CHINA AUTOMOTIVE SYSTEMS INC
Form 10-Q
May 12, 2009

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

FORM 10-Q

(Mark one)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2009
or
¨ 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 (State or other jurisdiction of incorporation or organization)	33-0885775 (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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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 ¨	Accelerated filer ¨
Non-accelerated filer ¨ (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 ¨ No x

As of March 31, 2009, the Company had 26,983,244 shares of common stock issued and outstanding.

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PART 1 — FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended March 31, 2009	2008
Net product sales, including $559,011 and $2,051,082 to related parties at March 31, 2009 and 2008	$ 44,697,446	$ 41,467,043
Cost of product sold, including $2,126,737 and $1,952,390 purchased from related parties at March 31, 2009 and 2008	32,499,615	29,254,673
Gross profit	12,197,831	12,212,370
Add: Gain on other sales	66,879	134,190
Less: Operating expenses-		
Selling expenses	2,359,166	2,475,341
General and administrative expenses	1,801,702	1,616,150
R&D expenses	439,922	175,678
Depreciation and amortization	571,413	1,294,727
Total Operating expenses	5,172,203	5,561,896
Income from operations	7,092,507	6,784,664
Add: Other income, net (note 22)	-	199,459
Financial income (expenses) net (note 23)	(439,480)	20,693
Gain (loss) on change in fair value of derivative (note 24)	(1,560,848)	-
Income before income taxes	5,092,179	7,004,816
Less: Income taxes (note 25)	1,449,670	824,395
Net income	3,642,509	6,180,421
Net income attributable to noncontrolling interests	1,383,697	1,750,247
Net income attributable to common shareholders	2,258,812	4,430,174
Net income per common share-		
Basic and diluted (note 2)	$ 0.08	$ 0.18
Weighted average number of common shares outstanding –		
Basic	26,983,244	23,959,702
Diluted	31,947,823	25,936,500

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

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

	Three Months Ended March 31,	
	2009	2008
Net income	$ 3,642,509	$ 6,180,421
Other comprehensive income:		
Foreign currency translation gain (loss)	(14,579)	3,311,329
Comprehensive income	$ 3,627,930	$ 9,491,750

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

China Automotive Systems, Inc.
Condensed Consolidated Balance Sheets

	March 31, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 37,585,291	$ 37,113,375
Pledged cash deposits (note 3)	7,840,724	6,739,980
Accounts and notes receivable, net, including $1,583,182 and $1,285,110 from related parties at March 31, 2009 and December 31, 2008 (note 4)	103,671,922	96,424,856
Advance payments and other, including $349,320 and $9,374 to related parties at March 31, 2009 and December 31, 2008	2,221,351	1,442,614
Inventories (note 6)	27,945,742	26,571,755
Total current assets	$ 179,265,030	$ 168,292,580
Long-term Assets:		
Property, plant and equipment, net (note 7)	$ 55,945,266	$ 51,978,905
Intangible assets, net (note 8)	745,474	504,339
Other receivables, net, including $743,209 and $903,674 from related parties at March 31, 2009 and December 31, 2008 (note 5)	1,439,303	1,349,527
Advance payments for property, plant and equipment, including $1,442,579 and $2,473,320 to related parties at March 31, 2009 and December 31, 2008	4,659,474	6,459,510
Long-term investments	78,995	79,010
Deferred income tax assets (note 9)	2,270,161	2,383,065
Total assets	$ 244,403,703	$ 231,046 ,936
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank loans (note 10)	$ 5,120,028	$ 7,315,717
Accounts and notes payable, including $1,522,755 and $1,097,642 to related parties at March 31, 2009 and December 31, 2008 (note 11)	66,304,165	59,246,043
Convertible notes payable, net, including discount of convertible note payable at March 31, 2009 (note 12)	33,044,424	32,922,077
Derivative liabilities (note 13)	3,065,422	1,502,597
Customer deposits	516,736	236,018
Accrued payroll and related costs	2,805,411	2,715,116
Accrued expenses and other payables(note 14)	13,066,626	12,460,784
Accrued pension costs (note 15)	3,714,541	3,806,519
Taxes payable (note 16)	9,495,915	5,717,438
Amounts due to shareholders/directors (note 17)	337,272	337,370
Total current liabilities	$ 137,470,540	$ 126,259,679
Long-term liabilities:		
Advances payable (note 18)	233,679	234,041
Total liabilities	$ 137,704,219	$ 126,493,720
Related Party Transactions and balances (note 27)		
Commitments and contingencies (note 28		
Stockholders' equity:		
Preferred stock, $0.0001 par value - Authorized - 20,000,000 shares Issued and outstanding – None	$ —	$ -
	2,698	2,698

