CHINA AUTOMOTIVE SYSTEMS INC
Form 10QSB
May 20, 2004

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

# FORM 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

[ ] 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 small business issuer 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) 716-8329196

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

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]

As of March 31, 2004, the Company had 22,574,542 shares of common stock issued and outstanding.

Transitional Small Business Disclosure Format: Yes [ ] No [X]

Documents incorporated by reference: None.

CHINA AUTOMOTIVE SYSTEMS, INC.

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Condensed Consolidated Balance Sheets

| | March 31, 2004 | December 31, 2003 |
|---|---|---|
| | (Unaudited) | (Restated - Note 12) |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 14,161,563 | $ 10,730,882 |
| Pledged cash deposits | 1,532,603 | 1,272,067 |
| Accounts and notes receivable, including $1,452,126 and $1,248,328 from related parties at March 31, 2004 and December 31, 2003, respectively, net of an allowance for doubtful accounts of $3,097,855 and $2,757,374 at March 31, 2004 and December 31, 2003, respectively | 39,358,302 | 38,680,011 |
| Advance payments, including $1,267,130 and $1,513,973 to related parties at March 31, 2004 and December 31, 2003, respectively, net of an allowance for doubtful accounts of $191,364 | 12,014,039 | 9,980,367 |
| Inventories | 12,551,586 | 10,229,422 |
| Total current assets | 79,618,093 | 70,892,749 |
| Property, plant and equipment | 29,457,296 | 28,050,079 |
| Less: Accumulated depreciation | (6,482,940) | (5,700,023) |
| | 22,974,356 | 22,350,056 |
| Intangible assets, net | 207,618 | 218,639 |
| Other receivables, including $1,931,081 and $1,472,758 from related parties at March 31, 2004 and December 31, 2003, respectively, net of an allowance for doubtful accounts of $1,053,047 | 3,295,250 | 2,313,017 |
| Long-term investments | 72,289 | 72,289 |
| Total assets | $ 106,167,606 | $ 95,846,750 |

(continued)

China Automotive Systems, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (continued)

| | March 31, 2004 (Unaudited) | December 31, 2003 (Restated - Note 12) |
|---|---|---|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Bank loans | $ 13,614,458 | $ 9,638,554 |
| Accounts and notes payable, including $656,273 and $1,175,006 to related parties at March 2004 and December 31, 2003, respectively | 24,974,337 | 23,017,221 |
| Customer deposits | 812,286 | 907,519 |
| Accrued payroll and related costs | 1,098,142 | 1,173,576 |
| Accrued expenses and other payables | 2,436,720 | 1,992,207 |
| Accrued pension costs | 1,735,794 | 1,516,649 |
| Liability related to acquisition of joint venture assets | -- | 1,204,819 |
| Taxes payable | 5,541,121 | 6,268,803 |
| Amounts due to shareholders/directors | 7,893,570 | 5,229,281 |
| Total current liabilities | 58,106,428 | 50,948,629 |
| Long-term liabilities | 196,547 | 196,547 |
| Minority interests | 20,831,795 | 18,686,712 |
| 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 Issued and Outstanding - 22,574,542 shares at March 31, 2004 and December 31, 2003 | 2,257 | 2,257 |
| Additional paid-in capital | 18,779,880 | 18,779,880 |
| Retained earnings - | | |
| Appropriated | 3,775,254 | 3,775,254 |
| Unappropriated | 4,475,410 | 3,461,621 |
| Foreign currency translation gain (loss) | 35 | (4,150) |
| Total stockholders' equity | 27,032,836 | 26,014,862 |
| Total liabilities and stockholders' equity | $106,167,606 | $ 95,846,750 |

See accompanying notes to condensed consolidated financial statements.



