CHINA AUTOMOTIVE SYSTEMS INC
Form 10-Q
November 12, 2008

Table of Contents

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

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2008

or

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number: 000-33123

China Automotive Systems, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**33-0885775**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

No. 1 Henglong Road, Yu Qiao Development Zone, Shashi District,
Jing Zhou City, Hubei Province, People's Republic of China
(Address of principal executive offices)

Issuer's telephone number: (86) 716- 832- 9196 **Issuer's fax number: (86) 716-832-9298**

Not Applicable
(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of September 30, 2008, the Company had 26,983,244 shares of common stock issued and outstanding.

Table of Contents

CHINA AUTOMOTIVE SYSTEMS, INC.
INDEX

	Page
Part I — Financial Information	
Item 1. Financial Statements	3
Condensed Consolidated Statements of Operations (Unaudited) for the Three Months and Nine Months Ended September 30, 2008 and 2007	3
Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the Three Months and Nine Months Ended September 30, 2008 and 2007	4
Condensed Consolidated Balance Sheets at September 30, 2008 (Unaudited) and December 31, 2007	7
Consolidated Statements of Stockholders' Equity for the Nine Months Ended September 30, 2008 (Unaudited) and the Year Ended December 31, 2007	8
Condensed Consolidated Statements of Cash Flows (Unaudited) for the Nine Months Ended September 30, 2008 and 2007	9
Notes to Condensed Consolidated Financial Statements (Unaudited) for the Three Months and Nine Months Ended September 30, 2008 and 2007	12
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	32
Item 3. Quantitative and Qualitative Disclosures About Market Risk	47
Item 4. Controls and Procedures	47
Part II — Other Information	
Item 1. Legal Proceedings	47
Item 1A. Risk Factors	47
ITEM 2. Unregistered Sales Of Equity Securities And Use Of Proceeds	52
ITEM 3. Defaults Upon Senior Securities	52
ITEM 4. Submission Of Matters To A Vote Of Security Holders	53
ITEM 5. Other Information	53
Item 6. Exhibits	53
Signature	55

Table of Contents

PART 1 — FINANCIAL INFORMATION

Item 1. Financial Statements

China Automotive Systems, Inc.
Condensed Consolidated Statements of Operations (Unaudited)

	Three Months Ended September 30,	
	2008	2007
Net product sales, including $967,591 and $1,635,676 sold to related parties for the three months ended September 30, 2008 and 2007	$ 36,936,755	$ 31,202,731
Cost of product sold, including $1,783,822 and $1,276,789 purchased from related parties for the three months ended September 30, 2008 and 2007	27,058,532	19,839,980
Gross profit	9,878,223	11,362,751
Add: Gain on other sales	343,326	102,371
Less: Operating expenses-		
Selling expenses	2,309,064	2,094,157
General and administrative expenses	2,060,675	1,683,190
R&D expenses	665,552	321,533
Depreciation and amortization	1,488,842	735,810
Total Operating expenses	6,524,133	4,834,690
Income from operations	3,697,416	6,630,432
Add: Other income (note 20)	123,167	—
Financial income (expenses) (note 21)	(446,261)	(215,400)
Gain (loss) on change in fair value of derivative (note 22)	677,417	—
Income before income taxes	4,051,739	6,415,032
Less: Income tax expenses (benefits) (note 23)	309,480	379,409
Income before minority interests	3,742,259	6,035,623
Less: Minority interests	983,480	3,461,205
Net income	$ 2,758,779	$ 2,574,418
Net income per common share-		
Basic	$ 0.10	$ 0.11
Diluted (note 2)	$ 0.09	$ 0.11
Weighted average number of common shares outstanding –		
Basic	26,983,244	23,959,702
Diluted	31,431,026	23,962,356

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

Table of Contents

China Automotive Systems, Inc.
Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended September 30,	
	2008	2007
Net income	$ 2,758,779	$ 2,574,418
Other comprehensive income:		
Foreign currency translation gain	662,475	—
Comprehensive income	$ 3,421,254	$ 2,574,418

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

Table of Contents

China Automotive Systems, Inc.
Condensed Consolidated Statements of Operations (Unaudited)

	Nine Months Ended September 30,	
	2008	2007
Net product sales, including $3,766,078 and $3,711,504 sold to related parties for the nine months ended September 30, 2008 and 2007	$ 124,912,138	$ 95,898,461
Cost of product sold, including $6,387,212 and $3,743,223 purchased from related parties for the nine months ended September 30, 2008 and 2007	88,358,541	63,249,998
Gross profit	36,553,597	32,648,463
Add: Gain on other sales	595,226	362,458
Less: Operating expenses-		
Selling expenses	7,721,240	6,500,969
General and administrative expenses	7,828,458	5,272,795
R&D expenses	1,404,525	909,515
Depreciation and amortization	4,234,633	2,564,234
Total Operating expenses	21,188,856	15,247,513
Income from operations	15,959,967	17,763,408
Add: Other income (note 20)	322,626	38,462
Financial income (expenses) (note 21)	(884,708)	(626,892)
Gain (loss) on change in fair value of derivative (note 22)	1,672,570	—
Income before income taxes	17,070,455	17,174,978
Less: Income tax expenses (note 23)	718,417	2,741,024
Income before minority interests	16,352,038	14,433,954
Less: Minority interests	4,418,730	7,761,281
Net income	$ 11,933,308	$ 6,672,673
Net income per common share-		
Basic	$ 0.47	$ 0.28
Diluted (note 2)	$ 0.45	$ 0.28
Weighted average number of common shares outstanding –		
Basic	25,272,884	23,952,573
Diluted	28,734,809	23,958,547

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

Table of Contents

China Automotive Systems, Inc.
Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	Nine Months Ended September 30,	
	2008	2007
Net income	$ 11,933,308	$ 6,672,673
Other comprehensive income:		
Foreign currency translation gain	5,397,297	1,265,553
Comprehensive income	$ 17,330,605	$ 7,938,226

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

Table of Contents

China Automotive Systems, Inc.
Condensed Consolidated Balance Sheets

	September 30, 2008 (Unaudited)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 27,188,579	$ 19,487,159
Pledged cash deposits (note 3)	9,171,215	4,645,644
Accounts and notes receivable, net, including $1,105,037 and $1,869,480 from related parties at September 30, 2008 and December 31, 2007, net of an allowance for doubtful accounts of $3,666,432 and $3,827,838 at September 30, 2008 and December 31, 2007 (note 4)	100,910,001	82,022,643
Advance payments and other, including $65,746 and $55,323 to related parties at September 30, 2008 and December 31, 2007	1,731,345	922,578
Inventories (note 6)	29,933,712	20,193,286
Total current assets	$ 168,934,852	$ 127,271,310
Long-term Assets:		
Property, plant and equipment (note 7)	$ 49,987,163	$ 46,585,041
Intangible assets (note 8)	563,558	589,713
Other receivables, net, including $707,979 and $638,826 from related parties at September 30, 2008 and December 31, 2007, net of an allowance for doubtful accounts of $970,385 and $652,484 at September 30, 2008 and December 31, 2007 (note 5)	1,075,389	888,697
Advance payments for property, plant and equipment, including $3,818,485 and $1,560,378 to related parties at September 30, 2008 and December 31, 2007.	8,587,824	6,260,443
Long-term investments	79,179	73,973
Deferred income tax assets	1,995,692	1,315,510
Total assets	$ 231,223,657	$ 182,984,687
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank loans (note 9)	$ 5,865,103	$ 13,972,603
Accounts and notes payable, including $851,631 and $1,134,817 to related parties at September 30, 2008 and December 31, 2007 (note 10)	59,732,630	47,530,383
Customer deposits	166,576	135,627
Accrued payroll and related costs	2,879,525	2,664,464
Accrued expenses and other payables (note 11)	13,079,635	14,938,055
Accrued pension costs (note 12)	3,757,655	3,622,729
Taxes payable (note 13)	8,173,052	9,080,493
Amounts due to shareholders/directors (note 14)	257,024	304,601
Total current liabilities	$ 93,911,200	$ 92,248,955
Long-term liabilities:		
Advances payable (note 15)	234,542	334,600
Derivative liabilities (note 16)	821,583	—
Convertible notes payable (note 17)	32,800,183	—
Total liabilities	$ 127,767,508	$ 92,583,555
Minority interests (note 18)	$ 22,618,205	$ 23,166,270
Related Party Translations (note 25)		

Commitments and contingencies (note 26)		
Stockholders' equity:		
Preferred stock, $0.0001 par value - Authorized - 20,000,000 shares, Issued and outstanding – None	$ —	$ —
Common stock, $0.0001 par value - Authorized - 80,000,000 shares		
Shares Issued and Outstanding - 26,983,244 shares and 23,959,702 shares at September 30, 2008 and December 31, 2007, respectively	2,698	2,396
Additional paid-in capital (note 19)	26,398,126	30,125,951
Retained earnings-		
Appropriated	7,525,777	7,525,777
Unappropriated	35,524,583	23,591,275
Accumulated other comprehensive income	11,386,760	5,989,463
Total stockholders' equity	$ 80,837,944	$ 67,234,862
Total liabilities and stockholders' equity	$ 231,223,657	$ 182,984,687

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

Table of Contents

China Automotive Systems, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity
Period Ended September 30, 2008 (unaudited) and December 31, 2007

	Common Stock Shares	Common Stock Par value	Additional Paid-in Capital	Retained Earnings Appropriated	Retained Earnings Unappropriated	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2006	23,851,581	$ 2,385	$ 28,651,959	$ 6,209,909	$ 16,047,237	$ 2,468,800	$ 53,380,290
Foreign currency translation gain	—	—	—	—	—	3,520,663	3,520,663
Sale of common stock	108,121	11	1,145,489	—	—	—	1,145,500
Increase in connection with minority shareholders' abandonment of all its right and interest in Joint-venture	—	—	174,828	—	—	—	174,828
Issuance of stock options to independent directors	—	—	153,675				153,675
Net income for the year ended December 31, 2007	—	—	—	—	8,859,906	—	8,859,906
Appropriation of retained earnings	—	—	—	1,315,868	(1,315,868)	—	—
Balance at December 31, 2007	23,959,702	$ 2,396	$ 30,125,951	$ 7,525,777	$ 23,591,275	$ 5,989,463	$ 67,234,862
Foreign currency translation gain	—	—	—	—	—	5,397,297	5,397,297
Difference between the book value of and Consideration paid for the 35.5% equity interest of Henglong	—	—	(25,912,921)	—	—	—	(25,912,921)
Issuance of common stock	3,023,542	302	22,089,696	—	—	—	22,089,998
Net income for the period ended September 30, 2008	—	—	—	—	11,933,308	—	11,933,308
Issuance of stock options to independent directors	—	—	95,400	—	—	—	95,400
Balance at September 30, 2008 (unaudited)	26,983,244	$ 2,698	$ 26,398,126	$ 7,525,777	$ 35,524,583	$ 11,386,760	$ 80,837,944

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

Table of Contents

China Automotive Systems, Inc.
Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine Months Ended September 30,	
	2008	2007
Cash flows from operating activities:		
Net income	$ 11,933,308	$ 6,672,673
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Minority interests	4,418,730	7,761,281
Stock-based compensation	95,400	—
Depreciation and amortization	7,320,365	4,968,142
Allowance for doubtful accounts (Recovered)	70,303	(318,421)
Deferred income taxes assets	(582,746)	—
Amortization for discount of convertible note payable	302,771	—
Gain (loss) on change in fair value of derivative	(1,672,570)	—
Other operating adjustments	(11,054)	38,516
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Pledged deposits	(4,188,067)	1,098,996
Accounts and notes receivable	(12,353,480)	(11,914,080)
Advance payments and other	(703,006)	(415,798)
Inventories	(8,253,097)	(3,507,361)
Increase (decrease) in:		
Accounts and notes payable	8,678,459	3,857,355
Customer deposits	19,248	16,472
Accrued payroll and related costs	29,914	473,542
Accrued expenses and other payables	1,049,671	(231,276)
Accrued pension costs	(126,889)	90,383
Taxes payable	(1,536,750)	1,318,795
Advances payable	(126,834)	—
Net cash provided by operating activities	$ 4,363,676	$ 9,909,219
Cash flows from investing activities:		
(Increase) decrease in other receivables	(385,893)	(547,216)
Cash received from equipment sales	143,672	599,294
Cash paid to acquire property, plant and equipment	(9,463,155)	(9,589,831)
Cash paid to acquire intangible assets	(117,064)	(173,107)
Cash paid for the acquisition of 35.5% of Henglong	(10,000,000)	—
Net cash (used in) investing activities	$ (19,822,440)	$ (9,710,860)
Cash flows from financing activities:		
(Decrease) in proceeds from bank loans	(9,030,840)	(2,182,860)
Dividends paid to the minority interest holders of Joint-venture companies	(5,159,657)	(5,153,764)
(Decrease) in amounts due to shareholders/directors	(78,857)	(89,800)
Proceeds from issuance of common stock	—	1,145,500
Capital Contribution from the minority interest holders of Joint-venture companies	745,723	—
Proceeds from issuance of convertible note payable	35,000,000	—
Net cash provided by (used in) financing activities	$ 21,476,369	$ (6,280,924)

Cash and cash equivalents effected by foreign currency	$	1,683,815	$	455,351
Net increase (decrease) in cash and cash equivalents		7,701,420		(5,627,214)
Cash and cash equivalents at beginning of period		19,487,159		27,418,500
Cash and cash equivalents at end of period	$	27,188,579	$	21,791,286

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

Table of Contents

China Automotive Systems, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited) (continued)

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

	Nine Months Ended September 30,	
	2008	2007
Cash paid for interest	$ 1,169,852	$ 630,832
Cash paid for income taxes	$ 2,333,676	$ 857,404

Table of Contents

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

	Nine Months Ended September 30,	
	2008	2007
Acquisition of 35.5% of Henglong from the minority shareholder on a cashless basis	$ (22,090,000)	$ —
Liability result from issuance of common stock to acquire 35.5% of Henglong's equity	22,090,000	—
Decrease in minority interests as a result of minority shareholder's withdrawal from Joint-venture.	—	(2,830,545)
Withdrawal of invested intangible assets by minority shareholder of Joint-venture.	—	2,600,204
Increase in equity in connection with minority shareholder's withdrawal from Joint-venture.	$ —	$ 230,341

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

Table of Contents

China Automotive Systems, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
Three Months and Nine Months Ended September 30, 2008 and 2007

1. Organization and business

China Automotive Systems, Inc., “China Automotive”, was incorporated in the State of Delaware on June 29, 1999 under the name Visions-In-Glass, Inc. China Automotive, including, when the context so requires, its subsidiaries and the subsidiaries’ interests in the Sino-foreign joint ventures described below, is referred to herein as the “Company”. The Company is primarily engaged in the manufacture and sale of automotive systems and components, as described below.

Great Genesis Holdings Limited, a company incorporated on January 3, 2003 under The Companies Ordinance in Hong Kong as a limited liability company, “Great Genesis”, is a wholly-owned subsidiary of the Company.

Henglong USA Corporation, “HLUSA”, which was incorporated on January 8, 2007 in Troy, Michigan, is a wholly-owned subsidiary of the Company, and mainly engages in marketing of automotive parts in North America, and provides after sales service and research and development support accordingly.

The Company owns the following aggregate net interests in eight Sino-foreign joint ventures organized in the PRC as of September 30, 2008 and 2007.

