$1,300	\$2,000	\$1,300	\$2,000
Tankers (2); Locomotive (1)	\$400	\$400	\$400	\$400
Total Investment	\$1,700	\$2,400	\$1,700	\$2,400
Annual sale volume ('000 m ³)	4,889	4,889	4,037	4,037
Average sale price net of VAT (\$/m ³)	0.34	0.34	0.41	0.41
Annual revenue	\$1,673	\$1,673	\$1,675	\$1,675
Gross margin (%)	52.5%	52.5%	54.1%	54.1%
EBITDA	751	751	793	793
EBITDA (%)	44.9%	44.9%	47.3%	47.3%
Cash Payback period (years) ⁽²⁾	2.26	3.19	2.14	3.03

Source: Company

Shaanxi Province has 65 CNG refueling stations and CHNG operates 24 which is a 37% share of the local market. The remaining stations are either Government or individually owned.

The Company expanded into adjacent Henan Province in 2008 when they acquired a local competitor that operated five stations. Current customers are mostly fleet owned busses and taxis that are large fuel consumers. Individual; car owners are a small percentage at this time but about 10-20% of new vehicles come equipped as 'flex fuel' so this segment offers excellent growth prospects.

LNG: CHNG is one of a few companies that received authority to build a natural gas liquefaction facility in China based on domestic natural gas supply. The fundamental reason to liquefy gas is that the volume is reduced by a factor of 600. This is done by cooling the gas to the liquefaction point (-273 degrees C) which requires specialized heat exchange equipment and is expensive and energy intensive. Typically LNG plants are built near sources of low cost stranded gas (Algeria, Indonesia, Middle East) and then the LNG is transported in specially built ocean vessels to overseas destinations where the LNG is gasified and consumed. These are usually very large, multi billion \$ facilities in order to capture the economies of scale. The other type of LNG plant is small operations located at a gas fired power plant. The utility takes advantage of the reduced LNG volume to store the fuel for time periods when supply is low and expensive i.e. winter cold spells. These are called peak shaving plants. The planned CHNG facility is a uniquely Chinese business: the size is similar to the peak shaving plants in the US but rather than store the LNG and use at a peak time period, CHNG intends to transport the LNG to more distant provinces and sell at a good margin. It is a pricing arbitrage. LNG consumer prices are set by market prices not the Government. Consequently CHNG is sourcing their product under low Government prices and selling at the market. A key to success is having trucks suitable to carry LNG and access to markets via major



highways. Management believes they have resolved these issues.

Vehicles run on CNG and LNG all over the world (including an emerging market in the US). T. Boone Pickens has proposed a “Clean Energy” plan that is centered on use of LNG and CNG as fuel, initially for heavy duty trucks. Natural gas vehicles have been growing at accelerating rates and increased 30% in 2008 (see Figure 6). Growth is primarily in Asia and Brazil where they provide the following benefits to consumers and Governments:

- Substantially lower emissions (87% less nitrogen oxide, 70% less carbon monoxide, 25% less carbon dioxide)
- Safe vehicles
- Ease of adoption
- Low cost conversions
- Flexibility of fuel choice to operator
- Refueling stations are easy to add nationwide
- Refueling stations connect easily to existing infrastructure
- Targeted financial subsidy
- Ongoing cost savings to operators vs. gasoline

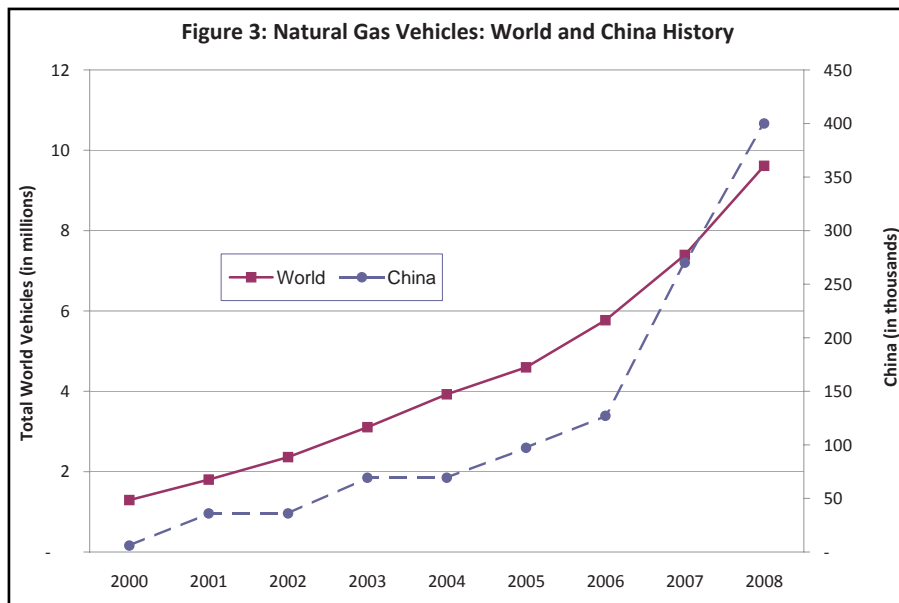
According to the International Association of Natural Gas Vehicles natural gas vehicles in China have grown over five fold in the last five years from 69,000 in 2005 to 400,000 in 2008. Since China has over 71 million vehicles on the road an extraordinary rate of growth could continue for some time.

Natural Gas Vehicles in China									
Country	2000	2001	2002	2003	2004	2005	2006	2007	Current-
China	6,000	36,000	36,000	69,300	69,300	97,200	127,100	270,000	400,000
Growth vs. Prior Yr,%	-	500%	0%	93%	0%	40%	31%	112%	48%

CNG vehicles have been growing at an 80+% rate the last eight years and over 30%/year worldwide. Although this rate of vehicle growth is probably not sustainable it is a very large number and will translate into demand for refueling stations. The automotive fleet in China is about 70 million (cars and light trucks) so conversions of even a small percentage will provide very high growth rates of CNG vehicles and thereby demand for refueling stations. See Figure 3

Growth Prospects. CNG for transportation is the primary business and has strong growth prospects.

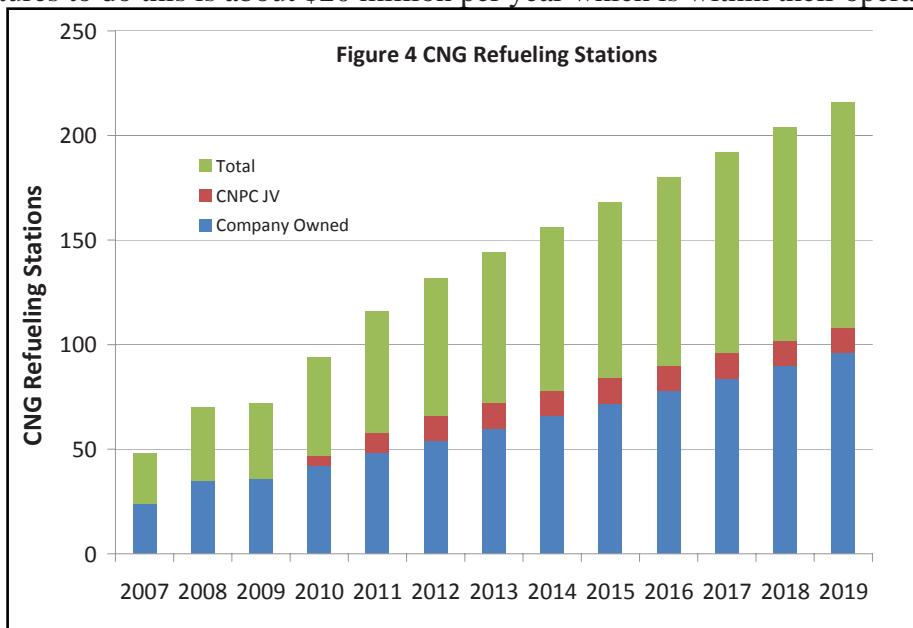
- Consumers Domestic manufacturers offer flex-fuel vehicles off the assembly line which makes CNG sales much easier by eliminating the task of buying the conversion kit. Domestic sales are 7 million/year and according to Management 10-20% have flex fuel capability
- Commercial Centers. The Company is in talks with large fleet owners that could utilize a captive refueling station (deliver and logistics companies as an example). They are also talking to a large port and harbor of a nearby river to install refueling for trucks and equipment at that facility. This is analogous to Clean Energy Fuels’ (NYSE:CLNE) arrangement with the Port of Long Beach.
- Geographic Expansion. The JV with CNPC will assure them supply of natural gas beyond their current base in Shaanxi and Hubei Provinces. Expansion along major highways would be a logical



Source: International Association of Natural Gas Vehicles <http://www.iangv.org/tools-resources/statistics.html>

step.