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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 |
| | | (Restated - Note 12) |
| Net sales, including $285,069 and $755,066 to related parties in 2004 and 2003, respectively | $ 12,833,756 | $ 11,102,071 |
| Cost of sales, including $394,176 and $567,714 purchased from related parties in 2004 and 2003, respectively | 8,245,750 | 5,902,110 |
| Gross profit | 4,588,006 | 5,199,961 |
| Costs and expenses: | | |
| Selling | 408,434 | 279,791 |
| General and administrative | 2,185,072 | 1,714,343 |
| Depreciation and amortization | 118,384 | 84,339 |
| Stock-based compensation | -- | 1,300,000 |
| Total costs and expenses | 2,711,890 | 3,378,473 |
| Income from operations | 1,876,116 | 1,821,488 |
| Other income (expense): | | |
| Other non-operating income | 118,833 | 238,476 |
| Financial expenses | (84,888) | (59,105) |
| Other income (expense), net | 33,945 | 179,371 |
| Income before income taxes | 1,910,061 | 2,000,859 |
| Income taxes | 312,400 | 445,528 |
| Income before minority interest | 1,597,661 | 1,555,331 |
| Minority interests | 583,872 | 1,589,429 |
| Net income (loss) | $ 1,013,789 | $ (34,098) |
| Net income per common share - | | |
| Basic | $ 0.04 | $ (0.00) |
| Diluted | $ 0.04 | $ (0.00) |

| | | |
|---|---|---|
| Weighted average number of common shares outstanding - | | |
| Basic | 22,574,542 | 21,244,475 |
| Diluted | 22,574,542 | 21,244,475 |

See accompanying notes to condensed consolidated financial statements.



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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 |
| | | (Restated - Note 12) |
| Net income (loss) | $ 1,013,789 | $ (34,098) |
| Other comprehensive income (loss): | | |
| Foreign currency translation gain (loss) | 4,185 | -- |
| Comprehensive income (loss) | $ 1,017,974 | $ (34,098) |

See accompanying notes to condensed consolidated financial statements.



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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 (Restated - Note 12) |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 1,013,789 | $ (34,098) |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Minority interests | 583,872 | 1,589,430 |
| Issuance of warrants to consultants | -- | 1,300,000 |
| Depreciation and amortization | 793,938 | 359,089 |
| Other operating adjustments | 4,185 | (67,552) |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in: | | |
| Pledged deposits | (260,536) | -- |
| Accounts receivable | (678,291) | (625,831) |
| Advance payments | (2,033,672) | (32,660) |
| Inventories | (2,322,164) | (350,573) |
| Increase (decrease) in: | | |
| Accounts and notes payable | 1,957,116 | 1,332,108 |
| Customer deposits | (95,233) | -- |
| Accrued payroll and related costs | (75,434) | (87,377) |
| Accrued expenses and other payables | 444,513 | 92,383 |
| Accrued pension costs | 219,145 | 176,530 |
| Taxes payable | (727,682) | 52,822 |
| Net cash provided by (used in) operating activities | (1,176,454) | 3,704,271 |
| Cash flows from investing activities: | | |
| Increase in other receivables | (982,233) | (1,241,873) |
| Cash paid to acquire fixed assets | (1,407,217) | (678,567) |

| | | |
|---|---|---|
| Net cash used in investing activities | (2,389,450) | (1,920,440) |

(continued)



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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 |
| | | (Restated - Note 12) |
| Cash flows from financing activities: | | |
| Proceeds from bank loans, net | $ 3,975,904 | $ 1,204,819 |
| Dividends paid | -- | (367,519) |
| Increase in amounts due to shareholders/directors | 2,664,289 | 1,443,067 |
| Contributions to capital by minority interest holders | 1,561,211 | -- |
| Decrease in liability related to acquisition of joint venture assets | (1,204,819) | -- |
| Net cash provided by financing activities | 6,996,585 | 2,280,367 |
| Cash and cash equivalents: | | |
| Net increase | 3,430,681 | 4,064,198 |
| At beginning of period | 10,730,882 | -- |
| Adjustment as a result of change to consolidation accounting from equity accounting effective January 1, 2003 | -- | 5,618,436 |
| At end of period | $ 14,161,563 | $ 9,682,634 |

Supplemental Disclosure of Non-Cash
Investing and Financing Activities:

| | | |
|---|---|---|
| Adjustment as a result of change to consolidation accounting from equity accounting effective January 1, 2003 | $ -- | $ (279,863) |
| Cancellation of dividends previously declared | -- | 17,167,000 |
| Shares of common stock retained by public shareholders in March 2003 recapitalization | -- | 110 |
| Issuance of warrants to consultants | -- | 1,300,000 |

See accompanying notes to condensed consolidated financial statements.