	Percentage Interest	
Name of Entity	September 30, 2008	September 30, 2007
Shashi Jiulong Power Steering Gears Co., Ltd., "Jiulong"	81.00%	81.00%
Jingzhou Henglong Automotive Parts Co., Ltd., "Henglong"	80.00%	44.50%
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., “Shenyang"	70.00%	70.00%
Zhejiang Henglong & Vie Pump-Manu Co., Ltd., "Zhejiang"	51.00%	51.00%
Universal Sensor Application Inc., “USAI”	83.34%	85.71%
Wuhan Jielong Electric Power Steering Co., Ltd., “Jielong”	85.00%	85.00%
Wuhu HengLong Automotive Steering System Co., Ltd., “Wuhu”	77.33%	77.33%
Jingzhou Hengsheng Automotive System Co., Ltd, “Hengsheng”	100.00%	100.00%

Jiulong was established in 1993 and mainly engaged in the production of integral power steering gears for heavy-duty vehicles.

Henglong was established in 1997 and mainly engaged in the production of rack and pinion power steering gear for cars and light duty vehicles.

On March 31, 2008, the Company’s wholly-owned subsidiary, Great Genesis, and Wiselink, both controlled by Hanlin Chen and his family, entered into an equity transfer agreement, the “Henglong Agreement”, pursuant to which Wiselink agreed to transfer and assign its 35.5% equity interest in Jingzhou Henglong, one of the Company’s currently consolidated subsidiaries, to Great Genesis for a total consideration of $32,090,000. The Company now holds an 80% equity interest in Jingzhou Henglong.

Under the terms of the Henglong Agreement, Great Genesis is deemed to be the owner of Jingzhou Henglong commencing from January 1, 2008. The Henglong Acquisition is considered as a business combination of companies

under common control and is being accounted for in a manner of pooling of interests.

Shenyang was established in 2002 and focuses on power steering parts for light duty vehicles.

Zhejiang was established in 2002 to focus on power steering pumps.

USAI was established in 2005 and mainly engaged in production and sales of sensor modulars.

Table of Contents

Jielong was established in 2006 and mainly engaged in production and sales of electric power steering, “EPS”.

Wuhu was established in 2006 and mainly engaged in production and sales of automobile steering systems.

Hengsheng was established in 2007 and mainly engaged in production and sales of automobile steering systems.

2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation - For the nine months ended September 30, 2008 and 2007, the accompanying unaudited consolidated financial statements include the accounts of the Company and its subsidiaries. The subsidiaries include eight Sino-foreign Joint-ventures mentioned in Note 1. Significant inter-company balances and transactions have been eliminated upon consolidation. The unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America.

Foreign Currencies - The Company maintains its books and records in Renminbi, “RMB”, the currency of the PRC, its functional currency. Foreign currency transactions in RMB are reflected using the temporal method. Under this method, all monetary items are translated into the functional currency at the rate of exchange prevailing at the balance sheet date. Non-monetary items are translated at historical rates. Income and expenses are translated at the rate in effect on the transaction dates. Transaction gains and losses, if any, are included in the determination of net income for the period.

In translating the financial statements of the Company from its functional currency into its reporting currency in United States dollars, balance sheet accounts are translated using the closing exchange rate in effect at the balance sheet date and income and expense accounts are translated using an average exchange rate prevailing during the reporting period. Adjustments resulting from the translation, if any, are included in cumulative other comprehensive income (loss) in stockholders’ equity.

Income Per Share - Basic income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated based on the treasury stock method, assuming the issuance of common shares, if dilutive, resulting from the exercise of warrants. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the “if converted” method.

The calculations of diluted income per share were:

	Three Months Ended September 30,	
	2008	2007
Numerator:		
Net income	$ 2,758,779	$ 2,574,418
Add: interest expenses of convertible notes payable	262,500	—
Add: Amortization for discount of convertible notes payable	121,443	—
	$ 3,142,722	$ 2,574,418
Denominator:		
Weighted average shares outstanding	26,983,244	23,959,702
Effect of dilutive securities	4,447,782	2,654
	31,431,026	23,962,356
Net income per common share- diluted	$ 0.09	$ 0.11

Table of Contents

	Nine Months Ended September 30,	
	2008	2007
Numerator:		
Net income	$ 11,933,308	$ 6,672,673
Add: interest expenses of convertible notes payable	656,250	—
Add: Amortization for discount of convertible notes payable	302,771	—
	$ 12,892,329	$ 6,672,673
Denominator:		
Weighted average shares outstanding	25,272,884	23,952,573
Effect of dilutive securities	3,461,925	5,974
	28,734,809	23,958,547
Net income per common share- diluted	$ 0.45	$ 0.28

During the three months ended September 30, 2008, the options and warrants outstanding have not been included in the computation of diluted income per share, because such inclusion would have had an anti-dilutive effect. The shares issuable upon conversion of Convertible Debt have been included in the computation.

During the nine months ended September 30, 2008, the options and warrants outstanding have not been included in the computation of diluted income per share, except the options issued on June 26, 2008, because such inclusion would have had an anti-dilutive effect. The shares issuable upon conversion of Convertible Debt have been included in the computation.

During the three months ended September 30 2007, the 156,250 shares underlying warrants issued to Cornell Capital Partners, LP on March 20, 2006, and 22,500 options issued to independent directors on July 16, 2006 have not been included in the computation of diluted income per share because such inclusion would have had an anti-dilutive effect.

Stock-Based Compensation - The Company may periodically issue shares of common stock for services rendered or for financing costs. Such shares will be valued based on the market price on the transaction date. The Company may periodically issue stock options to employees and stock options or warrants to non-employees in non-capital raising transactions for services and for financing costs.

In July 2004, the Company adopted a stock incentive plan. The maximum number of common shares for issuance under this plan is 2,200,000 with a period of 10 years. The stock incentive plan provides for the issuance, to the Company’s officers, directors, management and employees, of options to purchase shares of the Company’s common stock. As of September 30, 2008, the Company has issued 112,500 stock options under this plan and there remain 2,087,500 stock options issuable in the future.

The Company has adopted Statement of Financial Accounting Standards (“SFAS”) No. 123R, “Accounting for Stock-Based Compensation”, which establishes a fair value method of accounting for stock-based compensation plans. In accordance with SFAS No. 123R, the cost of stock options and warrants issued to employees and non-employees is measured on the grant date based on the fair value. The fair value is determined using the Black-Scholes option pricing model. The resulting amount is charged to expense on the straight-line basis over the period in which the Company expects to receive benefit, which is generally the vesting period.

Comprehensive Income - The Company has adopted the provisions of Statement of Financial Accounting Standards No. 130, “Reporting Comprehensive Income” (“SFAS No. 130”). SFAS No. 130 establishes standards for the reporting and display of comprehensive income, its components and accumulated balances in a full set of general purpose financial statements. SFAS No. 130 defines comprehensive income to include all changes in equity except those resulting from investments by owners and distributions to owners, including adjustments to minimum pension

liabilities, accumulated foreign currency translation, and unrealized gains or losses on marketable securities.

Table of Contents

Estimation -The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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.

Financial instruments - Derivative financial instruments, as defined in Financial Accounting Standard No. 133, Accounting for Derivative Financial Instruments and Hedging Activities (FAS 133), consist of financial instruments or other contracts that contain a notional amount and one or more underlying, e.g. interest rate, security price or other variable, require no initial net investment and permit net settlement. Derivative financial instruments may be free-standing or embedded in other financial instruments. Further, derivative financial instruments are initially, and subsequently, measured at fair value and recorded as liabilities or, in rare instances, assets.

The Company generally does not use derivative financial instruments to hedge exposures to cash-flow, market or foreign-currency risks. However, we have entered into certain other financial instruments and contracts, such as debt financing arrangements that embody features that are either (i) not afforded equity classification, (ii) embody risks not clearly and closely related to host contracts, or (iii) may be net-cash settled by the counterparty. As required by FAS 133, these instruments are required to be carried as derivative liabilities, at fair value, in our financial statements.

Registration Payment Arrangements - The Company has entered into registration payment arrangements with certain investors that provide for the payment of damages for failures to register common shares underlying the investor's financial instruments. FASB Staff Position 00-19-2, Accounting for Registration Payment Arrangements, provides for the exclusion of registration payments, such as the liquidated damages, from the consideration of classification of financial instruments. Rather, such registration payments would be accounted for pursuant to Financial Accounting Standard No. 5 Accounting for Contingencies, which is our current accounting practice. That is, all registration payments will require recognition when they are both probable and reasonably estimable. We do not currently believe that damages are probable.

Fair Value Measurements-Effective January 1, 2008, we adopted the provisions of FAS 157, Fair Value Measurements*,* except as it applies to those nonfinancial assets and nonfinancial liabilities as noted in proposed FSP FAS 157-b. The partial adoption of FAS 157 did not have a material impact on our consolidated financial position, results of operations or cash flows. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. In February 2008, the FASB issued FASB Staff Position ("FSP") 157-2, *Effective Date of FASB Statement No.157,* which delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

Comments - The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of management of the Company, contain all adjustments, which include normal recurring adjustments, necessary to present fairly the financial position, the results of operations and cash flows for the three months and nine months ended September 30, 2008 and 2007.

The consolidated balance sheet as of December 31, 2007 is derived from the Company's audited financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although the Company's management believes that the disclosures contained in these financial statements are adequate to make the information presented therein not

misleading. For further information, refer to the financial statements and the notes thereto included in the Company's 2007 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

The results of operations for the nine months ended September 30, 2008 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2008.

Table of Contents

3. Pledged cash deposits

The Company's pledged cash deposits at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Pledged as guarantee for the Company's notes payable	$ 9,171,215	$ 4,645,644
Balance at the end of the period	$ 9,171,215	$ 4,645,644

4. Accounts and notes receivable

The Company's accounts receivable at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Accounts receivable	$ 64,043,740	$ 49,605,411
Notes receivable	40,532,693	36,245,070
	104,576,433	85,850,481
Less: allowance for doubtful accounts	(3,666,432)	(3,827,838)
Balance at the end of the period	$ 100,910,001	$ 82,022,643

Notes receivable represent accounts receivable in the form of bills of exchange whose acceptances and settlements are handled by banks.

The activity in the Company's allowance for doubtful accounts during the nine months ended September 30, 2008 (unaudited) and the year ended December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Balance at beginning of period	$ 3,827,838	$ 4,086,218
Less: amounts recovered during the period	(410,800)	(532,392)
Add: foreign currency translation	249,394	274,012
Balance at the end of the period	$ 3,666,432	$ 3,827,838

5. Other receivables

The Company's other receivables at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Other receivables	$ 2,045,774	$ 1,541,181
Less: allowance for doubtful accounts	(970,385)	(652,484)
Balance at the end of the period	$ 1,075,389	$ 888,697

Table of Contents

Other receivables consist of amounts advanced to both related and unrelated parties, primarily as unsecured demand loans, with no stated interest rate or due date.

The activity in the Company's allowance for doubtful accounts of other receivable during the nine months ended September 30, 2008 (unaudited) and the year ended December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Balance at beginning of the period	$ 652,484	$ 898,203
Add: amounts provided (recovered) during the period	267,210	(297,870)
Add: foreign currency translation	50,691	52,151
Balance at the end of the period	$ 970,385	$ 652,484

6. Inventories

The Company's inventories at September 30, 2008 (Unaudited) and December 31, 2007 consisted of the following:

	September 30, 2008	December 31, 2007
Raw materials	$ 10,178,648	$ 7,904,167
Work in process	5,356,509	4,181,248
Finished goods	15,776,495	9,586,709
	31,311,652	21,672,124
Less: provision for loss	(1,377,940)	(1,478,838)
Balance at the end of the period	$ 29,933,712	$ 20,193,286

7. Property, plant and equipment

The Company's property, plant and equipment at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Land use rights and buildings	$ 25,797,236	$ 23,101,634
Machinery and equipment	51,749,534	42,512,900
Electronic equipment	4,273,685	3,480,008
Motor vehicles	2,677,716	2,427,375
Construction in progress	787,075	1,542,865
	85,285,246	73,064,782
Less: Accumulated depreciation	(35,298,083)	(26,479,741)
Balance at the end of the period	$ 49,987,163	$ 46,585,041

Depreciation charge for the nine months ended September 30, 2008 and the year ended December 31, 2007 are $7,134,822 and $7,079,313 respectively.

Table of Contents

8. Intangible assets

The activities in the Company's intangible asset account at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Balance at beginning of period	$ 589,713	$ 3,140,548
Add: additions during the period–		
Patent technology	—	144,390
Management software license	117,064	143,356
Less: decrease during the period–		
Patent technology*	—	(2,600,204)
Foreign currency translation	42,324	31,856
	749,101	859,946
Less: Amortization at end of the period	(185,543)	(270,233)
Balance at the end of the period	$ 563,558	$ 589,713

*When USAI was established in 2005, Sensor contributed $3,000,000 as capital, being the fair market value of the intangible assets, namely the sensor product and the technology for sensor production, as well as the Joint-venture's technical personnel training. As of March 30, 2007, Sensor withdrew from USAI, abandoned all its right and interest of the Joint-venture, and repossessed the rights to the intangible assets at the carrying value of the intangible assets of $2,600,204.

9. Bank loans

At September 30, 2008, the Company, through its Sino-foreign joint ventures, had outstanding fixed-rate short-term bank loans of $5,865,103, with weighted average interest rate at 7.27% per annum. These loans are secured with some of the property and equipment of the Company, and are repayable within one year.

At December 31, 2007, the Company, through its Sino-foreign joint ventures, had outstanding fixed-rate short-term bank loans of $13,972,603, with weighted average interest rate at 6.40% per annum. These loans are secured with some of the property and equipment of the Company and are repayable within one year.

10. Accounts and notes payable

The Company's accounts and notes payable at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Accounts payable	$ 39,426,056	$ 32,511,812
Notes payable	20,306,574	15,018,571
Balance at the end of the period	$ 59,732,630	$ 47,530,383

Notes payable represent accounts payable in the form of bills of exchange whose acceptances and settlements are handled by banks.

The Company has pledged cash deposits, notes receivable and certain property plant and machinery to secure trade financing granted by banks.

18

Table of Contents

11. Accrued expenses and other payables

The Company's accrued expenses and other payables at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Accrued expenses	$ 1,923,461	$ 1,957,146
Other payables	1,336,154	1,340,442
Warranty reserves*	6,774,470	4,919,491
Dividend payable to minority interest shareholders of Joint-ventures	3,037,115	6,720,976
Liabilities in connection with warrants**	8,435	—
Balance at the end of the period	$ 13,079,635	$ 14,938,055

*The Company provides for the estimated cost of product warranties when the products are sold. Such estimates of product warranties were based on, among other things, historical experience, product changes, material expenses, service and transportation expenses arising from the manufactured product. Estimates will be adjusted on the basis of actual claims and circumstances.

For the nine months ended September 30, 2008 (unaudited) and the year ended December 31, 2007, the warranties activities were as follows:

	September 30, 2008	December 31, 2007
Balance at the beginning of period	$ 4,919,491	$ 2,954,326
Additions during the period	4,037,919	5,228,556
Settlement within period, by cash or actual material	(2,549,208)	(3,529,875)
Foreign currency translation	366,268	266,484
Balance at end of period	$ 6,774,470	$ 4,919,491

The Company has recorded $6,774,470 and $4,919,491 product warranty reserves for the nine months ended September 30, 2008 (unaudited) and the year ended December 31, 2007, which were included in the accrued expenses and other payables in the accompanying unaudited consolidated financial statements.

**In connection with the Convertible Debt, the Company issued 1,317,864 of detachable warrants, "Warrants," to purchase from the Company shares of common stock at the exercise price of $8.8527 per share, subject to adjustments upon certain events occurring. The Warrants are exercisable immediately and will expire on February 15, 2009.