Common stock, $0.0001 par value - Authorized - 80,000,000 Shares Issued and Outstanding - 26,983,244 shares at March 31, 2009 and December 31, 2008 (note 19)		
Additional paid-in capital (note 19)	27,148,206	27,148,206
Retained earnings-		
Appropriated	7,702,835	7,525,777
Unappropriated	38,108,270	36,026,516
Deferred stock compensation (note 20)	(500,052)	(500,052)
Accumulated other comprehensive income	11,117,342	11,127,505
Non-controlling interests (note 21)	23,120,185	23,222,566
Total stockholders' equity	$ 106,699,484	$ 104,553,216
Total liabilities and stockholders' equity	$ 244,403,703	$ 231,046,936

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

China Automotive Systems, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity
Period Ended March 31, 2009 (unaudited) and December 31, 2008

	Common Stock		Additional	Retained Earnings		Deferred	Accumulated Other		
	Shares	Par value	Paid-in Capital	Appropriated	Unappropriated	stock Compensation	Comprehensive Income (Loss)	Non-controlling interests	Total
alance at ecember 1, 2007	23,959,702	$ 2,396	$ 30,125,951	$ 7,525,777	$ 23,591,275	$ —	$ 5,989,463	$ 23,166,270	$ 90,401,132
et income r the year nded ecember 1, 2008	—	—	—	—	12,435,241	—	—	5,071,408	17,506,649
oreign urrency anslation ain	—	—	—	—	—	—	5,138,042	1,432,977	6,571,019
apital ontribution								745,723	745,723
suance of ommon ock	3,023,542	302	22,089,698	—	—	—	—	—	22,090,000
suance of ock options dependent rectors and anagement	-	-	845,478	—	—	(500,052)	—	—	345,426
ayment for cquisition f 35.5% englong's quity	-	-	(25,912,921)	—	—	—	—	(6,177,079)	(32,090,000)
ividend stribution								(1,016,733)	(1,016,733)
alance at ecember 1, 2008	26,983,244	$ 2,698	$ 27,148,206	$ 7,525,777	$ 36,026,516	$ (500,052)	$ 11,127,505	$ 23,222,566	$ 104,553,216
et income r the year nded March 1, 2009	—	—	—	—	2,258,812	—	—	1,383,697	3,642,509
oreign urrency anslation ain (loss)							(10,163)	(4,416)	(14,579)

ividend stribution				177,058	(177,058)	—		(1,481,662)	(1,481,66
alance at arch 31, 009	26,983,244	$ 2,698	$ 27,148,206	$ 7,702,835	$ 38,108,270	$ (500,052)	$ 11,117,342	$ 23,120,185	$ 106,699,48

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

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

	Three Months Ended March 31, 2009	2008
Cash flows from operating activities:		
Net income	$ 3,642,509	$ 6,180,421
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	2,026,816	2,315,922
Allowance for doubtful accounts (Recovered)	(650,590)	(632,095)
Deferred income taxes assets	112,451	(109,320)
Amortization for discount of convertible note payable	122,347	99,449
(Gain) loss on change in fair value of derivative	1,560,848	-
Other operating adjustments	(1,234)	(16,769)
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Pledged deposits	(1,102,026)	(596,632)
Accounts and notes receivable	(6,482,746)	(10,110,607)
Advance payments and other	(779,329)	(1,388,073)
Inventories	(1,379,040)	(1,674,877)
Accounts and notes payable	7,069,389	5,328,884
Customer deposits	280,763	(19,651)
Accrued payroll and related costs	90,811	(93,253)
Accrued expenses and other payables	690,931	(29,553)
Accrued pension costs	(91,254)	253,894
Taxes payable	3,779,564	218,004
Net cash provided by (used in) operating activities	$ 8,890,210	$ (274,256)
Cash flows from investing activities:		
(Increase) decrease in other receivables	(111,395)	(427,014)
Cash received from equipment sales	34,020	-
Cash paid to acquire property, plant and equipment	(4,296,391)	(2,999,504)
Cash paid to acquire intangible assets	(292,573)	(99,672)
Net cash (used in) investing activities	$ (4,666,339)	$ (3,526,190)
Cash flows from financing activities:		
(Decrease) in proceeds from bank loans	(2,194,298)	(712,353)
Dividends paid to the non-controlling interest holders of Joint-venture companies	(1,550,637)	(712,352)
(Decrease) in amounts due to shareholders/directors	-	(70,294)
Proceeds from issuance of convertible note payable	-	35,000,000
Net cash provided by (used in) financing activities	$ (3,744,935)	$ 33,505,001
Cash and cash equivalents effected by foreign currency	$ (7,020)	$ 770,308
Net increase in cash and cash equivalents	471,916	30,474,863
Cash and cash equivalents at beginning of period	37,113,375	19,487,159
Cash and cash equivalents at end of period	$ 37,585,291	$ 49,962,022