China Automotive Systems, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
Three Months Ended March 31, 2004 and 2003

1. Organization and Basis of Presentation

Organization - Effective March 5, 2003, Visions-In-Glass, Inc., a United States public company incorporated in the State of Delaware ("Visions"), entered into a Share Exchange Agreement to acquire 100% of the shareholder interest in Great Genesis Holding Limited, a company incorporated on January 3, 2003 under The Companies Ordinance in Hong Kong as a limited liability company ("Great Genesis"), as a result of which Great Genesis became a wholly-owned subsidiary of Visions. At the closing, the old directors and officers of Visions resigned, and new directors and officers were appointed. Visions subsequently changed its name to China Automotive Systems, Inc.

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 described below, is engaged in the manufacture and sale of automotive systems and components in the People's Republic of China (the "PRC" or "China") as described below.

Ji Long Enterprise Investment Limited was incorporated on October 8, 1992 under the Companies Ordinance in Hong Kong as a limited liability company ("Ji Long"). Ji Long is an investment holding company. Effective March 4, 2003, all of the shareholders of Ji Long exchanged their 100% shareholder interest for a 100% shareholder interest in Great Genesis, as a result of which Ji Long became a wholly-owned subsidiary of Great Genesis.

In exchange for the acquisition of 100% of the shareholder interest in Great Genesis, the shareholders of Great Genesis were issued 20,914,250 shares of common stock of Visions. In addition, the shareholders of Great Genesis paid $250,000 to the former officer, director and controlling shareholder of Visions

for the cancellation of 17,424,750 shares of common stock, and have agreed to pay an additional $70,000, subject to certain conditions.

The acquisition of Great Genesis by the Company was accounted for as a recapitalization of Great Genesis, pursuant to which the accounting basis of Great Genesis continued unchanged subsequent to the transaction date. Accordingly, the pre-transaction financial statements of Great Genesis are the historical financial statements of the Company.

Ji Long owns the following aggregate net interests in five Sino-foreign joint ventures organized in the PRC as of March 31, 2004 and December 31, 2003:

| Name of Entity | Percentage Interest |
|---|---|
| Jingzhou Henglong Automotive Parts Co. Limited ("Henglong") | 42.0% |
| Shashi Jiulong Power Steering Co. Limited ("Jiulong") | 81.0% |
| Shenyang Jinbei Henglong Automotive Steering System Co. Limited ("Shenyang") | 55.0% |
| Zhejiang Henglong & Vie Pump-Manu Co. Limited ("Zhejiang") | 51.0% |
| Jingzhou Henglong Fulida Textile Co., Ltd. ("Jingzhou") | 51.0% |

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Henglong and Jiulong are mainly engaged in the production of rack and pinion power steering gears and integral ball and nut power steering gears for cars, light and heavy-duty vehicles. Shenyang and Zhejiang were established in 2002 and are focused on power steering parts and power steering pumps. Jingzhou was formed in 2003 to produce environmental textiles and raw materials. At present, Henglong, Jiulong and Shenyang are the main revenue-generating entities.

At December 31, 2002, the investors in Shenyang were Ji Long, Henglong, Shengyang Automotor Industry Investment Corporation and Shenyang Jinbei Automotor Industry Co., Ltd. On December 12, 2002, according to a decision made at the meeting of the board of directors, 30% of the stock rights in Shenyang held by Henglong were to be transferred to Ji Long, and 17% of the stock rights in Shenyang held by Shenyang Automotor Industry Investment Corporation were to be transferred to Shenyang Jinbei Automotor Industry Co., Ltd. On January 8, 2003, Ji Long and Henglong signed an agreement for the transfer of stock rights, which was approved by the applicable PRC authorities on May 22, 2003. As of December 31, 2002, the Company owned 25% of Shenyang directly and 12.6% of Shenyang indirectly through its ownership in Henglong, for a combined ownership of 37.6%. The Company accounted for this increase in ownership in Shenyang during the three months ended June 30, 2003, with an appropriate adjustment to the minority interest. As of March 31, 2004, the Company owned 55.0% of Shenyang directly.

Jingzhou was formed in February 2003 to produce environmental textiles and raw materials, and is owned 51% by Ji Long and 49% by Cixi City Fulida Synthetic Fibre Co., Ltd. As the minority interest partner has the right to participate in management, the Company accounted for its interest in this Sino-foreign joint

venture under the equity method of accounting through September 30, 2003. As a result of the execution of an "Act in Concert" Agreement for Jingzhou during the three months ended December 31, 2003, the Company consolidated Jingzhou as of December 31, 2003 and for the year the ended.