The exercise price or the number of shares to be converted by the Warrant will be adjusted in the event of no effective Registration Statement or delayed effectiveness of the Registration Statement. In addition a damage penalty will be paid if the delivery of share certificates occurs upon the Warrants conversion.

The Company will not effect any conversion of a Warrant, and each holder of any Warrant will not have the right to convert any portion of such Warrant to the extent that after giving effect to such conversion, each of these two holders would beneficially own in excess of 4.99% of the number of shares of Common Stock outstanding immediately after giving effect to such conversion.

If and whenever on or after the issuance date, the Company issues or sells its shares of common stock or other convertible securities for a consideration per share less than a price equal to the exercise price of a Warrant in effect on the issuance date immediately prior to such issue or sale, the exercise price of such Warrant then in effect will be adjusted.

19

Table of Contents

The warrants issued in connection with the financial arrangement were derivative instruments. The warrants require net cash settlement in the event that there is a fundamental transaction, contractually defined as a merger, sale of substantially all assets, tender offer or share exchange.

As a result of FASB Staff Position (FSP) FAS 150-5, it appears that the warrants require liability classification due to the possible cash redemption upon the event of an all cash acquisition. The FSP clarifies that warrants that contain any redemption features, including contingent redemption features, must be recorded as liabilities and marked to fair value each reporting period. As of the issuance date, i.e, February 15, 2008, the fair value of warrants was $798,626. Such warrant liabilities will be adjusted to its estimated fair value at the completion of each reporting period until the maturity of February 15, 2009.

The warrant agreements contain strike price adjustment provisions. In accordance with Section 8(iii), if the rate at which any Convertible Instruments are convertible into changes at any time, the warrant exercise price in effect at the time of the change will be adjusted based on the formula provided in Section 8(a) of the warrant agreement. Accordingly, the warrants will be valued at the exercise price of $8.55 as of August 15, 2008 and thereafter.

As of August 15, 2008, the Company valued the warrant using conversion price at inception and reset respectively. The fair value of the warrant is $489,719 at the inception conversion price of $8.8527, and $551,131 at the reset conversion price of $8.5500, respectively. Such difference resulting from using the reset conversion price has increased warrant liabilities by $61,412.

As of September 30, 2008, the fair value of warrants was $8,435, which was determined using the Black-Scholes option pricing model. The income from adjustment of fair value of liabilities in connection with warrants has been recorded in the income statement as gain or loss on change in fair value of derivative. (See note 22)

12. Accrued pension costs

Since the Company’s operations are all located in China, all the employees are located in China. The Company records pension costs and various employment benefits in accordance with the relevant Chinese social security laws, which is substantially based on a total of 31% of base salary as required by local governments. Base salary levels are the average salary determined by the local governments.

The activities in the Company’s pension account during the nine months ended September 30, 2008 (unaudited) and the year ended December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Balance at beginning of the period	$ 3,622,729	$ 3,266,867
Amounts provided during the period	1,748,484	1,286,566
Settlement during the period	(1,875,373)	(1,154,462)
Foreign currency translation	261,815	223,758
Balance at end of period	$ 3,757,655	$ 3,622,729

Table of Contents

13. Taxes payable

The Company's taxes payable at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Value-added tax payable	$ 6,709,404	$ 7,052,682
Income tax payable	1,422,207	1,883,185
Other tax payable	41,441	144,626
Balance at end of the period	$ 8,173,052	$ 9,080,493

14. Amounts due to shareholders/ directors

The activities in the amounts due to shareholders/directors at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Balance at the beginning of period	$ 304,601	$ 358,065
Decrease during the period	(78,857)	(84,476)
Foreign currency translation	31,280	31,012
Balance at end of period	$ 257,024	$ 304,601

The amounts due to shareholders/directors were unsecured, interest-free and repayable on demand.

15. Advances payable

The amounts mainly represent advances made by the Chinese government to the Company as subsidy on interest on loans related to production facilities expansion.

The balances are unsecured, interest-free and will be repayable to the Chinese government if the usage of such advance does not continue to qualify for the subsidy (see notes 20).

16. Derivative liabilities

The Company has evaluated the convertible notes for terms and conditions that are not clearly and closely associated with the risks of the debt-type host instrument (see Note 17). Generally, such features require separation from the host contract and treatment as derivative financial instruments. Certain features, such as the conversion option, were found to be exempt. Other features, such as puts and redemption features were found to require bifurcation and recognition as derivative liabilities. These derivative liabilities are recognized initially at fair value, using forward cash-flow valuation techniques. As of February 15, 2008, the compound derivative value amounted to $1,703,962. This derivative will be adjusted to its estimated fair value at the completion of each reporting period until the debt arrangement is ultimately settled, converted or paid. As of September 30, 2008, the compound derivative value amounted to $821,583. The income from adjustment of fair value of compound derivative has been recorded in the income statement as gain or loss on change in fair value of derivative. (See note 22)

17. Convertible notes payable

In February 2008, the Company sold to two accredited institutional investors $35 million of convertible debt, the "Convertible Debt", with a scheduled maturity date of February 15, 2013. The Convertible Debt, including any accrued but unpaid interest, is convertible into common shares of the Company at a conversion price of $8.8527 per

share, subject to adjustment upon the occurrence of certain events.

Table of Contents

The Convertible Debt bears annual interest rates of 3%, 3.5%, 4%, 4.5% and 5% for each year of 2008, 2009, 2010, 2011 and 2012. The interest on the Convertible Debt shall be computed commencing from the issuance date and will be payable in cash in arrears semi-annually on January 15, and July 15 of each year with the first interest payable date being July 15, 2008. From and after the occurrence and during the continuance of an Event of Default defined in the relevant Convertible Debt agreements, the interest rate then in effect shall be increased by two percent (2%) until the event of default is remedied.

The holders of the Convertible Debt will be entitled to convert any portion of the conversion amount into shares of common stock at the conversion price at any time or times on or after the thirtieth (30th) day after the issuance date and prior to the thirtieth (30th) Business Day prior to the expiry date of the Convertible Debt. A damage penalty will be paid if share certificates are not delivered timely after any conversion.

The Company will have the right to require the Convertible Debt holders to convert all or any portion of the conversion amount then remaining under the Convertible Debt obligation into shares of common stock, " Mandatory Conversion", if at any time during a six-month period, the beginning day of each such six-month period, a "Mandatory Conversion Period Start Date", the arithmetic average of the weighted average price of the common stock for a period of at least thirty (30) consecutive trading days following the Mandatory Conversion Period Start Date equals or exceeds the percentage of $8.8527 set forth in the chart below as applicable to the indicated six month period:

0-6 months:	125%
6-12 months:	125%
12-18 months:	135%
18-24 months:	135%
24-30 months:	145%
30-36 months:	145%
36-42 months:	155%
42-48 months:	155%

On each six month anniversary of the issuance date beginning August 15, 2008, the conversion price will be adjusted downward to the Reset Reference Price, as defined below, if the weighted average price for the twenty (20) consecutive trading days immediately prior to the applicable six month anniversary, the "Reset Reference Price", is less than 95% of the conversion price in effect as of such applicable six month anniversary date. The foregoing notwithstanding, the conversion price will not be reduced via such reset provision to less than $7.0822. The conversion price is also subject to weighted-average antidilution adjustments, but in no event will the conversion price be reduced to less than $6.7417. If and whenever on or after the issuance date, the Company issues or sells its shares of Common Stock or other convertible securities, except for certain defined exempt issuances, for a consideration per share less than a price equal to the conversion price in effect on the issuance date immediately prior to such issue or sale, the original conversion price then in effect shall be adjusted by a weighted-average antidilution formula, but in no event to a new conversion price less than $6.4717.

The Company will not effect any conversion of the Convertible Debt, and each holder of the Convertible Debt will not have the right to convert any portion of the Convertible Debt to the extent that after giving effect to such conversion, such holders would beneficially own in excess of 4.99% of the number of shares of Common Stock outstanding immediately after giving effect to such conversion.

The Company will not effect a Mandatory Conversion of more than twelve percent (12%) of the original principal amount of the Convertible Debt, with the applicable accrued but unpaid interest, in any six month period or twenty-four percent (24%) of the original principal amount of the Convertible Debt, with the applicable accrued but unpaid interest, in any twelve (12) month period.

Upon the occurrence of an event of default with respect to the Convertible Debt, the Convertible Debt holders may require the Company to redeem all or any portion of the Convertible Debt. Each portion of the Convertible Debt subject to redemption by the Company will be redeemed by the Company at a price equal to the sum of (i) the conversion amount to be redeemed and (ii) the Other Make Whole Amount. The “Other Make Whole Amount” will mean a premium to the conversion amount such that the total amount received by the Convertible Debt holder upon redemption represents a gross yield to the Convertible Debt holders on the original principal amount as of the redemption date equal to thirteen percent (13%), with interest computed on the basis of actual number of days elapsed over a 360-day year. The events of default includes the Company’s failure to cure a conversion failure by delivery of the required number of shares of Common Stock, the Company’s failure to pay to the Convertible Debt holder any amount of principal, interest, late charges or other amounts when and as due under the Convertible Debt and other events as defined in the Convertible Debt agreements.

Table of Contents

Upon the consummation of a change of control as defined in the Convertible Debt agreements, the Convertible Debt holder may require the Company to redeem all or any portion of the Convertible Debt. The portion of the Convertible Debt subject to redemption shall be redeemed by the Company in cash at a price equal to the sum of the conversion amount of being redeemed and the Other Make Whole Amount as defined above.

On each of February 15, 2010 and February 15, 2011, the Convertible Debt holders will have the right, in their sole discretion, to require that the Company redeem the Convertible Debt in whole but not in part, by delivering written notice thereof to the Company. The portion of this Convertible Debt subject to redemption pursuant to this annual redemption right will be redeemed by the Company in cash at a price equal to the sum of the conversion amount being redeemed and the Annual Redemption Make Whole Amount. The "Annual Redemption Make Whole Amount" will mean a premium to the conversion amount such that the total amount received by the Convertible Debt holder upon any annual redemption represents a gross yield on the original principal amount of eleven percent (11%), with interest computed on the basis of actual number of days elapsed over a 360-day year.

In the event that the Company has not completed the necessary filings to list the conversion shares on its principal market by the date that is ninety (90) days after the issuance date or has not so listed the conversion shares by the date that is ninety (90) days after the issuance date or the shares of the Company's common stock are terminated from registration under the Securities Act of 1933, the Convertible Debt holders will have the right, in its sole discretion, to require that the Company redeem all or any portion of the Convertible Debt. The portion of the Convertible Debt subject to redemption in connection with this listing default will be redeemed by the Company in cash at a price equal to the sum of the conversion amount being redeemed and the Other Make Whole Amount as mentioned above.

At any time following February 15, 2009, if the weighted average for twenty (20) consecutive trading days is less than $3.98, the Convertible Debt holder shall have the right, in its sole discretion, to require that the Company redeem all or any portion of the Convertible Debt. The portion of this Convertible Debt subject to redemption in connection with the share price change of the underlying common stock will be redeemed by the Company in cash at a price equal to the sum of the conversion amount being redeemed and the Other Make Whole Amount as mentioned above.

In connection with the Convertible Debt, the Company issued 1,317,864 detachable warrants, the "Warrants," to purchase from the Company shares of common stock of the Company at the exercise price of $8.8527 per share. The Warrants are exercisable immediately and will expire on February 15, 2009. The Warrants require net cash settlement in the event that there is a fundamental transaction, contractually defined as a merger, sale of substantially all assets, tender offer or share exchange. Due to this contingent redemption provision, the warrants require liability classification under SFAS 150 and must be recorded at fair value each reporting period. As of the issuance date, i.e, February 15, 2008, the fair value of warrants was $798,626, which was determined using the Black-Scholes option pricing model.

The Company has evaluated the convertible notes for terms and conditions that are not clearly and closely associated with the risks of the debt-type host instrument. Generally, such features require separation from the host contract and treatment as derivative financial instruments. Certain features, such as the conversion option, were found to be exempt. Other features, such as puts and redemption features, were found to require bifurcation and recognition as derivative liabilities. These derivative liabilities are recognized initially at fair value, using forward cash-flow valuation techniques. As of February 15, 2008, the compound derivative value amounted to $1,703,962. This derivative will be adjusted to its estimated fair value at the completion of each reporting period until the debt arrangement is ultimately settled, converted or paid.

When a financial instrument contains embedded derivatives that require bifurcation, such as the redemption put, and freestanding instruments that are recorded at fair value each period, such as the warrants, the accounting is to record the embedded derivative and the freestanding instruments at fair value on inception and the residual proceeds are

allocated to the debt instrument. Based on this premise, upon inception of the debt instruments, we recorded the redemption put at fair value $1,703,962 and we recorded the warrants at fair value $798,626. The remaining proceeds were then allocated to the debt instrument.

Table of Contents

As indicated above, according to the terms of the note, the conversion price was reset to $7.0822 as of August 15, 2008 based on the weighted average price of the stock on that date. In accordance with EITF 00-27, a contingency feature that cannot be measured at inception of the instrument, should be recorded when the contingent event occurs. Therefore, on the date of the reset, the difference in the number of indexed shares prior to the reset was compared to the indexed shares subsequent to the reset and this incremental number of shares was multiplied by the commitment date stock price to determine the incremental intrinsic value that resulted from the adjustment to the conversion price. This difference was recorded in equity as a beneficial conversion feature (“BCF”) and the related discount reduced the carrying value of the note and is being amortized over the remaining life of the instrument.

EITF 98-5 provides that the beneficial conversion feature, if any, embodied in a convertible debt instrument requires recognition and reclassification to stockholders' equity in an amount "not to exceed" the financing basis. For purposes of calculating the beneficial conversion feature, EITF 00-27, provides that the contractual conversion rate should give effect to the allocation of proceeds to other financial instruments, as required by APB 14. Accordingly, the "effective" conversion rate is calculated as the basis allocated to the debt instruments divided by the number of indexed shares. The reset conversion price was a contingent conversion price that was not known at inception of the agreement. Under the guidance of EITF 98-5, the beneficial conversion feature should be recalculated once the contingent conversion feature is known. The reset conversion feature was determined to be $7.0822 on August 15, 2008. The BCF was then calculated as if the reset amount was known at inception of the agreement in order to determine what the APB 14 allocation would have been using a conversion price of $7.0822.

Issue 7 (EITF 00-27) states that " the number of shares that would be received upon conversion based on the adjusted conversion price would be compared to the number that would have been received prior to the occurrence of the contingent event. The excess number of shares multiplied by the commitment date stock price equals the incremental intrinsic value that results from the resolution of the contingency and the corresponding adjustment to the conversion price." The guidance in Issue 7 does not specify whether the contingent BCF should only be calculated if the contingent conversion feature is below the market price of the stock and would have intrinsic value. The Company is of an opinion that the Issue 7 approach was not intended to override the intrinsic value method addressed in EITF Topic D-60, EITF 98-5 and EITF 00-27, and that the BCF should be calculated as the intrinsic spread between the adjusted effective conversion price and the market price at the commitment date.

As of August 15, 2008, the number of indexed shares were 3,953,596 and 4,941,967 at the inception conversion price and reset conversion price, respectively. At the commitment date, the stock price was $6.09, the “effective” conversion price was $6.93. Accordingly, since the effective conversion price is higher than the market value of the stock, the debt instruments are not considered "in the money" and no beneficial conversion feature is present.

Allocation of basis in the financing arrangement to the warrants and derivative liability has resulted in an original issue discount to the face value of the convertible notes in the amount of $2,502,588, which amount is subject to amortization over the Convertible Debt’s term using the effective method. The Company recorded amortization expense during the nine months ended September 30, 2008 of $302,771.