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

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

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

	Three Months Ended March 31,	
	2009	2008
Cash paid for interest	$ 702,501	$ 257,083
Cash paid for income taxes	$ 294,494	$ 547,541

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

	Three Months Ended March 31,	
	2009	2008
Transfer and assign a 35.5% equity interest in Henglong by non-controlling interest holders of Joint-venture companies	$ —	$ (6,177,079)
Difference between the book value of and consideration paid for the 35.5% equity interest of Henglong	—	(25,912,921)
Liabilities in connection with acquisition of 35.5% Henglong equity	—	32,090,000
Issuance of a warrant to purchase common stock	—	405,007
Derivative liabilities	—	3,972,068
Additional warrant of common stock and derivative liabilities for issuance of Convertible Notes are considered as discount of Convertible Notes.	—	(4,377,075)

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

China Automotive Systems, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
Three Months Ended March 31, 2009 and 2008

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, "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 March 31, 2009 and 2008.

	Percentage Interest	
Name of Entity	March 31, 2009	March 31, 2008
Shashi Jiulong Power Steering Gears Co., Ltd., "Jiulong"	81.00%	81.00%
Jingzhou Henglong Automotive Parts Co., Ltd., "Henglong"	80.00%	80.00%
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%	75.90%
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 gear 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, Genesis, and Wiselink Holdings Limited, "Wiselink", both controlled by Hanlin Chen and his family, entered into an equity transfer agreement, the "Henglong Agreement", pursuant to which Wiselink transferred and assigned its 35.5% equity interest in Jingzhou Henglong, one of the Company's currently consolidated subsidiaries, to Genesis for a total consideration of US$32,090,000. The Company now holds an 80% equity interest in Jingzhou Henglong.

Under the terms of the Henglong Agreement, 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. In 2008, Genesis and Shanghai Hongxi Investment Inc., "Hongxi", the other shareholder of USAI, agreed to increase USAI's capital to $2,600,000 from $1,800,000. The increased capital was wholly funded by Genesis. Therefore, the capital contributed by Genesis in USAI increased to $2,166,900 from $1,366,900, accounting for 83.34% of the total capital; while the capital contributed by Hongxi remained unchanged, accounting for 16.66% of the total capital.

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 three months ended March 31, 2009 and 2008, 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 March 31, 2009	2008
Numerator:		
Net income attributable to common shareholders	$ 2,258,812	$ 4,430,174
Add: interest expenses of convertible notes payable	284,375	131,250
Add: Amortization for discount of convertible notes payable	122,347	99,449
	$ 2,665,534	$ 4,660,873
Denominator:		
Weighted average shares outstanding	26,983,244	23,959,702
Effect of dilutive securities	4,964,579	1,976,798
	31,947,823	25,936,500
Net income per common share- diluted	$ 0.08	$ 0.18

During the three months ended March 31, 2009, the options and warrants outstanding have not been included in the computation of diluted income per share, except the options issued on December 10, 2008, because such inclusion would have had an anti-dilutive effect. The shares issuable upon conversion of Convertible Notes have been included in the computation.

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. Since the adoption of the stock incentive plan, the Company has issued 411,350 stock options under this plan, and there remain 1,788,650 stock options issuable in the future. As of March 31, 2009, the Company had 388,850 stock options outstanding.

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.

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, the Company has 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 the Company's 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 the Company’s current accounting practice. That is, all registration payments will require recognition when they are both probable and reasonably estimable. The Company does not currently believe that damages are probable.

Fair Value Measurements - Effective January 1, 2008, the Company 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 the Company’s 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).

Noncontrolling Interests in Consolidated Financial Statements - In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51." The objective of SFAS No. 160 is to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing additional accounting and reporting standards. Effective January 1, 2009, the Company adopted the provisions of SFAS No. 160, the noncontrolling interests are reported in the equity currently.