The ability of the Company to grow at these high rates will not be easy. The working assumption is that they can add about 12-18 refueling stations/year including those organized through the joint venture. The total capital expenditures to do this is about \$20 million per year which is within their operating cash flow.



The China National Development and Reform Commission (NDRC) has designated CNG/Gasoline hybrid vehicles as an “encouraged development” and can receive favorable treatment in taxes, rebates and subsidies. The NDRC has also encouraged production of CNG hybrid vehicles. Major vehicle manufacturers in China including BYD, Citroen, Chery, Volkswagen and Xiali have developed hybrids including flex fuel versions capable of running on CNG. <http://www.greencarcongress.com/2009/02/chery-launches.html>.



NATURAL GAS INDUSTRY IN CHINA

Natural gas consumption grew 23.8% in 2007 to 69.5 billion cubic meters (BCM) making China one of the ten largest gas consuming countries in the world even though gas is only 3.5% of the country’s energy mix. The Government has set a goal of natural gas consumption to grow to 10% of energy consumption by 2020. In order to reach this goal natural gas will have to grow faster than energy consumption. If energy grows at 5%/year then natural gas must grow at 13.8% to reach this goal. The actual natural gas growth rate is likely to be even higher than this since energy consumption is likely to exceed 5%/year growth.

Historically gas has been under-utilized for several reasons. One is the cost of building pipelines and compression stations to connect the producing basins in the west to the consuming areas on the east coast. Another is coal is widely available and cheap and in addition the concern or commitment to act to reduce air pollution was a low priority. Automobile consumption was also very low.

All of that has changed now: China has massive amounts of money for infrastructure, the pollution problem in the large cities has reached a point where something has to be done (seven of the ten most polluted cities in the world are in China). China is the second largest vehicle market in the world: total fleet of 72 million cars and buses with 2008 sales were 7.2 million (source: Department of Transportation, Ministry of Public Security, August 2009 basis). The Plan forward is to subsidize natural gas use for residents (heating) and conversion of busses and taxis to cheaper natural gas (CNG). China is increasing domestic production but realize they will never be ‘independent’ so are acting to secure stable supplies of gas by building LNG gasification centers on the coast (supplied from Australia mostly) and building pipelines from Russia (north) , Myanmar (south) and Central Asia (Turkmenistan) from the west. They have committed billions of US\$ for infrastructure pipelines (West-East).

Gas Reserves. China has very significant gas reserves in western and north central China estimated at 56 trillion cubic meters (TCM) on a prospective basis according to CNPC. In addition there is a potential of 37 TCM of coal bed methane gas. Three basins provide half of the reserves: the Tarim Basin in Xinjiang (far western province) the Ordos Basin across Shaanxi Province (where CHNG is located), Gansu and Ningxia and Inner Mongolia and Sichuan Basin in Sichuan.

Table 1. Natural gas resources by gas basin (tcm)			
	Prospective	Geological	Recoverable
Tarim	11.3	8.9	5.9
Ordos	10.7	4.7	2.9
Sichuan	7.2	5.4	3.4
East China Sea	5.1	3.6	2.5
Qaidam	2.6	1.6	0.9
Yinggehai	2.3	1.3	0.8
Bohai Bay	2.1	1.1	0.6
Qiong Southeast	1.9	1.1	0.7
Songliao	1.8	1.4	0.8
Others	10.8	6	3.6
Total	55.9	35	22
Source: CNPC (latest resources survey in China, 2005)			

Figure 5 Gas Producing Basins in China



Source: CNPC

Infrastructure. Traditionally natural gas was used for fertilizer production and these plants were established near the gas producing fields consequently few pipelines were required. Over the last ten years this has changed dramatically. Gas pipelines now total 31,000 km in length and numerous expansion plans exist as noted below:

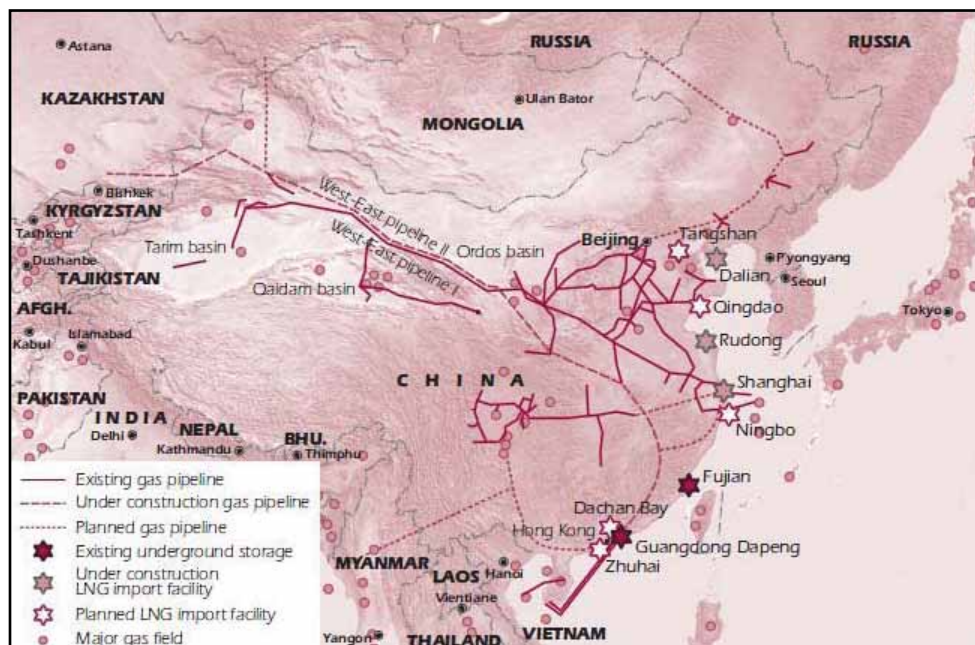
Pipeline	Route	Length, km	Capacity, BCM	Status
Ordos-Beijing	Shaanxi-Beijing	868	3.6	Operational
West-East	Tarim Basin (Zinjiang Province) – Shanghai	3,900	17	Operational
Ordos #2	Shaanxi-Beijing	868	12	Operational
Sub Sea	South China Sea-Hong Kong			Operational
Sub Sea	East China Sea-Shanghai			Operational
Others		25,364		Operational
Total		31,000		Operational
West-East- Part 1	Turmenistan-Shaanxi- Gansu			
West-East- Part 2	Gansu- Guangdong			
West-East #2	Turmenistan-Guangdong	4,843	30	Under Construction
Sichuan East	Sichuan-Shanghai			Planned
Sichuan South	Sichuan-Guangdong			Planned

Pipelines connecting natural gas from Russia to China have also been announced.

In addition to these major pipelines that are transporting gas within China as well as importing from other countries, China has started building a series of LNG terminals near the major consuming cities on the east

coast. The first was in Guangdong Province and started receiving shipments in 2006. The second in Fujian started in 2008. Additional terminals are planned in Shanghai, Jiangsu and Dalian as well as other cities. Total import capacity is 22 BCM per year.