18. Minority interests

The Company’s activities in respect of the amounts of the minority interests’ equity at September 30, 2008 (unaudited) and December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Balance at beginning of the period	$ 23,166,270	$ 23,112,667
Add: Additions during the period–		
Minority interest’s income	4,418,730	9,646,339

Capital Contribution from the minority interest holders of Joint-venture companies	745,723	55,512
Foreign currency translation	1,481,294	1,650,869
Less: decrease during the period		
Dividends declared to the minority interest holders of Joint-venture companies	(1,016,733)	(8,468,572)
Transfer and assign equity interest in Henglong and USAI by minority interest holders of Joint-venture companies*	(6,177,079)	(2,830,545)
Balance at end of period	$ 22,618,205	$ 23,166,270

Table of Contents

*On March 31, 2008, the Company's wholly-owned subsidiary, Great Genesis and Wiselink, both controlled by Hanlin Chen and his family, entered into an equity transfer agreement, pursuant to which Wiselink agreed to transfer and assign its 35.5% equity interest in Jingzhou Henglong, one of the Company's currently consolidated subsidiaries, to Great Genesis for a total consideration of $32,090,000.

Under the terms of the above agreement, Great Genesis is deemed to be the owner of the equity concerned commencing from January 1, 2008. In accordance with FASB 141 and APB 14, the acquisition is considered as a business combination of companies under common control and is being accounted for in a manner of pooling of interests.

As of January 1, 2008, the net book value of 35.5% equity of Henglong, which was transferred from minority shareholders, was $6,177,079.

19. Additional paid-in capital

The Company's activities in the Company's additional paid-in capital account during the nine months ended September 30, 2008 (unaudited) and the year ended December 31, 2007 are summarized as follows:

	September 30, 2008	December 31, 2007
Balance at beginning of the period	$ 30,125,951	$ 28,651,959
Add: Additions during the period		
Issuance of common stock for cash in accordance with the standby equity distribution agreement with Cornell Capital Partners, LP.	—	1,199,989
Issuance of stock options to independent directors	95,400	153,675
Issuance of common stock*	22,089,696	—
Increase in connection with minority shareholders' abandonment of all its right and interest in Joint-venture	—	174,828
Less: decrease during the period–		
Cash paid for retaining fee, commissions and placement agent fee in connection with offering	—	(54,500)
35.5% Henglong equity acquisition**	(25,912,921)	—
Balance at end of period	$ 26,398,126	$ 30,125,951

*On March 31, 2008, Wiselink Holdings Limited, "Wiselink", Great Genesis Holdings Limited, "Great Genesis", a wholly-owned subsidiary of China Automotive Systems, Inc., "the Company" and other parties entered into an equity transfer transaction, the "Acquisition", documented by an Equity Transfer Agreement, the "Agreement", pursuant to which Wiselink agreed to transfer and assign a 35.5% equity interest in Jingzhou Henglong Automotive Parts Co. Ltd., "Jingzhou Henglong" to Great Genesis for a total consideration of $32,090,000, the "Consideration".

Under the terms of the Agreement, the Consideration is to be paid as follows: $10,000,000 cash was paid by Great Genesis to Wiselink on April 30, 2008, and the balance of the purchase price ($22,090,000) was paid by issuance of 3,023,542 shares of common stock of the Registrant, in its capacity as the 100% parent company of Great Genesis.

On April 22 and June 30, 2008, the Company issued 1,170,000 and 1,853,542 shares of common stock, respectively, at an issuance price of $7.3060, par value of $0.0001. The difference between issuance price and par value was credited into additional paid-in capital.

**On March 31, 2008, the Company's wholly-owned subsidiary, Great Genesis and Wiselink, both controlled by Hanlin Chen and his family, entered into an equity transfer agreement, pursuant to which Wiselink agreed to transfer

and assign its 35.5% equity interest in Jingzhou Henglong, one of the Company's currently consolidated subsidiaries, to Great Genesis for a total consideration of $32,090,000.

Table of Contents

Under the terms of the above agreement, Great Genesis is deemed to be the owner of the equity concerned commencing from January 1, 2008. In accordance with FASB 141 and APB 14, the above acquisition is considered as a business combination of companies under common control and is being accounted for in a manner of pooling of interests.

As of January 1, 2008, the net book value of 35.5% equity of Henglong was $6,177,079. The difference between the acquisition consideration of $32,090,000 and 35.5% equity of Henglong, which was $25,912,921, has been debited to additional paid-in capital.

20. Other Income

Other income was $123,167 for the three months ended September 30, 2008, primarily as a result of the increased government subsidies received by USAI. Its product, sensor modules which was encouraged by Chinese government for government subsidies, has achieved the target of production expansion and quality enhancement in 2008. And there was no such income in the same period in 2007.

During the nine months ended September 30, 2008 and 2007 (unaudited), the Company recorded other income, government subsidies, of $322,626 and $38,462, respectively.

Government subsidies represent refunds by the Chinese Government of interest paid to banks by companies entitled to such subsidies. This applies only to interest on loans related to production facilities expansion. Commencing in 2004 and 2005, the Company had used this type of special loan to improve its production lines by increasing capacity and enhancing quality. The expansion was completed and began to operate at the end of 2006 and 2007. During 2008 and 2007, the Chinese Government sent experts to review and assess the Company's usage of its improved production facilities on site to confirm that the Company's improvements had achieved its goals and thereby qualify for the subsidy. The Company recorded the refunded interest which achieved its goals into Other income, and refunded interest which has not achieved its goals into advances payable.

21. Financial income (expenses)

During the three months and nine months ended September 30, 2008 (unaudited) and 2007, the Company recorded financial income (expenses) which is summarized as follows:

	Three Months Ended September 30,	
	2008	2007
Interest income (expenses),net	$ (300,104)	$ (151,675)
Foreign exchange gain (loss), net	(13,197)	(44,103)
Income (loss) of note discount, net	15,768	(9,972)
Amortization for discount of convertible note payable	(121,443)	—
Handling charge	(27,285)	(9,650)
Total	$ (446,261)	$ (215,400)

	Nine Months Ended September 30,	
	2008	2007
Interest income(expenses),net	$ (958,488)	$ (358,527)
Foreign exchange gain (loss), net	332,917	(124,958)
Income (loss) of note discount, net	107,814	(115,255)
Amortization for discount of convertible note payable	(302,771)	—
Handling charge	(64,180)	(28,152)

Total	$ (884,708)	$ (626,892)

26

Table of Contents

22. Gain (loss) on change in fair value of derivative

	Three Months Ended September 30,	
	2008	2007
Income from adjustment of fair value of liabilities in connection with warrants	$ 571,953	$ —
Income from adjustment of fair value of compound derivative liabilities	105,464	—
Total	$ 677,417	$ —

	Nine Months Ended September 30,	
	2008	2007
Income from adjustment of fair value of liabilities in connection with warrants	$ 790,191	$ —
Income from adjustment of fair value of compound derivative liabilities	882,379	—
Total	$ 1,672,570	$ —

23. Income Taxes

The Company's subsidiaries registered in the PRC are subject to state and local income taxes within the PRC at the applicable tax rate on the taxable income as reported in their PRC statutory financial statements in accordance with the relevant income tax laws applicable to foreign invested enterprise. The Company's PRC subsidiaries which are in the stage of its enterprise income tax exemption currently, are to remain subject to enterprise fixed income tax at a statutory rate of 33%, which comprises 30% national income tax and 3% local income tax.

On January 1, 2007, Jiulong has used up its enterprise income tax exemption. During 2007, Jiulong was subject to enterprise income tax at a rate of 30%, and 25% for 2008.

On January 1, 1999, Henglong was granted an enterprise income tax holiday of a 100% enterprise income tax exemption for two years commencing from 1999, and a 50% enterprise national income tax deduction and a 100% local income tax deduction for the next nine years thereafter, from 2001 to 2009, for income tax purposes. Henglong is subject to enterprise national income tax at a rate of 15% for 2008 and 2009, and is subject to enterprise income tax at a rate of 25% commencing from January 1, 2010.

On January 1, 2003, Shenyang was granted an enterprise income tax holiday of a 100% enterprise income tax exemption for two years commencing from 2003, a 75% enterprise national income tax deduction and a 100% local income tax deduction for the next three years thereafter, from 2005 to 2007, and a 50% enterprise national income tax deduction, from January 1, 2008, for income tax purposes. Commencing from 2008, Shenyang is subject to enterprise income tax at a rate of 18%, which comprises of 15% enterprise national income tax and 3% local income tax.

On January 1, 2004, Zhejiang was granted an enterprise income tax holiday of a 100% enterprise income tax exemption for two years commencing from 2004, and a 50% enterprise national income tax deduction, and a 50% local income tax deduction for the next three years thereafter, from 2006 to 2008, for income tax purposes. During 2008, Zhejiang is subject to enterprise income tax at a rate of 16.5%, which comprises of 15% enterprise national income tax and 1.5% local income tax, and is subject to enterprise income tax at a rate of 25% commencing from January 1, 2009.

USAI, Wuhu, Jielong and Hengsheng are at their start up stage in 2008 and 2007, accordingly, there is no assessable profit for the three months and nine months ended September 30, 2008 subject to PRC enterprise income tax. They have an enterprise income tax exemption in 2008 and 2009, and are subject to enterprise income tax at a rate of 16.5%

for the next three years thereafter, from 2010 to 2012, and a 25% enterprise national income tax for the years commencing from January 1, 2013.

Table of Contents

No provision for Hong Kong tax is made as Great Genesis is an investment holding company, and has no assessable income in Hong Kong for the three months and nine months ended September 30, 2008 and 2007. The enterprise income tax of Hong Kong is 17.5%.

No provision for US tax is made as the Company has no assessable income in the US for the three months and nine months ended September 30, 2008 and 2007. The enterprise income tax of US is 30%.

The account of income tax as of the September 30, 2008 and 2007 (unaudited) is summarized as follows:

	Three Months Ended September 30,	
	2008	2007
Current tax provision	$ 925,422	$ 1,180,468
Income tax refund*	(431,746)	(801,059)
Deferred tax (benefit) relating to the origination and reversal of temporary differences	(184,196)	—
Income tax expenses (income)	$ 309,480	$ 379,409

	Nine Months Ended September 30,	
	2008	2007
Current tax provision	$ 3,632,345	$ 4,068,355
Income tax refund*	(2,331,181)	(1,327,331)
Deferred tax (benefit) relating to the origination and reversal of temporary differences	(582,747)	—
Income tax	$ 718,417	$ 2,741,024

*For the three months and nine months ended September 30, 2008 and 2007 (unaudited), the income tax refunds received by the Company's Sino-foreign joint ventures for purchase of domestic equipment have been reflected as a reduction to income tax expense in the respective period of the Company's consolidated statements of operations.

24. Significant concentrations

The Company grants credit to its customers, generally on an open account basis. The Company's customers are all located in the PRC.

During the nine months ended September 30, 2008 (unaudited), the Company's ten largest customers accounted for 72.4% of the Company's consolidated net sales, with each of three customers individually accounting for more than 10% of consolidated net sales, i.e. 15.0%, 11.7%, and 10.7% individually, or an aggregate of 37.5%. At September 30, 2008, approximately 24.8% of accounts receivable were from trade transactions with the aforementioned three customers.

During the nine months ended September 30, 2007 (unaudited), the Company's ten largest customers accounted for 67.6% of the Company's consolidated net sales, with each of four customers individually accounting for more than 10% of consolidated net sales, i.e. 16.7%, 13.4%, 11.5% and 10.0% individually, or an aggregate of 51.6%. At September 30, 2007, approximately 38.8% of accounts receivable were from trade transactions with the aforementioned four customers.

Table of Contents

25. Related party transactions and balances

Related party transactions with companies with common directors are as follows:

Related sales (unaudited):

	Three Months Ended September 30,	
	2008	2007
Merchandise Sold to Related Parties	$ 967,591	$ 1,635,676

	Nine Months Ended September 30,	
	2008	2007
Merchandise Sold to Related Parties	$ 3,766,078	$ 3,711,504

Related purchases (unaudited):

	Three Months Ended September 30,	
	2008	2007
Materials Purchased from Related Parties	$ 1,783,822	$ 1,276,789
Technology Purchased from Related Parties	175,953	—
Equipment Purchased from Related Parties	499,782	331,619
Total	$ 2,459,557	$ 1,608,408

	Nine Months Ended September 30,	
	2008	2007
Materials Purchased from Related Parties	$ 6,387,212	$ 3,743,223
Technology Purchased from Related Parties	175,953	64,103
Equipment Purchased from Related Parties	2,615,992	626,455
Total	$ 9,179,157	$ 4,433,781

Purchase of 35.5% equity interest in Jinzhou Henglong (refer to note 19)

Related receivables (September 30, 2008 unaudited):

	September 30, 2008	December 31, 2007
Accounts receivable	$ 1,105,037	$ 1,869,480
Other receivables	707,979	638,826
Total	$ 1,813,016	$ 2,508,306

Table of Contents

Related advances (September 30, 2008 unaudited):

	September 30, 2008	December 31, 2007
Advanced Equipment Payment to Related Parties	$ 3,818,485	$ 1,560,378
Advanced Expenses and Others to Related Parties	65,746	55,323
Total	$ 3,884,231	$ 1,615,701

Related payables (September 30, 2008 unaudited)

	September 30, 2008	December 31, 2007
Accounts payable:	$ 851,631	$ 1,134,817

These transactions were consummated under similar terms as those with the Company's customers and suppliers.

26. Commitments and contingencies

Legal Proceedings - The Company is not currently a party to any threatened or pending legal proceedings, other than incidental litigation arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

The following table summarizes the Company’s major contractual payment obligations and commitments as of September 30, 2008 (unaudited):

	Payment Obligations by Period					
	2008 (a)	2009	2010	2011	Thereafter	Total
Obligations for service agreements	$ —$	110,000	$ 110,000	$ 110,000	$ —$	330,000
Obligations for purchasing agreements	5,383,399	1,447,448	$ —$	—	—	6,830,847
Total	$ 5,383,399	$ 1,557,448	$ 110,000	$ 110,000	$ —$	7,160,847

(a) Remaining 3 months in 2008

27. Off-balance sheet arrangements

At September 30, 2008 and 2007, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

Table of Contents

28. Segment reporting

The accounting policies of the product sectors are the same as those described in the summary of significant accounting policies except that the disaggregated financial results for the product sectors have been prepared using a management approach, which is consistent with the basis and manner in which management internally disaggregates financial information for the purposes of assisting them in making internal operating decisions. Generally, the Company evaluates performance based on stand-alone product sector operating income and accounts for inter segment sales and transfers as if the sales or transfers were to third parties, at current market prices.

During the three months and nine months ended September 30, 2008 and 2007 (unaudited), the Company had nine product sectors, five of them were principal profit makers, which were reported as separate sectors which engaged in the production and sales of power steering (Henglong), power steering (Jiulong), power steering (Shenyang), power pumps (Zhejiang), and power steering (Wuhu). The other four sectors which were established in 2005, 2006 and 2007 respectively, engaged in the production and sales of sensor modular (USAI), electronic power steering (Jielong), power steering (Hengsheng), and provider of after sales and R&D services (HLUSA). Since the revenues, net income and net assets of these four sectors are less than 10% of its segment in the consolidated financial statements, the Company incorporated these four sectors into “other sectors”.