Basis of Presentation - The accompanying condensed consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries and Sino-foreign joint ventures, except for Jingzhou for the three months ended March 31, 2003. All significant intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America.

During early 2003, the Directors of the Company and the other joint venturers in the Company's Sino-foreign joint ventures (except for Jingzhou) executed "Act in Concert" agreements, resulting in the Company having voting control in such Sino-foreign joint ventures. The Company is in the process of making application to the relevant PRC authorities for their approval to effect this change through amendments to the respective joint venture agreements. Consequently, effective January 1, 2003, the Company changed from equity accounting to consolidation accounting for its investments in Sino-foreign joint ventures (except for Jingzhou). Prior to January 1, 2003, the Company used the equity method pursuant to Emerging Issues Task Force Issue No. 96-16, which states that if a minority joint venture partner has the right to participate in management, the majority joint venture partner is required to account for its interest in the joint venture under the equity method of accounting.

In May 2003, Henglong outsourced to Jiulong the production of an integral power steering system. Jiulong sells the related finished product to Henglong, which then sells the product to third parties. All intercompany profit is eliminated on consolidation. The transferred profit due to this transaction has been recorded in the interest account of minority shareholders according to their investment ratios since that date.

Foreign Currencies - The Company maintains its books and records in Renminbi ("RMB"), the currency of the PRC, its functional currency. Translation of amounts into United States dollars ("US$") has been made at the rate of RMB8.30 to US$1.00.

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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 (loss) 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.

The RMB is not readily convertible into United States dollars or other foreign currencies. The foreign exchange rate between the United States dollar and the RMB has been stable at approximately 1RMB to US$0.1205 for the last few years.

No representation is made that the RMB amounts could have been, or could be, converted into United States dollars at that rate or at any other rate.

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 at March 31, 2004, the results of operations for the three months ended March 31, 2004 and 2003, and cash flows for the three months ended March 31, 2004 and 2003. The consolidated balance sheet as of December 31, 2003 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 management of the Company 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 Annual Report on Form 10-KSB, as filed with the Securities and Exchange Commission.

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.

The results of operations for the three months ended March 31, 2004 is not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2004.

Income (Loss) Per Share - Basic income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated assuming the issuance of common shares, if dilutive, resulting from the exercise of warrants. Income per common share calculations for the three months ended March 31, 2003 reflect the retroactive restatement of the shareholders' equity section to reflect the March 2003 recapitalization. The Company had potentially dilutive securities consisting of warrants to purchase 550,375 shares of common stock exercisable at $1.20 per share outstanding at March 31, 2003. The Company did not have any potentially dilutive securities outstanding at March 31, 2004.

The Company effected a 3.5 to 1 forward split of its outstanding shares of common stock during March 2003, prior to the transaction with Great Genesis described above. Unless otherwise indicated, all share and per share amounts presented herein have been adjusted to reflect the forward stock split.



Stock-Based Compensation - The Company may periodically issue shares of common stock for services rendered or for financing costs. Such shares are valued based on the market price on the transaction date.

The Company may periodically issue stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs.

The Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation", which establishes a fair value

method of accounting for stock-based compensation plans.

The provisions of SFAS No. 123 allow companies to either record an expense in the financial statements to reflect the estimated fair value of stock options or warrants to employees, or to continue to follow the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", but to disclose on an annual basis the pro forma effect on net income (loss) and net income (loss) per common share had the fair value of the stock options and warrants been recorded in the financial statements. SFAS No. 123 was amended by SFAS No. 148, which now requires companies to disclose in interim financial statements the pro forma effect on net income (loss) and net income (loss) per common share of the estimated fair market value of stock options or warrants issued to employees. The Company has elected to continue to account for stock-based compensation plans utilizing the intrinsic value method. Accordingly, compensation cost for stock options and warrants is measured as the excess, if any, of the fair market price of the Company's common stock at the date of grant above the amount an employee must pay to acquire the common stock.

In accordance with SFAS No. 123, the cost of stock options and warrants issued to non-employees is measured at the grant date based on the fair value of the award. The fair value of the stock-based award 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.

Pro Forma Financial Disclosure - Since the Company has not issued any stock options to employees, no pro forma financial disclosure has been presented.

Comprehensive Income (Loss) - 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 (loss) 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.