Comments - The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of the Company’s management, 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 ended March 31, 2009 and 2008 respectively.

The consolidated balance sheet as of December 31, 2008 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 2008 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

The results of operations for the three months ended March 31, 2009 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2009.

3. Pledged cash deposits

Pledged as guarantee for its notes payable, the Company regularly pays some of its suppliers by bank notes. The Company has to deposit a cash deposit, equivalent to 10%- 40% of the face value of the relevant bank note, at a bank in order to obtain the bank note.

4. Accounts and notes receivable

The Company's accounts receivable at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Accounts receivable	$ 68,262,886	$ 60,345,494
Notes receivable	39,535,923	40,989,840
	107,798,809	101,335,334
Less: allowance for doubtful accounts	(4,126,887)	(4,910,478)
Balance at the end of the period	$ 103,671,922	$ 96,424,856

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 three months ended March 31, 2009 (unaudited) and the year ended December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Balance at beginning of period	$ 4,910,478	$ 3,827,838
Amounts provided (recovered) during the period	(782,657)	841,078
Foreign currency translation gain (loss)	(934)	241,562
Balance at the end of the period	$ 4,126,887	$ 4,910,478

5. Other receivables

The Company’s other receivables at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Other receivables	$ 2,120,379	$ 2,009,364
Less: allowance for doubtful accounts	(681,076)	(659,837)
Balance at the end of the period	$ 1,439,303	$ 1,349,527

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 three months ended March 31, 2009 (unaudited) and the year ended December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Balance at beginning of the period	$ 659,837	$ 652,484
Amounts provided (recovered) during the period	21,365	(41,264)
Foreign currency translation gain (loss)	(126)	48,617
Balance at the end of the period	$ 681,076	$ 659,837

6. Inventories

The Company’s inventories at March 31, 2009 (Unaudited) and December 31, 2008 consisted of the following:

	March 31, 2009	December 31, 2008
Raw materials	$ 9,208,125	$ 8,354,397
Work in process	5,360,423	4,466,720
Finished goods	14,858,819	14,826,961
	29,427,367	27,648,078
Less: provision for loss	(1,481,625)	(1,076,323)
Balance at the end of the period	$ 27,945,742	$ 26,571,755

7. Property, plant and equipment

The Company’s property, plant and equipment at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Land use rights and buildings	$ 28,392,392	$ 27,416,977
Machinery and equipment	58,379,200	54,405,700
Electronic equipment	4,699,878	4,356,475
Motor vehicles	2,471,452	2,641,378
Construction in progress	1,307,843	1,007,415
	95,250,765	89,647,945
Less: Accumulated depreciation	(39,305,499)	(37,669,040)
Balance at the end of the period	$ 55,945,266	$ 51,978,905

Depreciation charge for the three months ended March 31, 2009 and the year ended December 31, 2008 are $1,975,474 and $9,672,948 respectively.

8. Intangible assets

The activities in the Company's intangible asset account at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Balance at beginning of period	$ 504,339	$ 589,713
Add: additions during the period–		
Patent technology	292,573	-
Management software license	-	125,550
Foreign currency translation gain (loss)	(96)	41,120
	796,816	756,383
Less: Amortization at end of the period	(51,342)	(252,044)
Balance at the end of the period	$ 745,474	$ 504,339

9. Deferred Income Tax Assets

Deferred income taxes are provided for temporary differences between amounts of assets and liabilities for financial reporting purposes and the basis of such assets and liabilities as measured by tax laws and regulations, as well as net operating loss, tax credit and other carryforwards. Additionally, deferred taxes have been provided for the purpose of repatriating earnings from consolidated foreign subsidiaries. Statement of Financial Accounting Standards No. 109 ("SFAS 109"), "Accounting for Income Taxes," requires that deferred tax assets be reduced by a valuation allowance if, based on all available evidence, it is considered more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods.