The Company’s product sectors information is as follows:

	Henglong	Jiulong	Shenyang	Zhejiang	Wuhu	Other sector	Other (1)	Total
For the Three Months Ended:								
September 30, 2008								
Revenue								
Net product sales – external	$ 14,526,593	$ 8,815,691	$ 5,584,941	$ 3,438,307	$ 4,531,666	$ 39,557	$ —	$ 36,936,755
Net product sales – internal	5,035,942	473,818	701,997	102,003	—	—	(6,313,760)	—
Gain on other sales	69,328	115,725	51,134	20,391	64,073	21,983	692	343,326
Total revenue	$ 19,631,863	$ 9,405,234	$ 6,338,072	$ 3,560,701	$ 4,595,739	$ 61,540	$ (6,313,068)	$ 37,280,081
Net income	$ 2,685,495	$ 95,627	$ 386,084	$ 278,641	$ (140,192)	$ (184,040)	$ (362,836)	$ 2,758,779

	Henglong	Jiulong	Shenyang	Zhejiang	Wuhu	Other sector	Other (1)	Total
For the Three Months Ended:								
September 30, 2007								
Revenue								
	$ 10,251,971	$ 8,106,377	$ 5,719,242	$ 2,911,860	$ 4,222,181	$ (8,900)	$ —	$ 31,202,731

Net product sales – external								
Net product sales – internal	5,635,023	537,459	410,175	(270)	—	—	(6,582,387)	—
Gain on other sales	99,880	(12,106)	16,720	(767)	—	—	(1,356)	102,371
Total revenue	$ 15,986,874	$ 8,631,730	$ 6,146,137	$ 2,910,823	$ 4,222,181	$ (8,900)	$ (6,583,743)	$ 31,305,102
Net income	$ 1,298,825	$ 423,236	$ 526,819	$ 309,971	$ (189,573)	$ (401,957)	$ 607,097	$ 2,574,418

Table of Contents

	Henglong	Jiulong	Shenyang	Zhejiang	Wuhu	Other sector	Other (1)	Total
For the Nine Months Ended:								
September 30, 2008								
Revenue								
Net product sales – external	$ 47,739,020	$ 33,650,090	$ 16,114,165	$ 11,200,250	$ 15,965,562	$ 243,051	—	$ 124,912,138
Net product sales – internal	20,691,684	1,949,031	2,866,379	591,842	—	—	(26,098,936)	—
Gain on other sales	208,724	131,092	123,695	31,041	81,861	21,086	(2,273)	595,226
Total revenue	$ 68,639,428	$ 35,730,213	$ 19,104,239	$ 11,823,133	$ 16,047,423	$ 264,137	$ (26,101,209)	$ 125,507,364
Net income	$ 9,889,489	$ 1,470,760	$ 1,417,763	$ 1,056,468	$ (546,062)	$ (720,900)	$ (634,211)	$ 11,933,308

	Henglong	Jiulong	Shenyang	Zhejiang	Wuhu	Other sector	Other (1)	Total
For the Nine Months Ended:								
September 30, 2007								
Revenue								
Net product sales – external	$ 32,025,588	$ 25,457,167	$ 14,660,207	$ 9,697,822	$ 14,041,721	$ 15,956	$ —	$ 95,898,461
Net product sales – internal	21,285,580	2,426,271	1,821,863	29,882	—	—	(25,563,596)	—
Gain on other sales	320,519	52,349	35,088	(4,932)	2,499	(579)	(4,024)	400,920
Total revenue	$ 53,631,687	$ 27,935,787	$ 16,517,158	$ 9,722,772	$ 14,044,220	$ 15,377	$ (25,567,620)	$ 96,299,381
Net income	$ 4,806,602	$ 1,965,930	$ 1,491,555	$ 1,134,895	$ (645,822)	$ (637,418)	$ (1,443,069)	$ 6,672,673

(1) Other includes activity not allocated to the product sectors and elimination of inter-sector transactions.

29. Subsequent events

None.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995:

This Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. Generally, the words "believes", "anticipates," "may," "will," "should," "expec "intend," "estimate," "continue," and similar expressions or the negative thereof or comparable terminology are intended to identify forward-looking statements which include, but are not limited to, statements concerning the Company's expectations regarding its working capital requirements, financing requirements, business prospects, and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. Such statements are subject to certain risks and uncertainties, including the matters set forth in this Quarterly Report or other reports or documents the Company files with the Securities and Exchange Commission from time to time, which could cause actual results or outcomes to differ materially from those projected. Undue reliance should not be placed on these forward-looking statements which speak only as of the date hereof. The Company undertakes no obligation to update these forward-looking statements. In addition, the forward-looking statements in this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008 involve known and unknown risks, uncertainties and other factors that could cause the actual results, performance or achievements of the Company to differ materially from those expressed in or implied by the forward-looking statements contained herein. Please see the discussion on risk factors in Item 1A of Part II of this quarterly report on Form 10-Q.

GENERAL OVERVIEW:

China Automotive Systems, Inc., including, when the context so requires, its subsidiaries and the subsidiaries' interests in the Sino-foreign joint ventures described below, is referred to herein as the "Company". The Company, through its Sino-foreign joint ventures, engages in the manufacture and sales of automotive systems and components in the People's Republic of China, the "PRC" or "China", as described below.

Great Genesis Holdings Limited, a company incorporated on January 3, 2003 under The Companies Ordinance in Hong Kong as a limited liability company, "Great Genesis", is a wholly-owned subsidiary of the Company.

Henglong USA Corporation, "HLUSA", which was incorporated on January 8, 2007 in Troy, Michigan, is a wholly-owned subsidiary of the Company, and mainly engages in marketing of automotive parts in North America, and provides after sales service and research and development support accordingly.

The Company owns the following aggregate net interests in eight Sino-foreign joint ventures organized in the PRC as of September 30, 2008 and 2007 (unaudited).

	Percentage Interest	
Name of Entity	September 30, 2008	September 30, 2007
Shashi Jiulong Power Steering Gears Co., Ltd., "Jiulong"	81.00%	81.00%
Jingzhou Henglong Automotive Parts Co., Ltd., "Henglong"	80.00%	44.50%
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., "Shenyang"	70.00%	70.00%
Zhejiang Henglong & Vie Pump-Manu Co., Ltd., "Zhejiang"	51.00%	51.00%
Universal Sensor Application Inc., "USAI"	83.34%	85.71%

Wuhan Jielong Electric Power Steering Co., Ltd., “Jielong”	85.00%	85.00%
Wuhu HengLong Automotive Steering System Co., Ltd., “Wuhu”	77.33%	77.33%
Jingzhou Hengsheng Automotive System Co., Ltd, “Hengsheng”	100.00%	100.00%

Jiulong was established in 1993 and mainly engaged in the production of integral power steering gears for heavy-duty vehicles.

Table of Contents

Henglong was established in 1997 and mainly engaged in the production of rack and pinion power steering gears for cars and light duty vehicles.

On March 31, 2008, the Company's wholly-owned subsidiary, Great Genesis and Wiselink, both controlled by Hanlin Chen and his family, entered into an equity transfer agreement, pursuant to which Wiselink agreed to transfer and assign its 35.5% equity interest in Jingzhou Henglong, one of the Company's currently consolidated subsidiaries, to Great Genesis for a total consideration of $32,090,000. The Company now holds an 80% equity interest in Jingzhou Henglong.

Under the terms of the above agreement, Great Genesis is deemed to be the owner of the equity concerned commencing from January 1, 2008. The Acquisition is considered as a business combination of companies under common control and is being accounted for in a manner of pooling of interests.

Shenyang was established in 2002 and focuses on power steering parts for light duty vehicles.

Zhejiang was established in 2002 to focus on power steering pumps.

USAI was established in 2005 and mainly engaged in production and sales of sensor modulars.

Jielong was established in 2006 and mainly engaged in production and sales of electric power steering, "EPS".

Wuhu was established in 2006 and mainly engaged in production and sales of automobile steering systems.

Hengsheng was established in 2007 and mainly engaged in production and sales of automobile steering systems.

CRITICAL ACCOUNTING POLICIES:

The Company prepares its condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Management periodically evaluates the estimates and judgments made. Management bases its estimates and judgments on historical experience and on various factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates as a result of different assumptions or conditions. The following critical accounting policies affect the more significant judgments and estimates used in the preparation of the Company's condensed consolidated financial statements.

We consider an accounting estimate to be critical if:

• It requires us to make assumptions about matters that were uncertain at the time we were making the estimate, and

• Changes in the estimate or different estimates that we could have selected would have had a material impact on our financial condition or results of operations.

Table of Contents

The table below presents information about the nature and rationale for the Company critical accounting estimates:

Balance Sheet Caption	Critical Estimate Item	Nature of Estimates Required	Assumptions/Approaches Used	Key Factors
Accrued liabilities and other long-term liabilities	Warranty Obligations	Estimating warranty requires us to forecast the resolution of existing claims and expected future claims on products sold. VMs are increasingly seeking to hold suppliers responsible for product warranties, which may impact our exposure to these costs.	We base our estimate on historical trends of units sold and payment amounts, combined with our current understanding of the status of existing claims and discussions with our customers.	• VM (Vehicle Manufacturer) sourcing • VM policy decisions regarding warranty claims VMs
Property, plant and equipment, intangible assets and other long-term assets	Valuation of long- lived assets and investments	We are required from time-to-time to review the recoverability of certain of our assets based on projections of anticipated future cash flows, including future profitability assessments of various product lines.	We estimate cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments.	• Future Production estimates • Customer preferences and decisions
Accounts and notes receivables	Provision for doubtful accounts and notes receivable	Estimating the provision for doubtful accounts and notes receivable require the Company to analyze and monitor each customer's credit standing and financial condition regularly. The Company grants	The Company grants credit to its customers for three to four months based on each customer's current credit standing and financial data. The Company assesses an allowance on an individual customer basis, under normal circumstances; the Company does not record any provision for	• Customers' credit standing and financial condition

		credit to its customers, generally on an open account basis. It will have material adverse effect on the Company's cost disclosure if such assessment were improper.	doubtful accounts for those accounts receivable amounts which were in credit terms. For those receivables out of credit terms, certain proportional provision, namely 25% to 100%, will be recorded based on respective overdue terms.	
Deferred income taxes	Recoverability of deferred tax assets	We are required to estimate whether recoverability of our deferred tax assets is more likely than not based on forecasts of taxable earnings in the related tax jurisdiction.	We use historical and projected future operating results, based upon approved business plans, including a review of the eligible carryforward period, tax planning opportunities and other relevant considerations.	• Tax law changes • Variances in future projected profitability, including by taxing entity

In addition, there are other items within our financial statements that require estimation, but are not as critical as those discussed above. These include the allowance for reserves for excess and obsolete inventory. Although not significant in recent years, changes in estimates used in these and other items could have a significant effect on our consolidated financial statements.

Table of Contents

RESULTS OF OPERATIONS——THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007:

The following table sets forth for the periods indicated certain items from the Company's Consolidated Statements of Income expressed as a percentage of net sales and the percentage change in the dollar amount of each such item from that in the indicated previous year.

	Percentage on net sales Three months ended September 30,		Change in percentage Three months ended September 30,
	2008	2007	2007 to 2008
Net sales	100.0%	100.0%	18.4%
Cost of sales	73.3	63.6	36.4
Gross profit	26.7	36.4	(13.1)
Gain on other sales	0.9	0.3	235.4
Less: operating expenses			
Selling expenses	6.3	6.7	10.3
General and administrative expenses	5.6	5.4	22.4
R & D expenses	1.8	1.0	107.0
Depreciation and amortization	4.0	2.4	102.3
Total operating expenses	17.7	15.5	34.9
Operating income	10.0	21.2	(44.2)
Other income	0.3	—	—
Financial income (expenses)	(1.2)	(0.7)	107.2
Gain on change in fair value of derivative	1.8	—	—
Income before income tax	11.0	20.6	(36.8)
Income tax	0.8	1.2	(18.4)
Income before minority interests	10.1	19.3	(38.0)
Minority interests	2.7	11.1	(71.6)
Net income	7.5%	8.3%	7.2%

Table of Contents

	Percentage on net sales Nine months ended September 30,		Change in percentage Nine months ended September 30,
	2008	2007	2007 to 2008
Net sales	100.0%	100.0%	30.3%
Cost of sales	70.7	66.0	39.7
Gross profit	29.3	34.0	12.0
Gain on other sales	0.5	0.4	64.2
Less: operating expenses			
Selling expenses	6.2	6.8	18.8
General and administrative expenses	6.3	5.5	48.5
R & D expenses	1.1	0.9	54.4
Depreciation and amortization	3.4	2.7	65.1
Total operating expenses	17.0	15.9	39.0
Operating income	12.8	18.5	(10.2)
Other income	0.3	0.0	738.8
Financial income (expenses)	(0.7)	(0.7)	41.1
Gain on change in fair value of derivative	1.3	—	—
Income before income tax	13.7	17.9	(0.6)
Income tax	0.6	2.9	(73.8)
Income before minority interests	13.1	15.1	13.3
Minority interests	3.5	8.1	(43.1)
Net income	9.6%	7.0%	78.8%

THREE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007:

NET SALES:

Net sales were $36,936,755 for the three months ended September 30, 2008, as compared to $31,202,731 for the three months ended September 30, 2007, an increase of $5,734,024, or 18.4%. The increase in net sales in 2008 as compared to 2007 was a result of the following factors:

(1) Increases in the income of Chinese residents and the growth of consumption led to an increase in the sales of passenger vehicles and an increase in the Company’s sales of steering gear and pumps. As a result, sales of steering gear and pumps for domestic passenger vehicles for the three months ended September 30, 2008 were $24,643,200 and $3,438,307, as compared to $20,193,392 and $2,911,861 for the same period of 2007, an increase of $4,449,808 and $526,446, or 22.0% and 18.1%, respectively.

(2) Increased investments and business activities in China led to an increase in sales of commercial vehicles and an increase in the Company’s sales of steering gear and accessories. For the three months ended September 30, 2008, sales of steering gear and accessories for commercial vehicles was $8,815,691, as compared to $8,106,379 for the same period of 2007, an increase of $709,312, or 8.8%.

(3) The Company has raised the technological contents in, and production efficiency of, its products as a result of technological improvement to its production lines, allowing the Company to reduce its costs and, correspondingly, its sales prices which led to increased sales volumes.

GROSS PROFIT

For the three months ended September 30, 2008, gross profit was $9,878,223, as compared to $11,362,751 for the three months ended September 30, 2007, a decrease of $1,484,528, or 13.1%.

Table of Contents

The increase of sales volume and selling prices contributed to an increase of $1,153,601 in gross profit, while the increase in unit cost resulted in a decrease of $2,638,129 in gross profit.

Gross margin was 26.7% for the three months ended September 30, 2008, a decrease of 9.7% from 36.4% for the same period of 2007, primarily due to an increase in materials price and unit cost. The Company plans to take the following measures in the remaining three months of 2008 to increase gross profit levels and to meet its yearly gross margin target of not less than 30%.

1. Reduce manufacturing costs by optimizing product design and production techniques. During 2008, the Company's technical personnel will improve product design and production techniques to reduce wastage in the production process and improve manufacturing efficiency, thus reducing costs. The Company estimates its manufacturing costs will be reduced by 1.5% as compared to 2007 as a result of the optimized product design and production techniques.

2. Raise the selling price of commercial vehicles steering gear. During the three months ended September 30, 2008, the unit cost of commercial vehicles steering gear increased, due to the sharp rise of the price of steel, its main raw material. In order to meet the gross margin target, the Company has raised the selling price of commercial vehicles steering gear after negotiation with OEMs.

GAIN ON OTHER SALES

Gain on other sales consists of net amount retained from sales of materials and other assets. For the three months ended September 30, 2008, gain on other sales was $343,326, as compared to $102,371 for the same period of 2007, an increase of $240,955, or 235.4%, mainly due to increased sales of materials.