The Company's only component of other comprehensive income (loss) is foreign currency translation gain of $4,185 for the three months ended March 31, 2004. This amount has been recorded as a separate component of stockholders' equity.

Reclassifications - Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation.

2. Certain Significant Risks and Uncertainties

The Company is subject to the consideration and risks of operating in the PRC. These include risks associated with the political and economic environment, foreign currency exchange and the legal system in the PRC.

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The economy of PRC differs significantly from the economies of the "western" industrialized nations in such respects as structure, level of development, gross national product, growth rate, capital reinvestment, resource allocation, self-sufficiency, rate of inflation and balance of payments position, among others. Only recently has the PRC government encouraged substantial private economic activities. The Chinese economy has experienced significant growth in

the past several years, but such growth has been uneven among various sectors of the economy and geographic regions. Actions by the PRC government to control inflation have significantly restrained economic expansion in the recent past. Similar actions by the PRC government in the future could have a significant adverse effect on economic conditions in PRC.

Many laws and regulations dealing with economic matters in general and foreign investment in particular have been enacted in the PRC. However, the PRC still does not have a comprehensive system of laws, and enforcement of existing laws may be uncertain and sporadic.

The Company's operating assets and primary sources of income and cash flows are the interests of its subsidiaries in Sino-foreign joint ventures in the PRC. The PRC economy has, for many years, been a centrally-planned economy, operating on the basis of annual, five-year and ten-year state plans adopted by central PRC governmental authorities, which set out national production and development targets. The PRC government has been pursuing economic reforms since it first adopted its "open-door" policy in 1978. There is no assurance that the PRC government will continue to pursue economic reforms or that there will not be any significant change in its economic or other policies, particularly in the event of any change in the political leadership of, or the political, economic or social conditions in, the PRC. There is also no assurance that the Company will not be adversely affected by any such change in governmental policies or any unfavorable change in the political, economic or social conditions, the laws or regulations, or the rate or method of taxation in the PRC.

As many of the economic reforms which have been or are being implemented by the PRC government are unprecedented or experimental, they may be subject to adjustment or refinement, which may have adverse effects on the Company. Further, through state plans and other economic and fiscal measures, it remains possible for the PRC government to exert significant influence on the PRC economy.

The Company's financial instruments that are exposed to concentration of credit risk consist primarily of cash and cash equivalents, and accounts receivable from customers. Cash and cash equivalents are maintained with major banks in the PRC. The Company's business activity is with customers in the PRC. The Company periodically performs credit analysis and monitors the financial condition of its clients in order to minimize credit risk.

Any devaluation of the Renminbi (RMB) against the United States dollar would consequently have adverse effects on the Company's financial performance and asset values when measured in terms of the United States dollar. Should the RMB significantly devalue against the United States dollar, such devaluation could have a material adverse effect on the Company's earnings and the foreign currency equivalent of such earnings. The Company does not hedge its RMB - United States dollar exchange rate exposure.

On January 1, 1994, the PRC government introduced a single rate of exchange as quoted daily by the People's Bank of China (the "Unified Exchange Rate"). No representation is made that the RMB amounts have been, or could be, converted into US$ at that rate. This quotation of exchange rates does not imply free convertibility of RMB to other foreign currencies. All foreign exchange transactions continue to take place either through the Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rate quoted by the People's Bank of China. Approval of foreign currency payments by the People's Bank of China or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

3. Recent Accounting Pronouncements

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". SFAS No. 143 addresses the diverse accounting practices for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company adopted SFAS No. 143 effective January 1, 2003. The adoption of SFAS No. 143 did not have a significant effect on the Company's financial statement presentation or disclosures.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections". SFAS No. 145 rescinds the provisions of SFAS No. 4 that requires companies to classify certain gains and losses from debt extinguishments as extraordinary items, eliminates the provisions of SFAS No. 44 regarding transition to the Motor Carrier Act of 1980 and amends the provisions of SFAS No. 13 to require that certain lease modifications be treated as sale leaseback transactions. The provisions of SFAS No. 145 related to classification of debt extinguishments are effective for fiscal years beginning after May 15, 2002. The adoption of SFAS No. 145 did not have a significant effect on the Company's financial statement presentation or disclosures.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", which requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Such costs covered by SFAS No. 146 include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS No. 146 replaces the previous accounting guidance provided by the EITF No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS No. 146 did not have a significant effect on the Company's financial statement presentation or disclosures.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure". SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for fiscal years beginning after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of SFAS No. 148 did not have a significant effect on the Company's financial statement presentation or disclosures.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies under what circumstances a contract with initial investments meets the characteristics of a derivative and when a derivative contains a financing component. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003. The adoption of SFAS No. 149 did not have a significant effect on the Company's financial statement presentation or disclosures.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 establishes standards for how an issuer classifies and measures in its statement