Figure 6 Existing and Planned Natural Gas Pipelines and LNG Terminals in China



Sources: Petroleum Economist, CNPC, IEA

Table 3. LNG Receiving Terminals

Status	Location	Capacity (mtpa)	Year Opened	Leading Companies
Under Construction	Shanghai	3	2009	CNOOC (45%), Shenergy (55%)
	Jiangsu	3.5	2011	CNPC (55%), Pacific Oil & Gas (35%)
	Dalian	3.5	2011	CNPC (75%)
Approved	Zhejiang	3		CNOOC (51%), Zhejiang Energy (29%)
	Qingdao	3		Sinopec
Planned	Zhuhai	3.5		CNOOC (25%), Guangdong Electric (35%)
	Shenzhen	3.5		CNPC (51%), CLP (24.5%)
	Caofeidian	3.5		CNPC
	Hainan			CNOOC

* The capacity will expand to 5.7 mtpa by 2011.

Sources: Media reports

mtpa - metric tons per annum

Policy and Regulation. Natural gas demand grew at 7% in the 1990's but was only 3.5% of energy consumption (coal was 69.5% in 2007). The 10th Five Year Plan (2001-2005) set the target of 10% gas consumption of energy mix by 2020 in order to address environmental problems and improve energy efficiency. According to projections this will be 250 BCM in 2020 vs. 70 BCM in 2007. The Government (NDRC National Development and Reform Commission) says natural gas has increased its share of energy consumption from 2.4% in 2000 to 3.5% in 2007 while coal increased from 67.8% to 69.5% during that



time. The policy changes initiated in 2007 for natural gas include establishing priorities by economic sector and pricing. Priorities will be given to the residential sector including city residential uses and public facilities and natural gas vehicles. Industrial uses will be allowed. Chemical feedstocks will be allowed but certain industrial uses of natural gas will be prohibited (methanol). The power sector will also be a priority but only for combined cycle (power and steam from cogen) projects.

Pricing. The Government (at a national and provincial basis) controls natural gas and energy prices. The current price regime is three fold: the ex-plant price, the transportation tariff and end-user price. The national Government (NRDC) set the ex-plant and transportation tariff while provincial authorities determine the end user price. The NRDC generally looks for a cost plus return (12% IRR) in setting prices. The City Gate price is the sum of the ex plant and transportation.

Ex Plant. Prices for each producing basin are set for each consuming sector: fertilizer, residential, industry and generally in that order from low to high. Prices in 2008 ranged from US\$2.13/MBTU (thousand British thermal units) (residential use in far west Zinjiang Province) to US\$5.24/MBTU for category 2 industrial users buying from the Dagang, Liaohe, Zhongyuan Field (in Bohai Bay, northern China). These prices were well below international rates for most of 2008 but now are reasonably in line with US well head prices.

Transportation Tariff. Rates are set for each pipeline to reflect construction cost and return and distance to the destination. Selected City Gate prices (sum of ex plant and transportation tariff) are shown for Shaanxi, Beijing and Shanghai Provinces. The larger prosperous cities pay over 50% more than Shaanxi Province.

Table 4. Selected City Gate Natural Gas Prices, 2008

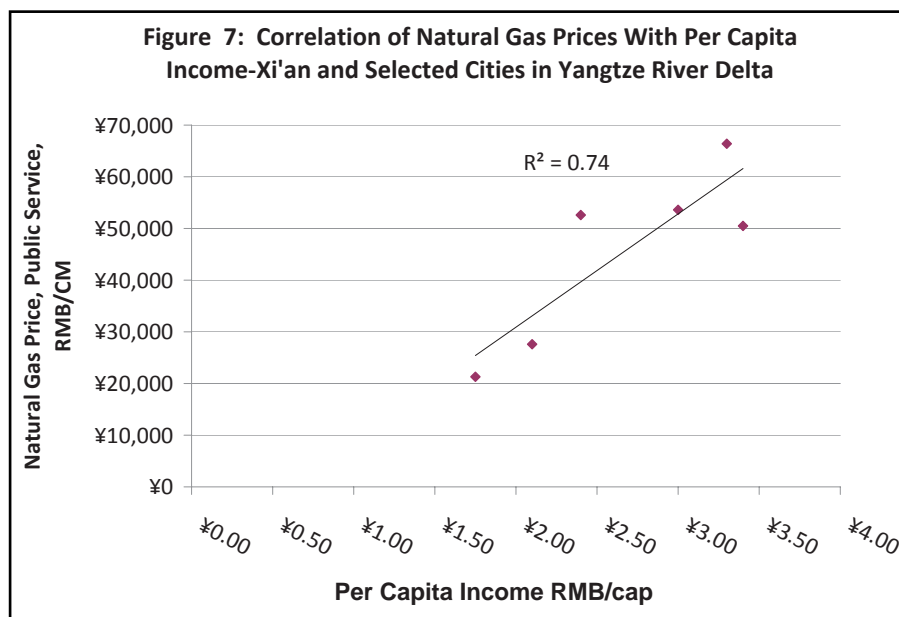
Pipeline	Destination	Sector	CNY/1000m3			USD/MBtu
			Ex-Plant	Pipeline Tariff	City Gate	City Gate
Ordos-Beijing	Shaanxi	-	830	120	950	\$3.61
Ordos-Beijing	Beijing	-	830	450	1,280	\$4.86
West-East	Shanghai	Industry	960	800	1,760	\$6.69
West-East	Shanghai	Residential	560	980	1,540	\$5.85
West-East	Shanghai	Power	560	670	1,230	\$4.67

End-User Price. These are set by Provincial officials according to the city gate price and end use. End user prices are higher in the more prosperous eastern cities. Independent gas distribution companies buy at the city gate price and sell at the end user price and secure the rather healthy 40-80% markups.

Table 5 End User Prices and Margin vs City Gate for Selected Cities

Region	Province	City	City Gate Price, USD/MBTU		End User Price, USD/MBTU		Margin, %	
			Public Service	Industry	Public Service	Industry	Public Service	Industry
West	Shaanxi	Xi'an	\$3.61	\$3.61	\$6.65	\$6.65	84.2%	84.2%
North	-	Beijing	\$4.86	\$4.86	\$9.69	\$8.93	99.4%	83.7%
Yangtze River Basin	-	Shanghai	\$5.85	\$6.69	\$12.54	\$11.02	114.4%	64.7%
Yangtze River Basin	Jiangsu	Nanjing	\$5.70	\$6.65	\$11.40	\$10.45	100.0%	57.1%
Yangtze River Basin	Zhejiang	Ningbo	\$5.85	\$7.37	\$12.92	\$12.92	120.9%	75.3%
Central	Henan	Zhengzhou	\$4.71	\$6.08	\$9.69	\$8.66	105.7%	42.4%

Figure 7 below clearly shows that end user pricing is correlated with the wealth of the local community. It also shows the magnitude of the margin available to independent natural gas distributors such as CHNG who can acquire gas at about 1 RMB/CM.



Supply and Demand. Gas consumption is growing over 20%/yr since 2004 due to the policy and price changes and economic growth already noted. The residential sector (including transportation) is the fastest growing sector at 25%/yr from 3.7 BCM in 2000 to 17.7 BCM in 2020. This corresponds to the number of cities having access to gas growing from 60 in 2003 to 140 in 2005 (per IEA 2007) and expectations to grow to 270 in 2010. A contributing factor to this growth was a policy that priced LPG (liquefied propane gas) comparably to petroleum and at a premium to natural gas.

Competition. Although the margins and growth are exceptionally high CHNG seems to be reasonably well protected from competition based on the time and effort to secure permits to operate refueling stations. This would not seem to prohibit new entrants from entering the business via acquisition, however. In addition, if it is so hard to secure permits how will CHNG grow by expanding into new provinces? The other major obstacle is arranging supply agreements with the E&P companies producing natural gas. In this regard CHNG's joint venture with the largest natural gas producer in China (China National Petroleum-CNPC) simultaneously puts them in both a strong offensive position based on available supply of gas and defensive position since CNPC will not be working with any other CNG operator. Supply shortages have resulted recently due to low temperatures and high residential heating demand. The Government responded by protecting consumer use and cutting back on supplies to industrial and commercial users.