SELLING EXPENSES

Selling expenses were $2,309,064 for the three months ended September 30, 2008, as compared to $2,094,157 for the same period of 2007, an increase of $214,907, or 10.3%. Material increases were salaries and wages, warranty reserve and transportation expenses.

The increase in salaries and wages, warranty reserve and transportation expenses was due to an increase of 18.4% in sales for the three months ended September 30, 2008, as compared to the same period of 2007, so that the salaries and wages, warranty reserve and transportation expenses recorded also increased accordingly.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses were $2,060,675 for the three months ended September 30, 2008, as compared to $1,683,190 for the same period of 2007, an increase of $377,485, or 22.4%, as a result of the following:

The increase in labor insurance expenses was mainly due to an increase of housing fund expenses at Henglong and Jiulong for the three months ended September 30, 2008.

The increase in supplies was mainly due to additional consumption during the construction of new joint-venture company.

The increase in provision for bad debts was mainly due to certain advance payment for equipment and other receivables which had remained outstanding after the credit period. Management believes that additional provision for bad debts should be made to avoid credit loss.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were $665,552 for the three months ended September 30, 2008, as compared to $321,533 for the three months ended September 30, 2007, an increase of $344,019, or 107.0%, as a result of the Company's new product development and more R&D personnel involved with the new product research and development program.

DEPRECIATION AND AMORTIZATION EXPENSE

For the three months ended September 30, 2008, the depreciation and amortization expense, excluding those recorded in cost of sales, was $1,488,842, as compared to $735,810 for the three months ended September 30, 2007, an increase of $753,032, or 102.3%, as a result of increased property, plant and equipment, so that depreciation expenses also materially increased.

Table of Contents

INCOME FROM OPERATIONS

Income from operations was $3,697,416 for the three months ended September 30, 2008, as compared to $6,630,432 for the three months ended September 30, 2007, a decrease of $2,933,016, or 44.2%, as a result of a decrease of $1,484,528, or 13.1% in gross profit, an increase of $240,955, or 235.4% in gain on other sales, and an increase of $1,689,443, or 34.9% in operating expenses.

OTHER INCOME

Other income was $123,167 for the three months ended September 30, 2008, primarily as a result of the achievement of targeted production expansion and quality enhancement of the sensors in 2008, which were encouraged by Chinese government for government subsidies. And there was no such income in the same period in 2007.

Whether or not a government interest subsidies can classify as other income depends on whether the company's technological improvement has achieved its expected goal of production expansion and quality enhancement.

FINANCIAL EXPENSES

Financial expenses were $446,261 for the three months ended September 30, 2008, as compared to financial expenses of $215,400 for the three months ended September 30, 2007, an increase of $230,861, primarily as a result of a decrease of foreign currency exchange loss of $30,906, an increase in notes discount gain of $25,740, an interest expense increase of $148,430, an increase in convertible notes discount amortization of $121,443 and an increase in bank service fee of $17,634.

GAIN ON CHANGE IN FAIR VALUE OF DERIVATIVE

Gain on change in fair value of derivative was $677,417 for the three months ended September 30, 2008.

INCOME BEFORE INCOME TAXES

Income before income taxes was $4,051,739 for the three months ended September 30, 2008, as compared to $6,415,032 for the three months ended September 30, 2007, a decrease of $2,363,293, or 36.8%, as a result of a decrease in income from operations of $2,933,016, an increase in other income of $123,167, an increase in financial expenses of $230,861and an increase in gain on change in fair value of derivative of $677,417.

INCOME TAXES

Income tax income was $309,480 for the three months ended September 30, 2008, as compared to $379,409 of income tax expenses for the three months ended September 30, 2007, a decrease of $69,929, mainly because of:

1. The Company has received an income tax refund of $431,746 for domestic equipment purchased during the three months ended September 30, 2008, as compared to $801,059 for the same period of 2007, a decrease of $369,313.

2. One of the Company's Sino-foreign joint ventures, Jiulong, implemented a new policy of income tax in 2008. Jiulong was subject to a state income tax rate of 25%, which was decreased from 30%. This decrease in income tax rate led to a decreased income tax expenses of $13,114.

3. An increase in deferred income taxes assets led to a decreased income tax expenses of $184,196.

4. A decrease in income before income taxes led to a decrease in income tax expenses of $241,932.

INCOME BEFORE MINORITY INTERESTS

Income before minority interests was $3,742,259 for the three months ended September 30, 2008, as compared to $6,035,623 for the three months ended September 30, 2007, a decrease of $2,293,364, or 38.0%, as a result of a decrease in income before income taxes of $2,436,421, or 38.0%, and a decrease in income taxes expenses of $69,929.

Table of Contents

MINORITY INTERESTS

Minority interests in the earnings of the Sino-foreign Joint-ventures amounted to $983,480 for the three months ended September 30, 2008, as compared to $3,461,205 for the three months ended September 30, 2007, a decrease of $2,477,725, or 71.6%.

The Company owns different equity interest in eight Sino-foreign joint ventures, through which it conducts its operations. All the operating results of these eight Sino-foreign joint ventures were consolidated in the Company's financial statements as of September 30, 2008 and 2007. The Company records the minority interests' share in the earnings of the respective Sino-foreign joint ventures for each period.

In 2008, minority interest decreased significantly as compared to 2007, primarily after the Company acquired an additional 35.5% equity interest in Jingzhou Henglong, which was owned by minority interests. Therefore, although the income increased, the income attributable to the minority interests decreased.

NET INCOME

Net income was $2,758,779 for the three months ended September 30, 2008, as compared to a net income of $2,574,418 for the three months ended September 30, 2007, an increase of $184,361, or 7.2%, as a result of a decrease in income before minority interest of $2,293,364, or 38.0%, and a decrease in minority interest of $2,477,725, or 71.6%.

NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007:

NET SALES:

Net sales were $124,912,138 for the nine months ended September 30, 2008, as compared to $95,898,461 for the nine months ended September 30, 2007, an increase of $29,013,677, or 30.3%. The increase in net sales in 2008 as compared to 2007 was a result of the following factors:

(1) Increases in the income of Chinese residents and the growth of consumption led to an increase in the sales of passenger vehicles and an increase in the Company's sales of steering gear and pumps. As a result, sales of steering gear and pumps for domestic passenger vehicles for the nine months ended September 30, 2008 were $79,818,747 and $11,200,250 as compared to $60,727,515 and $9,697,822 for the same period of 2007, an increase of $19,091,232 and $1,502,428, or 31.4% and 15.5%, respectively.

(2) Increased investments and business activities in China led to an increase in sales of commercial vehicles and an increase in the Company's sales of steering gear and accessories. For the nine months ended September 30, 2008, sales of steering gear and accessories for commercial vehicles was $33,650,090, as compared to $25,457,169 for the same period of 2007, an increase of $8,192,921, or 32.2%.

(3) The Company has raised the technological contents in, and production efficiency of, its products as a result of technological improvement to its production lines, allowing the Company to reduce its costs and, correspondingly, its sales prices which led to increased sales volumes.

GROSS PROFIT

For the nine months ended September 30, 2008, gross profit was $36,553,597, as compared to $32,648,463 for the nine months ended September 30, 2007, an increase of $3,905,134, or 12.0%.

The increase of sales volume and selling prices contributed to an increase of $21,560,730 in gross profit, while the increase in unit cost resulted in a decrease of $17,655,596 in gross profit.

Gross margin was 29.3% for the nine months ended September 30, 2008, a decrease of 4.7% from 34.0% for the same period of 2007, primarily due to an increase in materials price and unit cost. The Company plans to take the following measures in the remaining three months of 2008 to increase gross profit levels and to meet its yearly gross margin target of not less than 30%.

1. Reduce manufacturing costs by optimizing product design and production techniques. During 2008, the Company's technical personnel will improve product design and production techniques to reduce wastage in the production process and improve manufacturing efficiency, thus reducing costs. The Company estimates its manufacturing costs will be reduced by 1.5% as compared to 2007 as a result of the optimized product design and production techniques.

Table of Contents

2. Raise the selling price of commercial vehicles steering gear. During the nine months ended September 30, 2008, the unit cost of commercial vehicles steering gear increased, due to the sharp rise of the price of steel, its main raw material. In order to meet the gross margin target, the Company has raised the selling price of commercial vehicles steering gear after negotiation with OEMs.

GAIN ON OTHER SALES

Gain on other sales consists of net amount retained from sales of materials and other assets. For the nine months ended September 30, 2008, gain on other sales were $595,226, as compared to $362,458 for the same period of 2007, an increase of $232,768, or 64.2%, mainly due to increased sales of materials.

SELLING EXPENSES

Selling expenses were $7,721,240 for the nine months ended September 30, 2008, as compared to $6,500,969 for the same period of 2007, an increase of $1,220,271, or 18.8%. Material increases were salaries and wages, warranty reserve and transportation expenses.

The increase in salaries and wages, warrant reserve, and transportation expenses was due to an increase of 30.3% in sales for the nine months ended September 30, 2008, as compared to the same period of 2007, so that the salaries and wages, warranty reserve and transportation expenses recorded also increased accordingly.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses were $7,828,458 for the nine months ended September 30, 2008, as compared to $5,272,795 for the same period of 2007, an increase of $2,555,663, or 48.5%, as a result of the following:

The increase in labor insurance expenses was mainly due to an increase of housing fund expenses at Henglong and Jiulong for the nine months ended September 30, 2008.

The increase in supplies was mainly due to additional consumption during the construction of new joint-venture company.

The increase in provision for bad debts was mainly due to certain advance payment for equipment and other receivables which had remained outstanding after the credit period. Management believes that additional provision for bad debts should be made to avoid credit loss.

The increase in listing expenses was mainly due to increased retainer and professional consulting fees in connection with 35.5% Henglong equity acquisition and issuance of $35,000,000 convertible notes.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were $1,404,525 for the nine months ended September 30, 2008, as compared to $909,515 for the nine months ended September 30, 2007, an increase of $495,010, or 54.4%, as a result of the Company’s new product development and more R&D personnel involved with the new product research and development program.

DEPRECIATION AND AMORTIZATION EXPENSE

For the nine months ended September 30, 2008, the depreciation and amortization expense, excluding those recorded in cost of sales, was $4,234,633, as compared to $2,564,234 for the nine months ended September 30, 2007, an increase of $1,670,399, or 65.1%, primarily due to fixed assets acquisitions.

INCOME FROM OPERATIONS

Income from operations was $15,959,967 for the nine months ended September 30, 2008, as compared to $17,763,408 for the nine months ended September 30, 2007, a decrease of $1,803,441, or 10.2%, as a result of an increase of $3,905,134, or 12.0% in gross profit, an increase of $232,768, or 64.2%, in gain on other sales, and an increase of $5,941,343, or 39.0%, in operating expenses.

Table of Contents

OTHER INCOME

Other income was $322,626 for the nine months ended September 30, 2008, as compared to $38,462 for the same period of 2007, an increase of $284,164, or 738.8%, primarily as a result of increased government subsidies.

Whether or not a government interest subsidies can classify as other income depends on whether the company's technological improvement has achieved its expected goal of production expansion and quality enhancement.

FINANCIAL EXPENSES

Financial expenses were $884,708 for the nine months ended September 30, 2008, as compared to financial expenses of $626,892 for the nine months ended September 30, 2007, an increase of $257,816, primarily as a result of foreign currency exchange gain increase of $457,875, notes discount gain increase of $223,069, interest expenses increase of $599,961, convertible notes discount amortization increase of $302,771, and bank service fee increase of $36,028.

GAIN ON CHANGE IN FAIR VALUE OF DERIVATIVE

Gain on change in fair value of derivative was $1,672,570 for the nine months ended September 30, 2008.

INCOME BEFORE INCOME TAXES

Income before income taxes was $17,070,455 for the nine months ended September 30, 2008, as compared to $17,174,978 for the nine months ended September 30, 2007, a decrease of $104,523, or 0.6%, as a result of a decrease in income from operations of $1,803,441, or 10.2%, an increase in other income of $284,164, or 738.8%, an increase in financial expenses of $257,816 and an increase in gain on change in fair value of derivative of $1,672,570.

INCOME TAXES

Income tax expense was $718,417 for the nine months ended September 30, 2008, as compared to $2,741,024 for the nine months ended September 30, 2007, a decrease of $2,022,607, mainly because of:

1. The Company has received an income tax refund of $2,331,181 for domestic equipment purchased during the nine months ended September 30, 2008, as compared to $1,327,331 for the same period of 2007, an increase of $1,003,850.

2. One of the Company's Sino-foreign joint ventures, Jiulong, implemented a new policy of income tax in 2008. Jiulong was subject to a state income tax rate of 25%, which was decreased from 30%. This decrease in income tax rate led to a decreased income tax expenses of $140,948.

3. An increase in deferred income taxes assets led to a decreased income tax expenses of $582,747.

4. A decrease in income before income taxes led to a decrease in income tax expenses of $295,062.

INCOME BEFORE MINORITY INTERESTS

Income before minority interests was $16,352,038 for the nine months ended September 30, 2008, as compared to $14,433,954 for the nine months ended September 30, 2007, an increase of $1,918,084, or 13.3%, as a result of a decrease in income before income taxes of $104,523, and a decrease in income tax expenses of $2,022,607, or 73.8%.

MINORITY INTERESTS

Minority interests in the earnings of the Sino-foreign Joint-ventures amounted to $4,418,730 for the nine months ended September 30, 2008, as compared to $7,761,281 for the nine months ended September 30, 2007, a decrease of $3,342,551, or 43.1%.

The Company owns different equity interest in eight Sino-foreign joint ventures, through which it conducts its operations. All the operating results of these eight Sino-foreign joint ventures were consolidated in the Company’s financial statements as of September 30, 2008 and 2007. The Company records the minority interests' share in the earnings of the respective Sino-foreign joint ventures for each period.

Table of Contents

In 2008, minority interest decreased significantly as compared to 2007, primarily after the Company acquired an additional 35.5% equity interest in Jingzhou Henglong, which was owned by minority interests. Therefore, although the income increased, the income of the minority interest decreased.

NET INCOME

Net income was $11,933,308 for the nine months ended September 30, 2008, as compared to a net income of $6,672,673 for the nine months ended September 30, 2007, an increase of $5,260,635, or 78.8%, as a result of an increase in income before minority interest of $1,918,084, or 13.3%, and a decrease in minority interest of $3,342,551, or 43.1%.

LIQUIDITY AND CAPITAL RESOURCES

Capital resources and use of cash

The Company has historically financed its liquidity requirements from a variety of sources, including short-term borrowings under bank credit agreements, bankers' acceptance, issuances of capital stock and notes and internally generated cash. As of September 30, 2008, the Company had cash and cash equivalents of $27,188,579, as compared to $21,791,286 as of September 30, 2007, an increase of $5,397,293, or 24.8%.

The Company had working capital of $75,023,652 as of September 30, 2008, as compared to $38,159,885 as of September 30, 2007, an increase of $36,863,767, or 96.6%.

Financing activities:

For the Company's bank loans and banker's acceptance bill facilities, the Company's banks require the Company to sign documents to repay such facilities within one year. On the condition that the Company can provide adequate mortgage security and has not violated the terms of the line of credit agreement, it can extend such one year facilities for another year.

The Company had bank loans maturing in less than one year of $5,865,103 and bankers' acceptances of $20,306,574 as of September 30, 2008, including $5,718,667 which was not a part of the line of credit and fully mortgaged by notes receivable.