The components of estimated deferred income tax assets at March 31, 2009 (unaudited) and December 31, 2008 were as follows:

	March 31, 2009	December 31, 2008
Losses carryforward (U.S.)	$ 3,190,727	$ 2,300,322
Losses carryforward (PRC)	390,461	287,285
Product warranties and other reserves	1,707,356	1,737,052
Property, plant and equipment	2,507,972	2,471,716
Bonus accrual	217,033	297,208
Other	115,187	154,348
	8,128,736	7,247,931
Valuation allowance *	(5,858,575)	(4,864,866)
Total deferred tax assets	$ 2,270,161	$ 2,383,065

*As of March 31, 2009, valuation allowance was $5,858,575, including $3,190,727 and $2,667,848 allowance for the Company's deferred tax assets in the U.S. and allowance for the Company's non-U.S. deferred tax assets. As of December 31, 2008, valuation allowance was $4,864,866, including $2,300,322 allowance for the Company's deferred tax assets in the U.S. and $2,564,544 allowance for the Company's non-U.S. deferred tax assets. Based on the Company's current operations in the U.S., the management believes that the deferred tax assets in the U.S are not likely to be realized in the future. For the non-U.S. deferred tax assets, pursuant to certain tax laws and regulations in China, the management believes such amount will not be utilized to offset future taxable income.

10. Bank loans

At March 31, 2009, the Company, through its Sino-foreign joint ventures, had outstanding fixed-rate short-term bank loans of $5,120,028, with weighted average interest rate at 6.14% 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, 2008, the Company, through its Sino-foreign joint ventures, had outstanding fixed-rate short-term bank loans of $7,315,717, with weighted average interest rate at 6.17% per annum. These loans are secured with some of the property and equipment of the Company and are repayable within one year.

11. Accounts and notes payable

The Company's accounts and notes payable at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Accounts payable	$ 43,857,187	$ 38,595,446
Notes payable	22,446,978	20,650,597
Balance at the end of the period	$ 66,304,165	$ 59,246,043

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.

12. Convertible notes payable

In February 2008, the Company sold to two accredited institutional investors $35 million of convertible notes, the "Convertible Notes", with a scheduled maturity date of February 15, 2013. The Convertible Notes, including any accrued but unpaid interest, are 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.

The Convertible Notes bear 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 Notes 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 Note 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 Notes 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 Notes. 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 Note holders to convert all or any portion of the conversion amount then remaining under the Convertible Note 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 Notes, and each holder of the Convertible Notes will not have the right to convert any portion of the Convertible Notes 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 Notes, 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 Notes, 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 Notes, the Convertible Note holders may require the Company to redeem all or any portion of the Convertible Notes. Each portion of the Convertible Notes 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 Note holder upon redemption represents a gross yield to the Convertible Note 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 Note holder any amount of principal, interest, late charges or other amounts when and as due under the Convertible Notes and other events as defined in the Convertible Note agreements.

Upon the consummation of a change of control as defined in the Convertible Note agreements, the Convertible Note holder may require the Company to redeem all or any portion of the Convertible Notes. The portion of the Convertible Notes 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 Note holders will have the right, in their sole discretion, to require that the Company redeem the Convertible Notes in whole but not in part, by delivering written notice thereof to the Company. The portion of this Convertible Note 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 Note 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 Note holders will have the right, in its sole discretion, to require that the Company redeem all or any portion of the Convertible Notes. The portion of the Convertible Notes 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 Price (WAP) for twenty (20) consecutive trading days is less than 45% of the Conversion Price in effect on the Issuance Date, as adjusted, namely $3.187, the Convertible Note holder shall have the right, in its sole discretion, to require that the Company redeem all or any portion of the Convertible Notes. The portion of this Convertible Note 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.

Since the Company's stock Weighted Average Price for twenty (20) consecutive trading days ended on March 16, 2009 was below $3.187, which is less than 45% of the Conversion Price in effect of the Issuance Date, as adjusted, the "WAP Default", each Convertible Note holder shall have the right, at its sole discretion, to require that the Company redeem all or any portion of the Convertible Notes by delivering written redemption notice to the Company within five (5) business days after the receipt of the Company's notice of the WAP Default.

On March 17, 2009, the Company delivered two WAP Default notices to the Convertible Note holders. On March 27, 2009, the Company received a letter from YA Global, one of the Convertible Note holders, electing to require the Company to redeem all the three Convertible Notes it held in the total principal amount of $5,000,000, together with interest, late charges, if any, and the Other Make Whole Amount as defined in Section 5(d) of the Convertible Notes. After negotiation, the Company and YA Global reached a settlement agreement on April 8, 2009 whereby the Company paid a redemption amount of $5,041,667 to YA Global and YA Global waived its entitlement to the Other Make Whole Amount.