Since Government agencies establish prices this is a major risk to maintaining the current margins. How they will react to support E&P producers (increase well head prices), or to subsidize consumers (keep end user prices down) is not known with certainty. Longer term there may be more open market pricing which is also a threat.



There are also technological threats from competing ‘clean’ energy sources including electric hybrid vehicles, wind turbines, biodiesel and others.

VALUATION

Two conventional valuation methods were used. A Discounted Cash Flow (DCF) of expected cash flows over time, and comparison to a peer group of companies.

DCF Method. For valuation purposes CHNG is broken into three discrete segments: the existing business in Shaanxi and Henan Province and incorporating all of their current products and services (Base Business), the JV with China National Petroleum (CNPC JV), and the third is the LNG Project.

Pricing is assumed to be less than inflation or 2%/year vs. a capital cost inflation rate of 5%/year due to general economic growth and demand. This reflects an opinion that Government will tend to keep end user prices low. Unit growth will vary by segment (see Appendix Table 1). The Base business is assumed to grow at about six stations/year but the JV growth should be substantially higher due to entering new provinces and strength of their partner (12/year is assumed). The LNG business is assumed to quickly reach capacity of 150,000 CM/yr but is not expanded beyond that volume. This is due to the stated Government policy of not authorizing additional LNG terminals that are based on local gas (rather than imported gas). Base business and JV gross margins are quite high currently and are assumed to decline 1%/year due to equipment and natural gas cost increases and competition. Gross margins in year ten are 10% lower than in 2009. SG&A expenses, which include depreciation, are assumed constant at 19% of sales which is fairly conservative. LNG sales are assumed to have lower 25% gross margins due to substantially higher operating costs than the base business. The assumed 25% margin provides the 2-3 year payback Management presents. The key assumption is that CHNG can continually reinvest in the business and maintain the historical revenue/capital ratio of 1.2.

The result is sales growth of 25%/year over the next five years and EPS grows at 14%/year due to the gradually declining margins in the base business and the impact of the much lower margin LNG business.

The net asset value of discounted cash flows is \$17.80/share fully diluted. See Appendix Tables 1 and 2. The sensitivity to key assumptions is presented below. The NAV is \$5.20 higher if the current gross margins are retained making this a key assumption. A 1% higher discount rate (11% vs. 10%) reduces the NAV/share by \$1.20/share.

Case	NAV, \$/share	Change, \$/share
Base Case	17.8	-
1%/yr Higher Gross Margins	23	5.2
100 Basis Point Lower Discount Rate	16.6	1.2

The sales assumptions and resulting capital investment requirements are well within CHNG’s operating cash flow (\$20+/- million/year) so there is no apparent need for additional share or debt offerings under these assumptions.



Peer Group Comparables. Four companies operating in similar businesses and similar market capitalizations were selected as a peer group. China North East Petroleum Holdings Ltd is a small E&P Company operating in northern China with shares listed on the American Stock Exchange- New York Stock Exchange under the symbol NEP. CIMC Enric Holdings, Ltd is a manufacturer of natural gas compression and liquefaction equipment in China and is listed on the Hong Kong Stock Exchange. Sino Gas International Holdings is a distributor of natural gas to buildings (no transportation business). Longwei Petroleum Investment Holdings, Ltd is a distributor of petroleum products in central China and is listed on the OTC BB.

CHNG is currently valued at a 10-20% premium to this peer group based on the valuation measures of P/E, Price/book and price/sales. Their revenue growth over the last six months is substantially higher than for the peer group but that is mitigated somewhat by the sequential decline in CHNG revenue Q3 vs. Q2 of 2009. CHNG margins are above average. Each of the peers is in the energy/petroleum sector which should grow at about 10-20% for the next few years. CHNG might have stronger prospects due to the JV with CNPC and the LNG project. One can conclude that a 25% valuation premium on CHNG is reasonable which equates to a P/E multiple of 14 (the current value). A P/E to estimated EPS growth rate ratio of 1.0 is conventionally an excellent indicator of value. Applying this multiple to the fully diluted estimated 2010 EPS of \$0.85 calculates to a 12 month price target of \$12.00/share which implies an 11% return over current prices.

Company	Business	Symbol	Exchange	Shares Out, mil	Price	Market Cap, \$mil	Cash, \$ mil	Debt \$mil	Ent Value,\$mil
Northeast China Petroleum	E&P	NEP	AMEX	24.0	\$6.88	165	33.2	3.0	134.9
CIMC Enric Holdings Inc(1),(2)	natural gas compression equipment	3899	Hong Kong	459.0	\$0.63	291	29.8	5.8	267.3
Sino Gas International Holdings	natural gas distribution	SGAS	OTC BB	26.8	\$0.90	24	1.9	0.0	22.2
Longwei Petroleum Investment Holdings,Ltd	distributor of petroleum products	LPIH.OB	OTC BB	83.0	\$2.93	243	9.4	0.0	233.6
China Natural Gas	natural gas products distribution	CHNG	NASDAQ	21.2	\$11.20	237	55.9	40.0	221.5
Valuation									
							Margins, %		
Company	P/E (TTM)	EV/Op Profit	Price/Book Value	Price/Sales	Revenue Growth vs Prior Year, %		Operating Profit	Net Income	Growth Outlook, %/yr
Northeast China Petroleum	9.8	4.3	2.1	3.4	-21.0%	(3)	63.8%	34.1%	20%
CIMC Enric Holdings Inc(1),(2)	14.2	10.5	2.4	1.7	11.7%	(4)	15.2%	12.3%	20%
Sino Gas International Holdings	8.7	6.8	0.5	1.0	30.0%	(5)	13.9%	10.3%	20%
Longwei Petroleum Investment Holdings,Ltd	10.3	6.6	2.0	1.1	6.8%	(6)	16.8%	11.1%	15%
Average	10.8	7.0	1.8	1.8	6.9%		27.4%	17.0%	18.8%
China Natural Gas	13.7	9.1	1.7	3.0	20.4%	(7)	30.5%	21.7%	20%

(1) Converted at 6.9RMB/US\$
(2) Converted at 7.8HK\$/US\$
(3) 9 mo end 9/30/09
(4) 12 months end 6/30/09
(5) 9 mo end 9/30/09
(6) 12 mo end 6/30/09
(7) 9 mo end 9/30/09

Conclusion. A reconciliation of the NAV of \$17.8/share and a current price of \$11.00 indicates the market is discounting the NAV about 40%. This does not seem unreasonable given the uncertainty in the key growth assumptions used in the DCF calculations. The LNG plant has not started production and has been delayed once already. The CNPC JV has not made any acquisitions nor built any new refueling stations. Projecting the NAV forward at the assumed 10% discount rate gives a year ahead NAV of \$19.6/share. Assuming the LNG plant is on schedule and other milestones are met the stock might sell at a 10% discount to the future NAV (\$19.6 less 10%=\$17.6). Averaging the two values (\$17.6 and \$12.00) gives \$14.8 which we can round to \$15 as a 12 month price target.

It should be noted though that the DCF assumptions may very well prove too conservative and a share price substantially higher than the \$17.8 NAV may be realized over the next 2-3 years. These assumptions will be revisited over time.

Management and Directors. CHNG has a high quality Board of Directors of which 2 are employees and 5 are non-employees and meet the NASDAQ tests for independence.

Mr. Qinan Ji - Chairman of the Board and CEO

Mr. Qinan Ji joined China Natural Gas in February 2005 bringing with his more than 20 years experience in the energy and petroleum industry. Before joining CHNG, Mr. Ji founded Sunway Technology Industries Co., Ltd., in September 2001, where he served as Chairman and General Manager. In June 1990, Mr. Ji became a member of the Commission of the Chinese People's Political Consultative Conference representing Weinan City. During this time he also served as Chairman of the Board of Weinan Anxian Petroleum and Chemical Co. Ltd. Earlier in his career, Mr. Ji founded and ran Weinan Anxian Trade & Industry Company. Mr. Ji received a bachelor's degree in Economic Management from Northwest University (Shaanxi).