The Company currently expects to be able to obtain similar bank loans and bankers' acceptance bills in the future if it can provide adequate mortgage security following the termination of the above mentioned agreements. If the Company is not able to do so, it will have to refinance such debt as it becomes due or repay that debt to the extent it has cash available from operations or from the proceeds of additional issuances of capital stock. Owing to depreciation, the value of the mortgages securing the above-mentioned bank loans and banker's acceptance bills will be devalued by approximately $4,592,628. If the Company wishes to obtain the same amount of bank loans and banker's acceptance bills, it will have to provide $4,592,628 additional mortgages. The Company can obtain a reduced line of credit with a reduction of $2,296,314, if it cannot provide additional mortgages, $4,592,628 at 50% mortgage rates. The Company expects that the reduction of bank loans will not have a material adverse effect on its liquidity.

On February 15, 2008, the Company issued $35,000,000 of convertible notes to Lehman Brothers Commercial Corporation Asia Limited, and YA Global Investments, L.P., maturing in 5 years. According to the terms of the Senior Convertible Notes (as described in Note 17), convertible notes may be required to be repaid in cash on or prior to their maturity, and the Company's liquidity and capital resources will be adversely affected.

43

Table of Contents

(a) Bank loans

As of September 30, 2008, the principal outstanding under the Company's credit facilities and lines of credit was as follows:

	Bank	Amount available	Amount Borrowed
Comprehensive credit facilities	Bank of China	$ 8,651,027	$ 3,879,033
Comprehensive credit facilities	China Construction Bank	8,797,654	—
Comprehensive credit facilities	Shanghai Pudong Development Bank	6,598,240	4,853,141
Comprehensive credit facilities	Jingzhou Commercial Bank	9,530,792	—
Comprehensive credit facilities	Industrial and Commercial Bank of China	2,932,551	1,652,493
Comprehensive credit facilities	Bank of Communications Co., Ltd	3,343,109	1,129,032
Comprehensive credit facilities	China Merchants Bank	2,199,413	2,199,413
Comprehensive credit facilities	China CITIC Bank	6,819,126	6,739,897
Total		$ 48,871,912	$ 20,453,009

The Company may request banks to issue notes payable or bank loans within its credit line using a 364-day revolving line.

The Company refinanced its short-term debt during early 2008 at annual interest rates of 6.84% to 7.72%, and for terms of six to twelve months. Pursuant to the refinancing arrangement, the Company pledged $13,380,323 of equipment, $4,107,947 of land use rights and $3,248,548 of buildings as security for its comprehensive credit facility with the Bank of China; pledged $2,109,560 of land use rights and $11,416,921 of buildings as security for its comprehensive credit facility with Shanghai Pudong Development Bank; pledged $7,946,422 of land use rights and $7,471,393 of equipment as security for its revolving comprehensive credit facility with Jingzhou Commercial Bank; pledged $1,579,080 of land use rights and $1,066,801 of buildings as security for its comprehensive credit facility with Industrial and Commercial Bank of China; pledged $1,466,276 of accounts receivable, $7,049,120 of land use rights and $3,668,827 of buildings as security for its comprehensive credit facility with China Construction Bank; pledged $2,992,155 of land use rights and $4,261,320 of buildings as security for its comprehensive credit facility with China CITIC Bank; pledged $3,473,211 of land use rights and $1,924,212 of buildings as security for its comprehensive credit facility with China Merchants Bank; pledged $4,160,689 of land use rights and $2,346,921 of buildings as security for its comprehensive credit facility with Bank of Communications Co., Ltd.

(b) Financing from investors:

On February 15, 2008, the Company sold $30,000,000 and $5,000,000 convertible notes to Lehman Brothers Commercial Corporation Asia Limited, and YA Global Investments, L.P., respectively, with a scheduled maturity date of February 15, 2013 and an initial conversion price for conversion into the Company's common stock of $8.8527 per share. According to the terms of the convertible notes, the conversion price was reset to $7.0822 as of August 15, 2008 based on the weighted average price of the stock on that date.

If the Company fails to obtain the same or similar terms for any debt or equity refinancing to meet its debt obligations, or if the Company fails to obtain extensions of the maturity dates of these obligations as they become due, its overall liquidity and capital resources will be adversely affected.

If the aforementioned convertible debt must be repaid in cash at or before scheduled maturity, and if at that time the Company cannot issue new notes or stock to refinance, or acquire enough bank loans, or cannot extend the maturity

dates of such notes, the Company's liquidity and capital resources will be adversely affected.

Cash Requirements:

The following table summarizes the Company's expected cash outflows resulting from financial contracts and commitments. The Company has not included information on its recurring purchases of materials for use in its manufacturing operations. These amounts are generally consistent from year to year, closely reflecting the Company's levels of production, and are not long-term in nature being less than three months.

	Payment Due Dates				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Short-term bank loan	$ 5,865,103	$ 5,865,103	—	—	—
Notes payable	20,306,574	20,306,574	—	—	—
Other contractual purchase commitments, including information technology	7,160,847	5,383,399	1,667,448	110,000	—
Total	$ 33,332,524	$ 31,555,076	$ 1,667,448	$ 110,000	$ —

Table of Contents

Short-term bank loans:

The following table summarizes the contract information of short-term borrowings between the banks and the Company as of September 30, 2008:

Bank	Purpose	Borrowing Date	Borrowing Term (Year)	Annual Percentage Rate	Date of Interest Payment	Date of Payment	Amount Payable on Due Date
Bank of China	Working Capital	29-Dec-07	1	7.47%	Pay monthly	29-Dec-08	$ 733,138
China Merchants Bank	Working Capital	28-Sep-08	0.5	6.83%	Pay monthly	28-Mar-09	2,199,413
Bank of Shanghai Pudong Development	Working Capital	18-Oct-07	1	7.47%	Pay monthly	18-Oct-08	2,932,552
Total							$ 5,865,103

The Company must use the loans for the purposes described in the table. If the Company fails, it will be charged a penalty interest at 100% of the specified loan rate. The Company has to pay interest at the interest rate described in the table on the 20th of each month. If the Company fails, it will be charged a compound interest at the specified rate. The Company has to repay the principal outstanding on the specified date in the table. If it fails, it will be charged a penalty interest at 50% of the specified loan rate. Management believes that the Company had complied with such financial covenants as of September 30, 2008, and will continue to comply with them.

The following table summarizes the contract information of issuing notes payable between the banks and the Company as of September 30, 2008:

Purpose	Term (Month)	Due Date	Amount Payable on Due Date
Working Capital	3-6	Oct-08	$ 4,523,858
Working Capital	3-6	Nov-08	2,626,690
Working Capital	3-6	Dec-08	2,516,569
Working Capital	3-6	Jan-09	2,501,466
Working Capital	3-6	Feb-09	4,159,692
Working Capital	3-6	Mar-09	3,978,299
Total			$ 20,306,574

The Company must use the loan for the purposes described in the table. If it fails, the banks will no longer issue the notes payable, and it may have an adverse effect on the Company's liquidity and capital resources. The Company has to deposit sufficient cash in the designated account of the bank on the due date of notes payable for payment to the suppliers. If the bank has advanced payment to the Company, it will be charged a penalty interest at 150% of the specified loan rate. Management believes that the Company had complied with such financial covenants as of September 30, 2008, and will continue to comply with them.

The Company had approximately $7,160,847 of capital commitments as of September 30, 2008, arising from equipment purchases for expanding production capacity. The Company intends to disperse $5,383,399 in the remaining three months of 2008 using its working capital. Management believes that it will not have a material adverse effect on the Company's liquidity.

Table of Contents

Cash flows:

(a) Operating activities

Net cash generated from operations during the nine months ended September 30, 2008 was $4,363,676, compared with net cash $9,909,219 generated from the same period of 2007, a decrease of $5,545,543.

Similar to the same period of 2007, the increased cash outflows from operating activities were primarily due to increases in accounts and notes receivable and inventories.

First, cash outflow increased by about $10,700,000 owing to increased accounts receivable, mainly due to increased sales in 2008 over in 2007. The credit terms on sale of goods between customers and the Company generally range from 3 - 4 months, which resulted in increased accounts receivable as sales increased. This is a normal capital circulation and the Company believes that it will not have a material adverse effect on future cash flows. Second, cash outflow increased by about $1,600,000 owing to increased notes receivable, mainly due to the Company having sufficient working capital, thus having less notes receivable discounted during this period. Since the notes receivable were based on bank credit standing, they may turn into cash any time the Company elects. Therefore, the increase of notes receivable will not have a material adverse effect on the Company's future operating activities. Third, increased inventories led to an increased cash outflow of about $8,300,000, mainly due to the Company's intention to produce sufficient inventories to meet increasing demands in the fourth quarter of 2008.

(b) Investing activities

The Company expended net cash of $19,822,440 in investment activities during the nine months ended September 30, 2008, and $9,710,860 during the same period of 2007.

Compared with the same period of 2007, cash used in the nine months ended September 30, 2008 on investment activities increased by $10,111,580, or 104.1%, mainly as a result of the acquisition of the additional 35.5% of Henglong's equity.

(c) Financing activities

During the nine months ended September 30, 2008, the Company obtained net cash of $21,476,369 in financing activities, as compared to expending net cash of $6,280,924 through financing activities for the same period of 2007, an increase of $27,757,293 as a result of the following factors:

During the nine months ended September 30, 2008, the Company sold $30,000,000 and $5,000,000 of convertible notes to Lehman Brothers Commercial Corporation Asia Limited, and YA Global Investments, L.P., respectively. During the same period in 2007, the Company issued 108,121 shares of common stock and raised $1,145,500.

OFF-BALANCE SHEET ARRANGEMENTS

At September 30, 2008 and 2007, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

COMMITMENTS AND CONTINGENCIES

The following table summarizes the Company's contractual payment obligations and commitments as of September 30, 2008:

	Payment Obligations by Period					
	2008 (a)	2009	2010	2011	Thereafter	Total
Obligations for service agreements	$ -	$ 110,000	$ 110,000	$ 110,000	$ —	$ 330,000
Obligations for purchasing agreements	5,383,399	1,447,448	—	—	—	6,830,847
Total	$ 5,383,399	$ 1,557,448	$ 110,000	$ 110,000	$ —	$ 7,160,847

Table of Contents

(a) Remaining 3 months in 2008

SUBSEQUENT EVENTS

None

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4 CONTROLS AND PROCEDURES

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports the Company files with the SEC under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

The Company's management carried out an evaluation, under the supervision and with the participation of the CEO and the CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2008. Based upon that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective.

(b) CHANGES IN INTERNAL CONTROLS

There were no changes in the Company's internal control over financial reporting during the quarter ended September 30, 2008 that have materially effected, or are reasonably likely to materially effect, the Company's internal control over financial reporting.

PART II. — OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

The Company is not currently a party to any threatened or pending legal proceedings, other than incidental litigation arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

ITEM 1A RISK FACTORS

Any investment in our securities involves a high degree of risk. You should carefully consider the risks described below, together with the information contained elsewhere in this prospectus, before you make a decision to invest in our company. Our business, financial conditions and results of operations could be materially and adversely affected by many risk factors. Because of these risk factors, actual results might differ significantly from those projected in any forward-looking statements. Factors that might cause such differences include, among others, the following:

Table of Contents

Risks Related to the Company's Business and Industry

Because we are a holding company with substantially all of our operations conducted through our subsidiaries, our performance will be affected by the performance of our subsidiaries.

We have no operations independent of those of Great Genesis and its subsidiaries, and our principal assets are our investments in Great Genesis and its subsidiaries. As a result, we are dependent upon the performance of Great Genesis and its subsidiaries and will be subject to the financial, business and other factors affecting Great Genesis as well as general economic and financial conditions. As substantially all of our operations are and will be conducted through our subsidiaries, we will be dependent on the cash flow of our subsidiaries to meet our obligations.

Because virtually all of our assets are and will be held by operating subsidiaries, the claims of our stockholders will be subordinate to all existing and future liabilities and obligations, and trade payables of such subsidiaries. In the event of our bankruptcy, liquidation or reorganization, our assets and those of our subsidiaries will be available to satisfy the claims of our stockholders only after all of our and our subsidiaries' liabilities and obligations have been paid in full.

The Senior Convertible Notes are our unsecured obligations, but are not obligations of our subsidiaries. In addition, our secured commercial debt is senior to the Senior Convertible Notes.

With the automobile parts markets being highly competitive and many of our competitors having greater resources than we do, we may not be able to compete successfully.

The automobile parts industry is a highly competitive business. Criteria for the Company's customers include:

- Quality;
- Price/cost competitiveness;
- System and product performance;
- Reliability and timeliness of delivery;
- New product and technology development capability;
- Excellence and flexibility in operations;
- Degree of global and local presence;
- Effectiveness of customer service; and
- Overall management capability.

Our competitors include independent suppliers of parts, as well as suppliers formed by spin-offs from our customers, who are becoming more aggressive in selling parts to other vehicle manufacturers. Depending on the particular product, the number of our competitors varies significantly. Many of our competitors have substantially greater revenues and financial resources than we do, as well as stronger brand names, consumer recognition, business relationships with vehicle manufacturers, and geographic presence than we have. We may not be able to compete favorably and increased competition may substantially harm our business, business prospects and results of operations.

Internationally, we face different market dynamics and competition. We may not be as successful as our competitors in generating revenues in international markets due to the lack of recognition of our products or other factors. Developing product recognition overseas is expensive and time-consuming and our international expansion efforts may be more costly and less profitable than we expect. If we are not successful in our target markets, our sales could decline, our margins could be negatively impacted and we could lose market share, any of which could materially harm our business, results of operations and profitability.

The cyclical nature of automotive production and sales could result in a reduction in automotive sales, which could adversely affect our business and results of operations.

Our business relies on automotive vehicle production and sales by our customers, which are highly cyclical and depend on general economic conditions and other factors, including consumer spending and preferences and the price and availability of gasoline. They also can be affected by labor relations issues, regulatory requirements, and other factors. In addition, in the last two years, the price of automobiles in China has generally declined. As a result, the volume of automotive production in China has fluctuated from year to year, which gives rise to fluctuations in the demand for our products. Any significant economic decline that results in a reduction in automotive production and sales by our customers would have a material adverse effect on our results of operations. Moreover, if the prices of automobiles do not remain low, then demand for automobile parts could fall and result in lower revenues and profitability.

Table of Contents

Increasing costs for manufactured components and raw materials may adversely affect our profitability.

We use a broad range of manufactured components and raw materials in our products, including castings, electronic components, finished sub-components, molded plastic parts, fabricated metal, aluminum and steel, and resins. Because it may be difficult to pass increased prices for these items on to our customers, a significant increase in the prices of our components and materials could materially increase our operating costs and adversely affect our profit margins and profitability.

Pricing pressure by automobile manufacturers on their suppliers may adversely affect our business and results of operations.

Recently, pricing pressure from automobile manufacturers has been prevalent in the automotive parts industry in China. Virtually all vehicle manufacturers seek price reductions each year, including requiring suppliers to pay a "3-R Guarantees" service charge for repair, replacement and refund in an amount equal to one percent of the total amount of parts supplied. Although we have tried to reduce costs and resist price reductions, these reductions have impacted our sales and profit margins. If we cannot offset continued price reductions through improved operating efficiencies and reduced expenditures, price reductions will have a material adverse effect on our results of operations.

Our business, revenues and profitability would be materially and adversely affected if we lose any of our large customers.

For the quarter ended September 30, 2008, approximately 15.0% of our sales were to Chery Automobile Co., Ltd, approximately 10.7% were to Brilliance China Automotive Holdings Limited, and approximately 11.7% were to Beiqi Foton Motor Co., Ltd, our three largest customers. The loss of, or significant reduction in purchases by, one or more of these major customers could adversely affect our business.