Following the WAP Default notices, the Company received a letter from the provisional liquidator acting on behalf of Lehman Brothers Commercial Corporation Asia Limited, the "LBCCA Liquidator", the other Convertible Note holder, requesting that it be granted an extension of time until April 24, 2009 to consider its rights under the Convertible Notes. The Company has granted an extension to April 15, 2009. The LBCCA Liquidator further requested another extension to April 24, 2009. On April 24, 2009, LBCCA's lawyers sent three Holder Redemption Notices via fax electing to redeem the entire outstanding principal of $30,000,000, together with interest, late charges, if any, and the Other Make Whole Amount, to be paid on July 23, 2009. The Company is reviewing whether the LBCCA letter, request for extension, its three Holder Redemption Notices and other matters have followed the terms of the securities purchase agreement dated February 1, 2008 and the Convertible Notes and the Company will negotiate with LBCCA Liquidator to resolve this situation.

In connection with the Convertible Notes, 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 expired 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, the Company recorded the redemption put at fair value $1,703,962 and the Company recorded the warrants at fair value $798,626. The remaining proceeds were then allocated to the debt instrument.

As indicated above, 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. 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.

The Financing Agreements embody a contingent conversion feature (reset conversion price). 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 was 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, and 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.

On the date of inception, 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 Note’s term using the effective method. As of March 31, 2009, the amortization expense balance recorded by the Company was $547,012. As the convertible note has been elected by the holders to be redeemed, the unamortized discount on the convertible note will be written off as expense on the redemption date.

13. 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 12). 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 March 31, 2009, the compound derivative value amounted to $3,065,422. 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 12 and 24)

14. Accrued expenses and other payables

The Company's accrued expenses and other payables at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Accrued expenses	$ 2,576,652	$ 2,441,352
Other payables	1,586,555	1,690,046
Warranty reserves*	6,980,977	6,335,613
Dividend payable to non-controlling interest shareholders of Joint-ventures	1,922,442	1,991,796
Liabilities in connection with warrants**	-	1,977
Balance at the end of the period	$ 13,066,626	$ 12,460,784

*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 three months ended March 31, 2009 (unaudited) and the year ended December 31, 2008, the warranties activities were as follows:

	March 31, 2009	December 31, 2008
Balance at the beginning of period	$ 6,335,613	$ 4,919,491
Additions during the period-	1,294,487	5,861,782
Settlement within period, by cash or actual material	(647,918)	(4,797,457)
Foreign currency translation gain (loss)	(1,205)	351,797
Balance at end of period	$ 6,980,977	$ 6,335,613

**In connection with the Convertible Notes, 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 expired 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.

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 March 31, 2009, the fair value of warrant was $0 due to its expiration on February 15, 2009. The income from adjustment of fair value of liabilities in connection with warrants amount of gain has been recorded in the income statement as gain or loss on change in fair value of derivative. (see note 24)

15. 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 three months ended March 31, 2009 (unaudited) and the year ended December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Balance at beginning of the period	$ 3,806,519	$ 3,622,729
Amounts provided during the period	628,018	2,311,049
Settlement during the period	(719,272)	(2,381,047)
Foreign currency translation gain (loss)	(724)	253,788
Balance at end of period	$ 3,714,541	$ 3,806,519

16. Taxes payable

The Company’s taxes payable at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Value-added tax payable	$ 8,985,306	$ 6,279,089
Income tax payable	389,984	(652,865)
Other tax payable	120,625	91,214
Balance at end of the period	$ 9,495,915	$ 5,717,438

17. Amounts due to shareholders/ directors

The activities in the amounts due to shareholders/directors at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Balance at the beginning of period	$ 337,370	$ 304,601
Increase (decrease) during the period	-	2,415
Foreign currency translation gain (loss)	(98)	30,354
Balance at end of period	$ 337,272	$ 337,370

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

18. 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 22).

19. Share Capital and Additional paid-in capital

The activities in the Company’s share capital and additional paid-in capital account during the three months ended March 31, 2009 and the year ended December 31, 2008 are summarized as follows:

	Share Capital		
	Shares	Par Value	Additional paid-in
Balance at December 31, 2007	23,959,702	$ 2,396	$ 30,125,951
Issuance of common stock*	3,023,542	302	22,089,698
Decrease in additional paid-in capital in connection with Henglong equity acquisition **	-	-	(25,912,921)
Issuance of stock options to independent directors and management***	-	$ -	$ 845,478
Balance at December 31, 2008 and March 31, 2009	26,983,244	$ 2,698	$ 27,148,206

*On March 31, 2008, Wiselink Holdings Limited, “Wiselink”, Great Genesis Holdings Limited, “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., “Henglong” to 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 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 Genesis.