Peidong Lee-COO

Mr. Lee served as a vice general manager in Shaanxi Wu Yang Enterprise Group from June 2005 to February 2008, mainly taking charge of Shaanxi Wu Yang Real Estate Development Co., Ltd., Shaanxi Wu Yang Restaurant Entertainment Co. Ltd., Tangyu Lake Forest Garden. From 2003 to May 2005, he served as the manager of GOME Electrical Appliance. From 1980 to 2002, he served in the Air Ministry, where he was appointed as platoon commander, company commander, battalion commander, regimental commander, standing commissioner and secretary in party committee. Mr. Lee attained bachelor degree from Chinese People Liberation Army Second Flight University.

Mr. David She CFO

Mr. She joined China Natural Gas in February 2008 as Vice President of Finance and was placed in charge of the Company's New York office. He returned to the Company's headquarters in Xi'an, China, in December 2008 and was soon promoted to Assistant Chief Financial Officer. Mr. She was in charge of several functions within the Company, including the oversight of quarterly and annual filings with the U.S. Securities and Exchange Commission, evaluations of the Company's major acquisition opportunities, and the management of investor relations. He helped to coordinate the Company's \$40 million debt financing



in March 2008 and supervised legal, audit and regulatory reporting issues in the Company's \$57 million underwritten public offering in September 2009. Prior to joining China Natural Gas, Mr. She served as a securities analyst for West China Securities in Beijing. He received bachelor's degrees in mathematics and business administration from Beijing Institute of Technology as well as a master's degree in finance from State University of New York in Buffalo.

Ms. Fang Zhang - Corporate Secretary

Ms Zhang obtained her law bachelor degree from social science department of Xidian University. From 1985 to 2003 she worked as a director in Xi'an office of Shaanxi Province Yulin City government.

Ms Lixia Cao - Vice president of Engineering and Technology Department.

Ms. Cao worked in Xi'an natural gas Co. Ltd. which is a state-owned company. She has many years working experience in technology and engineering department in natural gas industry.

Bin Wang - Chief Engineer

Mr. Wang graduated at Nanchang Hangkong Industry College. He has served in Xi'an and Dongguan Xin'ao Natural Gas Co., Ltd. Previously he worked in Hainan Minsheng Natural Gas Co., Ltd. and Shaanxi Steel Factory Steel Research Institution.

Zhiwei Deng - Technology Consultant

Mr. Deng is a leader of Xi'an Clean Energy Vehicle Association. He is an expert of CNG and Clean Fuel Vehicle. He is also an editor of China Clean Fuel Vehicle magazine.

BOARD OF DIRECTORS

Mr. Qinan Ji - Chairman of the Board and CEO (see Management section)

Mr. Zhiqiang Wang - Chairman of Governance and Nominating Committee

Mr. Zhiqiang Wang was named Vice Chairman and an Independent Advisor of China Natural Gas in 2004. From 2002 to 2004 Mr. Wang served as the Chief Executive Officer of Xi'an Municipal Government Construction Company where he was in charge of the city's major construction projects. From 1992 to 2002 Mr. Wang served as Vice Mayor of the City of Xi'an as well as Head of the Energy Industry Regulations Committee, in which he was responsible for regulating and licensing the city's energy and natural gas businesses. In 2004 Mr. Wang retired from public practice and has since served as an independent advisor to the management of CHNG. Mr. Wang graduated from the Northwest College of Law (Shaanxi) in 1962.

Mr. Donald Yang--Director

Mr. Yang is a founding partner and president of Abax Global Capital (AGC), a leading Hong Kong based investment firm focused on Pan-Asian public and private investments especially in Greater China and Southeast Asia. He was a Managing Director responsible for Merrill Lynch's Hong Kong and China Debt Capital Markets division from 2000 to 2007. 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, is the sole investor in the Company's \$40 million note financing which closed in March, 2008.



Mr. Carl Yeung - Chairman of Audit Committee

Mr. Carl Yeung is the Chief Financial Officer of ATA Inc, a China based, leading provider of computer-based testing and education services in China listed on the NASDAQ Global Market. Prior to that, Mr. Yeung worked as an associate and analyst at Merrill Lynch (Asia Pacific) Limited from 2002 to 2006. Mr. Yeung holds a bachelor's degree in economics with concentrations in finance and operations management from Wharton School, University of Pennsylvania, and a bachelor's degree in applied science with concentration in systems engineering from School of Engineering and Applied Sciences, University of Pennsylvania.

Mr. Lawrence W. Leighton -Chairman of Compensation Committee

Mr. Leighton has had an extensive 40 year international investment banking career. Beginning at what is now 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. 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.

RISKS

Pricing. Governments at the national and local level set prices of natural gas at the producer level as well as for each class of consumer (industrial, commercial, residential). Currently these are quite attractive to CHNG but there is no certainty that they can be maintained over time. The price levels represent a 'win-lose- decision between the interests of the consuming public and producers (which are typically majority State owned entities).

Corporate Structure. The Company is listed on the NASDAQ and has an independent Board of Directors. However, they have no assets in the US but act as a holding company for the operating entities in China. They rely on contracts between their China based subsidiary and the local operating entities to establish control.

Competition. CHNG competes with other private operators and city owned enterprises in the CNG business. They have competitors in the LNG business as well. The use of CNG is just one flex fuel, environmentally clean alternative for vehicles. Competing technologies include methanol, biodiesel, ethanol, electric vehicles, electric hybrids and others that may develop into viable alternatives to CNG.

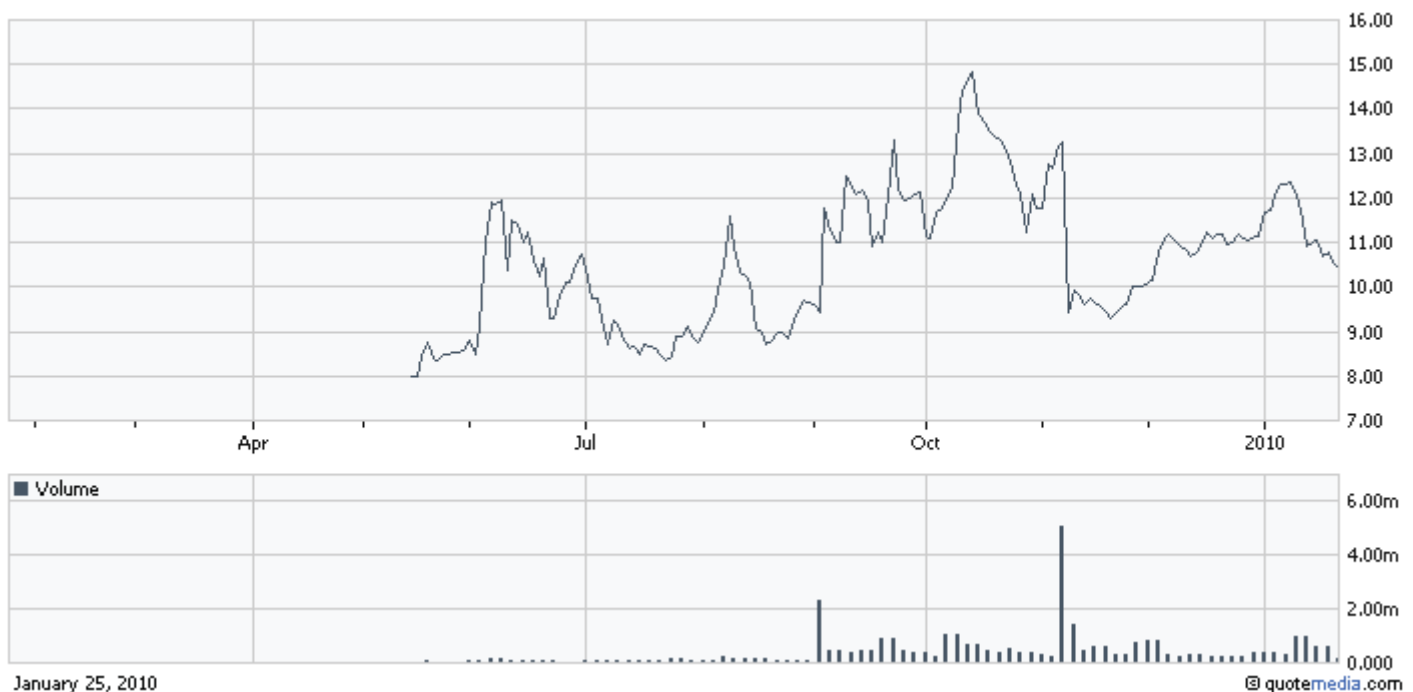
China Economic Growth. China's GDP has been growing at a 9-10% clip for several years which extraordinarily high and may decline at some point.