We may be subject to product liability and warranty and recall claims, which may increase the costs of doing business and adversely affect our financial condition and liquidity.

We may be exposed to product liability and warranty claims if our products actually or allegedly fail to perform as expected or the use of our products results, or is alleged to result, in bodily injury and/or property damage. We started to pay some of our customers' increased after-sales service expenses due to consumer rights protection policies of "recall" issued by the Chinese Government in 2004, such as the recalling flawed vehicles policy. Beginning in 2004, automobile manufacturers unilaterally required their suppliers to pay a "3-R Guarantees" service charge for repair, replacement and refund in an amount equal to one percent of the total amount of parts supplied. Accordingly, we have experienced and will continue to experience higher after sales service expenses. Product liability, warranty and recall costs may have a material adverse effect on our financial condition.

We are subject to environmental and safety regulations, which may increase our compliance costs and may adversely affect our results of operation.

We are subject to the requirements of environmental and occupational safety and health laws and regulations in China. We cannot provide assurance that we have been or will be at all times in full compliance with all of these requirements, or that we will not incur material costs or liabilities in connection with these requirements. Additionally, these regulations may change in a manner that could have a material adverse effect on our business, results of operations and financial condition. The capital requirements and other expenditures that may be necessary to comply with environmental requirements could increase and become a material expense of doing business.

Non-performance by our suppliers may adversely affect our operations by delaying delivery or causing delivery failures, which may negatively affect demand, sales and profitability.

We purchase various types of equipment, raw materials and manufactured component parts from our suppliers. We would be materially and adversely affected by the failure of our suppliers to perform as expected. We could experience delivery delays or failures caused by production issues or delivery of non-conforming products if our suppliers failed to perform, and we also face these risks in the event any of our suppliers becomes insolvent or bankrupt.

Table of Contents

Our business and growth may suffer if we fail to attract and retain key personnel.

Our ability to operate our business and implement our strategies effectively depends on the efforts of our executive officers and other key employees. We depend on the continued contributions of our senior management and other key personnel. Our future success also depends on our ability to identify, attract and retain highly skilled technical staff, particularly engineers and other employees with electronics expertise, and managerial, finance and marketing personnel. We do not maintain a key person life insurance policy on Mr. Hanlin Chen or Mr. Qizhou Wu. The loss of the services of any of our key employees or the failure to attract or retain other qualified personnel could substantially harm our business.

Our management controls approximately 82.3% of our outstanding common stock and may have conflicts of interest with our minority stockholders.

Members of our management beneficially own approximately 82.3% of the outstanding shares of our common stock. As a result, these majority stockholders have control over decisions to enter into any corporate transaction and have the ability to prevent any transaction that requires the approval of stockholders, which could result in the approval of transactions that might not maximize stockholders' value. Additionally, these stockholders control the election of members of our board, have the ability to appoint new members to our management team and control the outcome of matters submitted to a vote of the holders of our common stock. The interests of these majority stockholders may at times conflict with the interests of our other stockholders. The Henglong Acquisition was a transaction involving us and a counterparty controlled by Mr. Hanlin Chen, our Chairman and controlling stockholder. We regularly engage in transactions with entities controlled by one of more of our officers and directors.

Covenants contained in the Securities Purchase Agreement and the Senior Convertible Notes may restrict our operating flexibility.

There is a limited public float of our common stock, which can result in our stock price being volatile and prevent the realization of a profit on resale of our common stock or derivative securities.

There is a limited public float of our common stock. Of our outstanding common stock, approximately 17.7% is considered part of the public float. The term "public float" refers to shares freely and actively tradable on the NASDAQ GlobalMarket and not owned by officers, directors or affiliates, as such term is defined under the Securities Act. As a result of the limited public float and the limited trading volume on some days, the market price of our common stock can be volatile, and relatively small changes in the demand for or supply of our common stock can have a disproportionate effect on the market price for our common stock. This stock price volatility could prevent a securityholder seeking to sell our common stock or derivative securities from being able to sell them at or above the price at which the stock or derivative securities were bought, or at a price which a fully liquid market would report.

Provisions in our certificate of incorporation and bylaws and the General Corporation Law of Delaware may discourage a takeover attempt.

Provisions in our certificate of incorporation and bylaws and the General Corporation Law of Delaware, the state in which we are organized, could make it difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders. Provisions of our certificate of incorporation and bylaws impose various procedural and other requirements, which could make it difficult for stockholders to effect certain corporate actions and possibly prevent transactions that would maximize stockholders' value.

We do not pay cash dividends on our common stock.

We have never paid common stock cash dividends and do not anticipate doing so in the foreseeable future. In addition, the Securities Purchase Agreement prohibits us from paying cash dividends on common stock without the approval of the holders of the Senior Convertible Notes.

Risks Related to Doing Business in China and Other Countries Besides the United States

Because our operations are all located outside of the United States and are subject to Chinese laws, any change of Chinese laws may adversely affect our business.

Table of Contents

All of our operations are outside the United States and in China, which exposes us to risks, such as exchange controls and currency restrictions, currency fluctuations and devaluations, changes in local economic conditions, changes in Chinese laws and regulations, exposure to possible expropriation or other Chinese government actions, and unsettled political conditions. These factors may have a material adverse effect on our operations or on our business, results of operations and financial condition.

Our international expansion plans subject us to risks inherent in doing business internationally.

Our long-term business strategy relies on the expansion of our international sales outside China by targeting markets, such as the United States. Risks affecting our international expansion include challenges caused by distance, language and cultural differences, conflicting and changing laws and regulations, foreign laws, international import and export legislation, trading and investment policies, foreign currency fluctuations, the burdens of complying with a wide variety of laws and regulations, protectionist laws and business practices that favor local businesses in some countries, foreign tax consequences, higher costs associated with doing business internationally, restrictions on the export or import of technology, difficulties in staffing and managing international operations, trade and tariff restrictions, and variations in tariffs, quotas, taxes and other market barriers. These risks could harm our international expansion efforts, which could in turn materially and adversely affect our business, operating results and financial condition.

We face risks associated with currency exchange rate fluctuations; any adverse fluctuation may adversely affect our operating margins.

Although we are incorporated in the United States (Delaware), the majority of our current revenues are in Chinese currency. Conducting business in currencies other than US dollars subjects us to fluctuations in currency exchange rates that could have a negative impact on our reported operating results. Fluctuations in the value of the US dollar relative to other currencies impact our revenues, cost of revenues and operating margins and result in foreign currency translation gains and losses. Historically, we have not engaged in exchange rate hedging activities. Although we may implement hedging strategies to mitigate this risk, these strategies may not eliminate our exposure to foreign exchange rate fluctuations and involve costs and risks of their own, such as ongoing management time and expertise requirements, external costs to implement the strategy and potential accounting implications.

If relations between the United States and China worsen, our stock price may decrease and we may have difficulty accessing the U.S. capital markets.

At various times during recent years, the United States and China have had disagreements over political and economic issues. Controversies may arise in the future between these two countries. Any political or trade controversies between the United States and China could adversely affect the market price of our common stock and our ability to access US capital markets.

The Chinese Government could change its policies toward private enterprise, which could adversely affect our business.

Our business is subject to political and economic uncertainties in China and may be adversely affected by China's political, economic and social developments. Over the past several years, the Chinese Government has pursued economic reform policies including the encouragement of private economic activity and greater economic decentralization. The Chinese Government may not continue to pursue these policies or may alter them to our detriment from time to time. Changes in policies, laws and regulations, or in their interpretation or the imposition of confiscatory taxation, restrictions on currency conversion, restrictions or prohibitions on dividend payments to stockholders, devaluations of currency or the nationalization or other expropriation of private enterprises could have a material adverse effect on our business. Nationalization or expropriation could result in the total loss of our

investment in China.

The economic, political and social conditions in China could affect our business.

All of our business, assets and operations are located in China. The economy of China differs from the economies of most developed countries in many respects, including government involvement, level of development, growth rate, control of foreign exchange, and allocation of resources. The economy of China has been transitioning from a planned economy to a more market-oriented economy. Although the Chinese Government has implemented measures recently emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the Chinese Government. In addition, the Chinese Government continues to play a significant role in regulating industry by imposing industrial policies. It also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Therefore, the Chinese Government's involvement in the economy could adversely affect our business operations, results of operations and/or financial condition.

Table of Contents

The Chinese Government's macroeconomic policies could have a negative effect on our business and results of operations

The Chinese Government has implemented various measures from time to time to control the rate of economic growth. Some of these measures benefit the overall economy of China, but may have a negative effect on us.

Government control of currency conversion and future movements in exchange rates may adversely affect our operations and financial results.

We receive substantially all of our revenues in Renminbi, the currency of China. A portion of such revenues will be converted into other currencies to meet our foreign currency obligations. Foreign exchange transactions under our capital account, including principal payments in respect of foreign currency-denominated obligations, continue to be subject to significant foreign exchange controls and require the approval of the State Administration of Foreign Exchange in China. These limitations could affect our ability to obtain foreign exchange through debt or equity financing, or to obtain foreign exchange for capital expenditures.

The Chinese Government controls its foreign currency reserves through restrictions on imports and conversion of Renminbi into foreign currency. Although the exchange rate of the Renminbi to the US dollar has been stable since January 1, 1994, and the Chinese Government has stated its intention to maintain the stability of the value of Renminbi, there can be no assurance that exchange rates will remain stable. The Renminbi could devalue against the US dollar. Our financial condition and results of operations may also be affected by changes in the value of certain currencies other than the Renminbi in which our earnings and obligations are denominated. In particular, a devaluation of the Renminbi is likely to increase the portion of our cash flow required to satisfy our foreign currency-denominated obligations.

Because the Chinese legal system is not fully developed, our and the securityholders' legal protections may be limited.

The Chinese legal system is based on written statutes and their interpretation by the Supreme People's Court. Although the Chinese government introduced new laws and regulations to modernize its business, securities and tax systems on January 1, 1994, China does not yet possess a comprehensive body of business law. Because Chinese laws and regulations are relatively new, interpretation, implementation and enforcement of these laws and regulations involve uncertainties and inconsistencies and it may be difficult to enforce contracts. In addition, as the Chinese legal system develops, changes in such laws and regulations, their interpretation or their enforcement may have a material adverse effect on our business operations. Moreover, interpretative case law does not have the same precedential value in China as in the United States, so legal compliance in China may be more difficult or expensive.

It may be difficult to serve us with legal process or enforce judgments against our management or us.

All of our assets are located in China and three of our directors and officers are non-residents of the United States, and all or substantial portions of the assets of such non-residents are located outside the United States. As a result, it may not be possible to effect service of process within the United States upon such persons to originate an action in the United States. Moreover, there is uncertainty that the courts of China would enforce judgments of U.S. courts against us, our directors or officers based on the civil liability provisions of the securities laws of the United States or any state, or an original action brought in China based upon the securities laws of the United States or any state.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

None

Table of Contents

ITEM4 SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5 OTHER INFORMATION

None

ITEM 6. EXHIBITS

INDEX TO EXHIBITS

Exhibit Number	**Description**
3.1(i)	Certificate of Incorporation (incorporated by reference from the filing on Form 10KSB File No. 000-33123.)
3.1(ii)	Bylaws (incorporated by reference from the Form 10KSB for the year ended December 31, 2002.)
10.1	Registration Rights Agreement dated March 20, 2006 between us and Cornell Capital Partners, LP (incorporated by reference to our Form S-3 Registration Statement (File No. 333 - 133331) filed on April 17, 2006)
10.2	Investor Registration Rights Agreement dated March 20, 2006 between us and Cornell Capital Partners, LP. (incorporated by reference to our Form S-3 Registration Statement (File No. 333 - 133331) filed on April 17, 2006)
10.3	Warrant to purchase 86,806 shares of common stock at $14.40 per share, issued to Cornell Capital Partners, LP. (incorporated by reference to our Form S-3 Registration Statement (File No. 333 - 133331) filed on April 17, 2006)
10.4	Warrant to purchase 69,444 shares of common stock at $18.00 per share, issued to Cornell Capital Partners, LP. (incorporated by reference to our Form S-3 Registration Statement (File No. 333 - 133331) filed on April 17, 2006)
10.5	Joint-venture Agreement, dated March 31, 2006, as amended on May 2, 2006, between Hongkong Great Genesis Group Co., Ltd. and Wuhu Chery Technology Co., Ltd. (incorporated by reference to the exhibit 10.8 to our Form 10Q Quarterly Report on May 10, 2006)
10.6	Securities Purchase Agreement dated February 1, 2008 among us, Lehman Brothers Commercial Corporation Asia Limited, and YA Global Investments, L.P. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.7	Securities Purchase Agreement dated February 15, 2008 between us and the investors. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.8	Escrow Agreement dated February 15, 2008 among us, U.S. Bank National Association, Lehman Brothers Commercial Corporation Asia Limited, and YA Global Investments, L.P. (incorporated by reference to

our Form 10-K for the year ended December 31, 2007.)

10.9 Registration Rights Agreement dated February 15, 2008 among us, Lehman Brothers Commercial Corporation Asia Limited, and YA Global Investments, L.P. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)

Table of Contents

10.10	Senior Convertible Note dated February 15, 2008 in the original principal amount of $8,571,429 issued by us in favor of TFINN & CO. as nominee for Lehman Brothers Commercial Corporation Asia Limited. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.11	Senior Convertible Note dated February 15, 2008 in the original principal amount of $6,428,571 issued by us in favor of TFINN & CO. as nominee for Lehman Brothers Commercial Corporation Asia Limited. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.12	Senior Convertible Note dated February 15, 2008 in the original principal amount of $15,000,000 issued by us in favor of TFINN & CO. as nominee for Lehman Brothers Commercial Corporation Asia Limited. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.13	Closing Warrant to purchase 564,799 shares of common stock at $8.8527 per share, dated February 15, 2008, issued by us in favor of TFINN & CO. as nominee for Lehman Brothers Commercial Corporation Asia Limited. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.14	Escrow Warrant to purchase 564,799 shares of common stock at $8.8527 per share, dated February 15, 2008, issued by us in favor of TFINN & CO. as nominee for Lehman Brothers Commercial Corporation Asia Limited. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.15	Senior Convertible Note dated February 15, 2008 in the original principal amount of $1,428,571 issued by us in favor of YA Global Investments, L.P. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.16	Senior Convertible Note dated February 15, 2008 in the original principal amount of $1,071,429 issued by us in favor of YA Global Investments, L.P. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.17	Senior Convertible Note dated February 15, 2008 in the original principal amount of $2,500,000 issued by us in favor of YA Global Investments, L.P. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.18	Closing Warrant to purchase 94,133 shares of common stock at $8.8527 per share, dated February 15, 2008, issued by us in favor of YA Global Investments, L.P. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
10.19	Escrow Warrant to purchase 94,133 shares of common stock at $8.8527 per share, dated February 15, 2008, issued by us in favor of YA Global Investments, L.P. (incorporated by reference to our Form 10-K for the year ended December 31, 2007.)
31.1	Rule 13a-14(a) Certification*
31.2	Rule 13a-14(a) Certification*
32.1	Section 1350 Certification*
32.2	Section 1350 Certification*

* Filed herewith

54

Table of Contents

SIGNATURES

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

CHINA AUTOMOTIVE SYSTEMS, INC.
(Registrant)

Date: November 12, 2008	By:	/s/ Qizhou Wu Qizhou Wu President and Chief Executive Officer
Date: November 12, 2008	By:	/s/ Jie Li Jie Li Chief Financial Officer