**Under the terms of the above agreement, 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 similar to that of pooling of interests.

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.

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.

***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. Since the adoption of the stock incentive plan, the Company has issued 411,350 stock options under this plan, and there remain 1,788,650 stock options issuable in future. As of March 31, 2009, the Company had 388,850 stock options outstanding.

The Company issued 312,350 common stock options to independent directors and management, and the fair value of the options at the grant date was $845,478, for the year of 2008, which was calculated based on Black-Scholes option pricing model. The fair value was credited in additional paid-in capital, debited in operating expenses using straight line method over the expected beneficiary period. As of March 31, 2009, the Company has amortized $345,426 and the remaining 199,233 stock options, valued at $500,052, are reflected as deferred stock compensation under shareholders' equity in the balance sheet.

20. Deferred stock compensation

The Company issued 312,350 common stock options to independent directors and management, and the fair value of the options at the grant date was $845,478, for the year of 2008, which was calculated based on Black-Scholes option pricing model. As of March 31, 2009, the Company has amortized $345,426 and the remaining 199,233 stock options, valued at $500,052, are reflected as deferred stock compensation under shareholders' equity in the balance sheet.

21. Non-controlling interests

The Company's activities in respect of the amounts of the non-controlling interests' equity at March 31, 2009 (unaudited) and December 31, 2008 are summarized as follows:

	March 31, 2009	December 31, 2008
Balance at beginning of the period	$ 23,222,566	$ 23,166,270
Add: Additions during the period–		
Income attributable to non-controlling interests	1,383,697	5,071,408
Capital Contribution from the non-controlling interest holders of Joint-venture companies	-	745,723
Less: Decreases during the period		
Dividends declared to the non-controlling interest holders of Joint-venture companies	(1,481,662)	(1,016,733)
Transfer and assign equity interest in Henglong and USAI by non-controlling interest holders of Joint-venture companies*	-	(6,177,079)
Foreign currency translation gain (loss)	(4,416)	1,432,977
Balance at end of period	$ 23,120,185	$ 23,222,566

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*On March 31, 2008, the Company's wholly-owned subsidiary, 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 Genesis for a total consideration of $32,090,000.

Under the terms of the above agreement, 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.

On January 1, 2008, the net book value of 35.5% equity of Henglong, which was transferred from non-controlling shareholders, was $6,177,079.

22. Other Income

During the three months ended March 31, 2009, there was no other income in the Company. During the three months ended March 31, 2008, other income was $199,459, mainly was Government subsidies.

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. 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.

23. Financial income (expenses)

During the three months ended March 31, 2009 (unaudited) and 2008, the Company recorded financial income (expenses) which is summarized as follows:

	Three Months Ended March 31,	
	2009	2008
Interest income (expenses),net	$ (288,279)	$ (263,769)
Foreign exchange gain (loss), net	(14,568)	376,638
Income (loss) of note discount, net	(110)	18,036
Amortization for discount of convertible note payable	(122,347)	(99,449)
Handling charge	(14,176)	(10,763)
Total	$ (439,480)	$ 20,693

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

During the three months ended March 31, 2009 (unaudited) and 2008, the Company recorded gain (loss) on change in fair value of derivative is summarized as follows:

	Three Months Ended March 31,	
	2009	2008
Income from adjustment of fair value of liabilities in connection with warrants	$ 1,977	$ -
Income (loss) from adjustment of fair value of compound derivative liabilities	(1,562,825)	-
Total	$ 1,560,848	$ -

25. 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 of 25% 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 2008, Jiulong was subject to enterprise income tax at a rate of 25%. During 2008, Jiulong was to be awarded the title of Advanced Technology Enterprises, and subjected to enterprise income tax at a rate of 15% for 2009.

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.

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 and was subject to enterprise income tax at a rate of 18%. Commencing from 2009, Shenyang is subject to enterprise income tax at a rate of 20% .

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 2009 and 2008, accordingly, there is no assessable profit for the three months ended March 31, 2009 and 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.

No provision for Hong Kong tax is made as Genesis is an investment holding company, and has no assessable income in Hong Kong for the three months ended March 31, 2009 and 2008. 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 ended March 31, 2009 and 2008. The enterprise income tax of US is 35%.