Foreign Currency Exposure. China currency, the renminbi (RMB) or yuan (¥) exchange rate is ‘pegged’ by PRC Government officials at RMB 6.9 to 1 US\$. . Since CHNG has revenue and earnings in RMB which are converted to US\$ for reporting purposes, the Company would see an increase in earnings if the RMB was strengthened, and conversely earnings would decline if the RMB was devalued from current levels. Although investors generally believe the RMB has historically been undervalued since that helps exports resulting in a massive trade surplus (exports exceed imports), there cannot be any assurance a revaluation would occur. In addition, China has injected massive funds into the local economy over the last year in order to stabilize the local economy from the global recession and higher inflation and currency devaluation cannot be ruled out as a possibility.

LNG Facility. The Company started construction of the LNG Plant in 2007 and originally announced a start date of December 2009. In November 10, 2009 Management announced that they would not meet the December 2009 start date and indicated start up would now be Q2 2010. The reasons given were delays in importing equipment and changes in safety regulations requiring additional equipment.

12-MONTH PRICE CHART





China Natural Gas, Inc. (NasdaqGM: CHNG)

APPENDIX TABLE 1

INITIAL REPORT

Appendix Table 1 Discounted Free Cash Flow Model										
Forecasting Variables:										
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue growth factor	31%	74%	11%	10%	9%	9%	8%	8%	7%	7%
Expected gross profit margin	46%	39%	39%	39%	39%	38%	38%	38%	37%	36%
S, G, & A expense % of revenue	19%	19%	19%	19%	19%	19%	19%	19%	19%	19%
Depr. & Amort. % of revenue	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Capital expenditure growth factor	-45%	-25%	8%	2%	8%	2%	2%	2%	2%	2%
Net working capital to sales ratio	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
Income tax rate	19%				40%					
Assumed long-term sustainable growth rate	4%	per year after 2011			5%					
Discount rate	10%				20%					
Terminal Value, multiple of Yr 10 Cash Flow	10									
Valuation Model Outputs:										
Gross profit margin	46%	39%	39%	39%	39%	38%	38%	38%	37%	36%
Net operating profit margin	20%	15%	15%	15%	15%	15%	15%	15%	14%	14%
Free cash flow (\$ mil)	\$7.5	\$20.6	\$25.6	\$30.3	\$50.1	\$51.1	\$42.3	\$46.1	\$49.8	\$53.2
Terminal value (\$ mil)										\$532.1
PV of Company Operations (\$ mil)	\$413.7									
Market Value of Company Assets (\$ mil)	\$475.1									
Growth vs Prior Year, %										
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Base Business	11.3%	10.4%	9.6%	8.9%	8.4%	7.9%	7.4%	7.1%	6.7%	6.4%
CNPC JV		204.0%	82.1%	46.0%	32.1%	24.8%	20.3%	17.2%	15.0%	13.3%
LNG		500.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Revenue										
Base Business	88.5	97.7	107.1	116.6	126.4	136.3	146.4	156.8	167.3	178.1
CNPC JV	3.7	11.2	20.3	29.7	39.3	49.0	58.9	69.1	79.4	89.9
LNG	12.0	72.0	73.4	74.9	76.4	77.9	79.5	81.1	82.7	84.4
Total	104.2	180.9	200.9	221.2	242.0	263.2	284.8	306.9	329.4	352.4
Growth vs Prior	31.0%	73.6%	11.0%	10.1%	9.4%	8.8%	8.2%	7.7%	7.3%	7.0%
CAGR, 2010-2015	24.9%									
Gross Margin % (include adjustments)										
Base Business	49.0%	48.0%	47.0%	46.0%	45.0%	44.0%	43.0%	42.0%	41.0%	40.0%
CNPC JV	49.0%	48.0%	47.0%	46.0%	45.0%	44.0%	43.0%	42.0%	41.0%	40.0%
LNG	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
Total										
Gross Margin Reduction, %	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%
Gross Margin, \$										
Base Business	43	47	50	54	57	60	63	66	69	71
CNPC JV	2	5	10	14	18	22	25	29	33	36
LNG	3	18	18	19	19	19	20	20	21	21
Total	48	70	78	86	94	101	108	115	122	128
GM,%	46.2%	38.8%	39.0%	38.9%	38.7%	38.4%	38.0%	37.5%	37.0%	36.4%
New CNG Stations										
Base Business	6	6	6	6	6	6	6	6	6	6
CNPC JV	5	10	12	12	12	12	12	12	12	12
Total New Stations	11	16	18	18	18	18	18	18	18	18
CapEx, \$mil										
Base Business	7.2	7.6	7.9	8.3	8.8	9.2	9.6	10.1	10.6	11.2
CNPC JV	3.0	6.0	7.0	7.0	8.0	8.0	8.0	8.0	8.0	8.0
LNG	10.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Other	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Total	22.2	16.6	17.9	18.3	19.8	20.2	20.6	21.1	21.6	22.2
Capex/Station										
Base Capex, \$/Station	1.2	1.3	1.3	1.4	1.5	1.5	1.6	1.7	1.8	1.9
JV CHNG Capex/Station	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7
LNG Business										
Volume, CM/yr	25	150	150	150	150	150	150	150	150	150
Revenue @ \$0.48/CM	12	72	73.4	74.9	76.4	77.9	79.5	81.1	82.7	84.4
Revenue/Station										
Base- Revenue/Station	1.5	1.5	1.6	1.6	1.6	1.7	1.7	1.7	1.8	1.8
JV CHNG Revenue/Station	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.9	0.9
Inflation, %/yr, 2010-2019	Prices	Capital Costs								
Base Business	2.0%	5.0%								
CNPC JV	2.0%	5.0%								
LNG	2.0%	N/A								

	Appendix Table 2 China Natural Gas, Inc Discounted Cash Flow Projections										
	Estimated	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Revenue	\$79,520,554	\$104,195,554	\$180,872,554	\$200,852,482	\$221,232,009	\$242,019,126	\$263,221,985	\$284,848,902	\$306,908,357	\$329,409,001	\$352,359,658
Cost of Goods Sold	\$40,173,328	\$56,019,733	\$110,613,728	\$122,608,615	\$135,196,133	\$148,391,914	\$162,211,984	\$176,672,761	\$191,791,075	\$207,584,169	\$224,069,716
Gross Profit	\$39,347,226	\$48,175,821	\$70,258,826	\$78,243,867	\$86,035,876	\$93,627,212	\$101,010,001	\$108,176,141	\$115,117,282	\$121,824,832	\$128,289,942
Gross Margin, %	49.5%	46.2%	38.9%	38.0%	38.9%	38.7%	38.4%	38.0%	37.5%	37.0%	36.4%
Selling, General and Administrative Expenses	\$15,117,811	\$19,887,442	\$34,522,514	\$38,336,013	\$42,225,782	\$46,193,347	\$50,240,263	\$54,368,117	\$58,578,528	\$62,873,148	\$67,253,660
Earnings Before Interest, Taxes, Depr. & Amort. (EBITDA)	\$24,169,415	\$28,288,379	\$35,736,312	\$39,907,854	\$43,810,094	\$47,433,865	\$50,769,738	\$53,808,024	\$56,538,754	\$58,951,684	\$61,036,282
Depreciation and Amortization	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Non-Operating Expense	-\$2,623,497	-\$2,361,147	-\$2,125,033	-\$1,912,529	-\$1,721,276	-\$1,549,149	-\$1,394,234	-\$1,254,810	-\$1,129,329	-\$1,016,396	-\$914,757
Earnings Before Interest and Taxes (EBIT)	\$21,545,918	\$25,927,232	\$33,611,279	\$37,995,325	\$42,088,817	\$45,884,716	\$49,375,504	\$52,553,213	\$55,409,424	\$57,935,287	\$60,121,525
Available Tax-Loss Carryforwards	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net Taxable Earnings	\$21,545,918	\$25,927,232	\$33,611,279	\$37,995,325	\$42,088,817	\$45,884,716	\$49,375,504	\$52,553,213	\$55,409,424	\$57,935,287	\$60,121,525
Federal and State Income Taxes	\$4,186,501	\$5,037,817	\$6,530,873	\$7,382,719	\$8,178,109	\$8,915,675	\$9,593,956	\$10,211,404	\$10,766,383	\$11,257,174	\$11,681,973
Net Operating Profit After-Tax (NOPAT)	\$17,359,417	\$20,889,415	\$27,080,406	\$30,612,605	\$33,910,708	\$36,969,041	\$39,781,548	\$42,341,809	\$44,643,041	\$46,678,114	\$48,439,552
Add Back Depreciation and Amortization	\$5,566,900	\$9,624,788	\$11,876,916	\$13,556,881	\$15,376,641	\$17,236,665	\$19,240,414	\$21,286,555	\$23,383,306	\$25,527,000	\$27,722,082
Subtract Capital Expenditures	(\$40,578,879)	(\$22,521,278)	(\$16,799,656)	(\$18,197,598)	(\$18,600,242)	(\$20,037,490)	(\$20,481,405)	(\$20,947,516)	(\$21,436,932)	(\$21,950,819)	(\$22,490,401)
Subtract New Net Working Capital	(\$212,989)	(\$493,500)	(\$1,533,540)	(\$399,699)	(\$407,591)	(\$415,742)	(\$424,057)	(\$432,538)	(\$441,189)	(\$450,013)	(\$459,013)
Existing Financing - Exercise of Outstanding Options and Warrants	(\$17,865,531)	\$7,499,425	\$20,624,126	\$25,572,290	\$30,279,516	\$36,127,003	\$51,090,515	\$42,250,310	\$46,148,226	\$49,804,281	\$53,212,220
Free Cash Flow											
Terminal Value, 2019											\$532,122,201
Present Value of Free Cash Flows @ %		\$6,817,659	\$17,044,732	\$19,212,840	\$20,681,317	\$31,124,925	\$28,839,264	\$21,681,089	\$21,528,488	\$21,121,877	\$20,515,614
Present Value of Terminal Value		\$205,156,144	\$413,723,949								
Total Present Value of Company Operations		\$61,335,660									
Plus Current Assets											
Total Market Value of Assets		\$475,059,609									
Less Present Value of Debt		(\$40,000,000)									
Value of Equity		\$435,059,609									
Share Outstanding as of 1/14/09		21,183,894									
Plus Options and Warrants Outstanding or Authorized		3,293,669									
Total Fully Diluted Common Shares		24,477,563									
DCF Value, \$/Share		\$17.77									
EPS		\$0.82	\$0.99	\$1.28	\$1.45	\$1.60	\$1.75	\$1.88	\$2.00	\$2.12	\$2.24
EPS Fully Diluted		\$0.71	\$0.85	\$1.11	\$1.25	\$1.39	\$1.51	\$1.63	\$1.73	\$1.82	\$1.91
CAGR, EPS, Next 5 yrs		16.3%									
CAGR, Sales, Next 5 yrs		24.9%									
Net Income Margin, %		21.8%	20.0%	16.0%	15.2%	15.3%	15.3%	15.1%	14.9%	14.5%	14.2%

Years Ending December 31

Forecast



Appendix Table 3 LNG and Natural Gas Conversions						
Natural Gas and LNG	1 billion cubic meters NG	1 billion cubic feet NG	1 billion cubic feet NG	1 billion cubic feet NG	1 billion cubic feet NG	1 million barrels oil equivalent
1 billion cubic meters NG	1.00	35.30	0.90	0.73	36.00	6.29
1 billion cubic feet NG	0.03	1.00	0.03	0.02	1.03	0.18
1 million tonnes oil equivalent	1.11	39.20	1.00	0.81	40.40	7.33
1 million tonnes LNG	1.38	48.70	1.23	1.00	52.00	8.68
1 trillion British thermal units	0.03	0.98	0.03	0.02	1.00	0.17
1 million barrels oil equivalent	0.16	5.61	0.14	0.12	5.80	1.00
1 million tones LNG	=	2.2 million cubic meter LNG				
1 million tones per year (tpy) LNG	=	140 million standard cubic per day (MMscfd) gas				
100 MMscfd gas	~	730,000 tpy LNG 2,100 tpd LNG				
1 million cubic meter LNG	=	6.29 million bbl LNG 460,000 tonnes LNG				
1 cubic meter LNG	~	600 cubic meter gas 21200 cubic foot gas				
1 standard cubic foot (scf)	=	0.0268 normal cubic meter (Nm ³)				
1 standard cubic meter (scm)	=	1.057 normal cubic metter (Nm ³)				



Quarterly Income Statement					
All Figures in US\$ 000's, except per share data					
FY Ending December 31,	3Q08	4Q08	1Q09	2Q09	3Q09
Total Revenue	18,401	18,403	18,528	20,743	20,125
Cost of Goods Sold	8,909	8,911	8,894	10,464	10,407
Gross Profit	9,492	9,492	9,634	10,278	9,718
Selling General & Admin Exp.	3,067	3,721	4,006	3,514	3,829
Total Operating Exp.	3,067	3,721	4,006	3,514	3,829
Operating Income	6,426	5,772	5,628	6,764	5,889
Interest Expense, Total	(213)	(979)	(582)	(389)	(68)
Interest and Invest. Income	14	89	9	8	7
Net Interest Exp.	(199)	(890)	(573)	(381)	(61)
Currency Exchange Gains (Loss)	(49)	(397)	(51)	-	-
Other Non-Operating Inc. (Exp.)	(7)	231	195	(1,334)	179
EBT Excl. Unusual Items	6,171	4,715	5,199	5,049	6,007
EBT Incl. Unusual Items	6,171	4,715	5,199	5,049	5,649
Income Tax Expense	1,035	983	997	1,187	1,001
Net Income	5,137	3,732	4,202	3,863	4,648
Per Share Items					
Basic EPS	0.35	0.26	0.29	0.27	0.30
Basic EPS Excl. Extra Items	0.35	0.26	0.29	0.26	0.29
Weighted Avg. Basic Shares Out.	14,600	14,600	14,600	14,600	15,755
Diluted EPS	0.35	0.26	0.29	0.26	0.29
Diluted EPS Excl. Extra Items	0.35	0.26	0.29	0.26	0.29
Weighted Avg. Diluted Shares Out.	14,640	14,600	14,600	14,727	16,140



Annual Income Statement			
All Figures in US\$ 000's, except per share data			
FY Ending December 31,	FY06	FY07	FY08
Revenue	18,829	35,392	67,721
Cost of Goods Sold	9,718	18,025	34,982
Gross Profit	9,111	17,367	32,739
Selling General & Admin Exp.	2,596	6,289	11,677
Total Operating Exp.	2,596	6,289	11,677
Operating Income	6,515	11,078	21,062
Interest Expense, Total	-	-	(2,228)
Interest and Invest. Income	41	71	210
Net Interest Exp.	41	71	(2,019)
Currency Exchange Gains (Loss)	-	(151)	(397)
Other Non-Operating Inc. (Exp.)	(79)	32	112
EBT	6,477	11,030	18,758
Income Tax Expense	1,026	1,914	3,568
Net Income	5,451	9,116	15,190
Per Share Items			
Basic EPS	0.46	0.70	1.04
Basic EPS Excl. Extra Items	0.46	0.70	1.04
Weighted Avg. Basic Shares Out.	11,936	13,100	14,600
Diluted EPS	0.46	0.69	1.04
Diluted EPS Excl. Extra Items	0.46	0.69	1.04
Weighted Avg. Diluted Shares Out.	11,936	13,151	14,645