26. 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 three months ended March 31, 2009 (unaudited), the Company’s ten largest customers accounted for 74.2% of its consolidated net sales, with each of four customers individually accounting for more than 10% of consolidated net sales, i.e. 13.8%, 11.7%, 11.1% and 10.9% individually, or an aggregate of 47.5%. At March 31, 2009, approximately 39.7% of accounts receivable were from trade transactions with the aforementioned four customers.

During the three months ended March 31, 2008 (unaudited), the Company’s ten largest customers accounted for 67.7% of the Company’s consolidated net sales, with each of four customers individually accounting for more than 10% of consolidated net sales, i.e. 13.1%, 11.5%, 11.3% and 10.2% individually, or an aggregate of 46.1%. At March 31, 2008, approximately 33.4% of accounts receivable were from trade transactions with the aforementioned four customers.

27. Related party transactions and balances

Related party transactions with companies with common directors are as follows:
Related sales (unaudited):

	Three Months Ended March 31,	
	2009	2008
Merchandise Sold to Related Parties	$ 559,011	$ 2,051,082

Related purchases (unaudited):

	Three Months Ended 2009	March 31, 2008
Materials Purchased from Related Parties	$ 2,126,737	$ 1,952,390
Technology Purchased from Related Parties	43,886	-
Equipment Purchased from Related Parties	1,076,335	417,438
Total	$ 3,246,958	$ 2,369,828

Purchase of 35.5% equity interest in Jinzhou Henglong during the three months ended March 31, 2008 (refer to note 19)

Related receivables (March 31, 2009 unaudited):

	March 31, 2009	December 31, 2008
Accounts receivable	$ 1,583,182	$ 1,285,110
Other receivables	743,209	903,674
Total	$ 2,326,391	$ 2,188,784

Related advances (March 31, 2009 unaudited):

	March 31, 2009	December 31, 2008
Advanced Equipment Payment to Related Parties	$ 1,442,579	$ 2,473,320
Advanced Expenses and Others to Related Parties	349,320	9,374
Total	$ 1,791,899	$ 2,482,694

Related payables (March 31, 2009 unaudited)

	March 31, 2009	December 31, 2008
Accounts payable	$ 1,522,755	$ 1,097,642

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

28. 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 March 31, 2009 (unaudited):

	Payment Obligations by Period					
	2009 (a)	2010	2011	2012	Thereafter	Total
Obligations for service agreements	$ 110,000	$ 110,000	$ 110,000	$ -	$ -	$ 330,000
Obligations for purchasing agreements	5,013,714	1,239,355	$ —	$ —	-	6,253,069
Total	$ 5,123,714	$ 1,349,355	$ 110,000	$ -	$ -	$ 6,583,069

(a) Remaining 9 months in 2009

29. Off-balance sheet arrangements

At March 31, 2009 and 2008, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

30. 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 ended March 31, 2009 and 2008 (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:								
31-Mar-09								
Revenue								
Net product sales – external	$ 18,075,293	$ 9,764,562	$ 6,405,993	$ 5,422,811	$ 4,828,229	$ 200,558	$ —	$ 44,697,446
Net product sales – internal	8541,592	214,904	502,829	120,086	—	—	(9,379,411)	-
Gain on other sales	42,460	(13,040)	14,530	3,420	18,135	2,878	(1,504)	66,879
Total revenue	$ 26,659,345	$ 9,966,426	$ 6,923,352	$ 5,546,317	$ 4,846,364	$ 203,436	$ (9,380,915)	$ 44,764,325
Net income	$ 4,865,838	$ 426,272	$ 763,816	$ 505,084	$ (190,181)	$ (336,051)	$ (2,392,269)	$ 3,642,509
Net income attributable to non-controlling interests	973,167	80,992	229,144	247,491	(43,114)	(37,144)	(66,839)	1,383,697
Net income attributable to common shareholders	$ 3,892,671	$ 345,280	$ 534,672	$ 257,593	$ (147,067)	$ (298,907)	$ (2,325,430)	$ 2,258,812

	Henglong	Jiulong	Shenyang	Zhejiang	Wuhu	Other sector	Other (1)	Total
For the Three Months Ended:								
31-Mar-08								
Revenue								
Net product sales – external	$ 14,925,533	$ 11,269,992	$ 6,212,496	$ 3,724,796	$ 5,295,038	$ 39,188	$ —	$ 41,467,043
Net product sales – internal	7,363,909	598,839	418,131	276,836	—	—	(8,657,715	