China Natural Gas, Inc. (NasdaqGM: CHNG)

FINANCIAL STATEMENTS

INITIAL REPORT

Quarterly Balance Sheet All Figures in US\$ 000's FY Ending December 31,	3Q08	4Q08	1Q09	2Q09	3Q09
Assets					
Cash And Equivalents	20,385	5,854	9,058	9,701	55,932
Accounts Receivable	1,623	906	946	979	1,142
Other Receivables	-	61	-	-	-
Accounts Receivable, Total	1,623	967	946	979	1,142
Inventory	445	520	488	1,197	1,465
Prepaid Exp.	891	778	954	559	456
Loans Receivable Current	-	293	293	293	293
Other Current Assets	2,092	1,170	865	1,258	2,049
Total Current Assets	25,436	9,582	12,604	13,987	61,336
Property, Plant & Equipment					
Gross Property, Plant & Equipment	80,823	105,553	108,501	116,927	125,547
Accumulated Depreciation	(6,260)	(7,463)	(8,841)	(10,178)	(11,582)
Net Property, Plant & Equipment	74,564	98,090	99,660	106,750	113,965
Other Long-Term Assets					
Other Intangibles	1,061	1,061	1,406	-	1,423
Deferred Charges, LT	1,849	1,747	1,644	1,542	1,439
Other Long-Term Assets	9,218	7,783	7,872	9,021	11,927
Total Assets	112,127	118,262	123,187	131,300	190,090
Liabilities					
Accounts Payable	716	800	1,104	1,622	1,412
Accrued Exp.	350	861	531	1,238	275
Curr. Income Taxes Payable	1,912	1,863	1,905	2,167	1,943
Unearned Revenue, Current	385	944	1,139	1,969	1,742
Other Current Liabilities	98	124	337	197	245
Total Current Liabilities	3,460	4,592	5,015	7,193	5,617
Long-Term Debt	23,896	24,522	25,156	25,833	26,542
Other Non-Current Liab., Total	17,500	17,500	18,317	19,630	19,988
Total Liabilities	44,856	46,614	48,488	52,656	52,147
Equity					
Common Stock	3	3	1	1	2
Additional Paid In Capital	32,099	32,114	25,271	25,357	79,813
Retained Earnings	27,139	30,871	40,917	44,779	49,427
Comprehensive Inc. and Other	8,031	8,661	8,509	8,506	8,701
Total Equity	67,271	71,648	74,698	78,644	137,943
Total Liabilities And Equity	112,127	118,262	123,187	131,300	190,090



Annual Balance Sheet			
All Figures in US\$ 000's			
FY Ending December 31,	FY06	FY07	FY08
Assets			
Cash And Equivalents	5,294	13,292	5,854
Short Term Investments	-	239	-
Accounts Receivable	569	306	906
Other Receivables	-	292	61
Accounts Receivable, Total	569	598	967
Inventory	286	231	520
Prepaid Exp.	305	110	778
Loans Receivable Current	-	274	293
Other Current Assets	1,672	921	1,170
Total Current Assets	8,125	15,665	9,582
Gross Property, Plant & Equipment	21,407	38,215	105,553
Accumulated Depreciation	(1,869)	(3,713)	(7,463)
Net Property, Plant & Equipment	19,537	34,502	98,090
Other Intangibles	128	994	1,061
Deferred Charges, LT	-	-	1,747
Other Long-Term Assets	676	2,129	7,783
Total Assets	28,466	53,290	118,262
Liabilities			
Accounts Payable	406	488	800
Accrued Exp.	-	-	861
Curr. Income Taxes Payable	1,867	1,212	1,863
Unearned Revenue, Current	284	327	944
Other Current Liabilities	279	56	124
Total Current Liabilities	2,836	2,083	4,592
Long-Term Debt	-	-	24,522
Other Non-Current Liab., Total	-	-	17,500
Total Liabilities	2,836	2,083	46,614
Common Stock	2	3	3
Additional Paid In Capital	18,224	32,047	32,114
Retained Earnings	6,564	15,680	30,871
Comprehensive Inc. and Other	839	3,477	8,661
Total Equity	25,630	51,207	71,648
Total Liabilities And Equity	28,466	53,290	118,262



Quarterly Statement of Cash Flow					
All Figures in US\$ 000's					
FY Ending December 31,	3Q08	4Q08	1Q09	2Q09	3Q09
Net Income	5,137	3,732	4,202	3,863	4,648
Depreciation & Amort.	937	1,179	1,390	1,393	1,393
Other Amortization	120	531	209	60	75
(Gain) Loss On Sale of Assets	-	13	-	21	-
Stock-Based Compensation	13	15	15	86	86
Change in Acc. Receiv.	(756)	701	(41)	(33)	(161)
Change In Inventories	75	(73)	31	(519)	(266)
Change in Acc. Payable	205	83	305	518	(211)
Change in Unearned Rev.	(496)	549	195	831	(230)
Change in Inc. Taxes	176	(50)	45	262	(227)
Change in Other Net Operating Assets	(825)	1,525	85	363	(1,599)
Other Operating Activities	-	-	(197)	1,313	358
Cash from Ops.	4,585	8,205	6,239	8,158	3,865
Capital Expenditures	(17,380)	(22,821)	(2,993)	(7,512)	(12,041)
Sale of Property, Plant and Equipment	-	195	-	41	-
Purchase/Sale of Intangibles	36	(84)	(36)	(495)	7
Net Cash from Investments	3	1	-	-	-
Net (Increase)/Decrease in Loans Orig/Sold	287	(287)	-	-	-
Total Other Investing Activities	2,837	-	-	450	-
Cash from Investing	(14,217)	(22,995)	(3,028)	(7,516)	(12,035)
Issuance of Common Stock	-	-	-	-	57,608
Other Financing Activities	-	-	-	-	(3,238)
Cash from Financing	-	-	-	-	54,370
Foreign Exchange Rate Adj.	836	259	(6)	1	30
Net Change in Cash	(8,796)	(14,530)	3,204	643	46,230



Annual Statement of Cash Flow			
All Figures in US\$ 000's			
FY Ending December 31,	FY06	FY07	FY08
Net Income	5,451	9,116	15,190
Depreciation & Amort.	732	1,640	3,475
Other Amortization	-	-	1,233
(Gain) Loss On Sale of Assets	-	-	25
Stock-Based Compensation	-	-	67
Change in Acc. Receiv.	(551)	291	(568)
Change In Inventories	(234)	71	(268)
Change in Acc. Payable	202	29	276
Change in Unearned Rev.	(29)	22	584
Change in Inc. Taxes	(8)	(755)	556
Change in Other Net Operating Assets	(1,178)	63	347
Cash from Ops.	4,386	10,476	20,917
Capital Expenditures	(9,739)	(16,614)	(67,968)
Sale of Property, Plant and Equipment	-	-	195
Purchase/Sale of Intangibles	-	(43)	(84)
Net Cash from Investments	-	(229)	251
Cash from Investing	(9,739)	(16,885)	(67,607)
Long-Term Debt Issued	-	-	40,000
Issuance of Common Stock	11,450	15,000	-
Other Financing Activities	(1,557)	(1,177)	(2,123)
Cash from Financing	9,893	13,823	37,877
Foreign Exchange Rate Adj.	79	583	1,375
Net Change in Cash	4,619	7,998	(7,437)



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	13.3%
Buy	10	66.7%
Speculative Buy	3	20.0%
Hold	0	0.0%
Sell	0	0.0%

RedChip Rating System

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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