of financial position certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the



first interim period beginning after June 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of SFAS No. 150 and still existing at the beginning of the interim period of adoption. Restatement is not permitted. The adoption of SFAS No. 150 did not have a significant effect on the Company's financial statement presentation or disclosures.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair market value of the obligations it assumes under that guarantee and must disclose that information in its interim and annual financial statements. The initial recognition and measurement provisions of FIN 45 apply on a prospective basis to guarantees issued or modified after December 31, 2002. The Company implemented the disclosure provisions of FIN 45 in its December 31, 2002 consolidated financial statements, and the measurement and recording provisions of FIN 45 effective January 1, 2003.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", relating to consolidation of certain entities. In December 2003, the FASB issued a revised version of FIN 46 ("FIN 46R") that replaced the original FIN 46. FIN 46R requires identification of a company's participation in variable interest entities ("VIEs"), which are defined as entities with a level of invested equity that is not sufficient to fund future activities to permit it to operate on a standalone basis. For entities identified as a VIE, FIN 46R sets forth a model to evaluate potential consolidation based on an assessment of which party to the VIE (if any) bears a majority of the exposure to its expected losses, or stands to gain from a majority of its expected returns. FIN 46R also sets forth certain disclosures regarding interests in VIEs that are deemed significant, even if consolidation is not required. The Company is not currently participating in, or invested in any VIEs, as defined in FIN 46R. The implementation of the provisions of FIN 46R in 2003 did not have a significant effect on the Company's consolidated financial statement presentation or disclosures.

4. Inventories

Inventories at March 31, 2004 (Unaudited) and December 31, 2003 consisted of the following:

| | March 31, 2004 | December 31, 2003 |
|---|---|---|
| Raw materials | $ 4,150,244 | $ 3,622,369 |

| | | |
|---|---|---|
| Work-in-process | 2,423,951 | 2,110,612 |
| Finished goods | 6,254,894 | 4,808,434 |
| | 12,829,089 | 10,541,415 |
| Less: provision for loss | (277,503) | (311,993) |
| | $ 12,551,586 | $ 10,229,422 |

5. Liability Related to Acquisition of Joint Venture Assets

In conjunction with the formation of the Jingzhou Sino-foreign joint venture in February 2003, the Company purchased certain operating assets from an unrelated entity and had a remaining liability outstanding of $1,204,819 at December 31, 2003. The Company paid this obligation during the three months ended March 31, 2004.

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6. Amounts Due to Shareholders/Directors

The activity in the amounts due to shareholders/directors for the three months ended March 31, 2004 is as follows:

| | |
|---|---|
| Balance, December 31, 2003 | $5,229,281 |
| Cash advances from shareholders | 2,664,289 |
| Balance, March 31, 2004 | $7,893,570 |

At March 31, 2004 and December 31, 2003, the amounts due to shareholders/directors were unsecured, interest-free and repayable on demand.

During the three months ended March 31, 2003, amounts due to shareholders/directors aggregating $17,167,000 were cancelled. This transaction was accounted for as a contribution to capital.

7. Minority Interests

During the three months ended March 31, 2004, minority interest holders contributed $1,561,211 of capital to the Company's Sino-foreign joint ventures, which has been shown as an increase in the liability to minority interests in the accompanying balance sheet at March 31, 2004.

8. Stockholders' Equity

During March 2003, in conjunction with the transaction with Great Genesis described at Note 1, the Company effected a 3.5 to 1 forward split of its outstanding shares of common stock, thus increasing the 5,293,000 shares of common stock outstanding at that time to 18,525,500 shares, of which 17,424,750 shares were then returned to the Company and cancelled.

During March 2003, in conjunction with the transaction with Great Genesis described at Note 1, the Company issued common stock purchase warrants to three consultants to acquire an aggregate of 550,375 shares of common stock, exercisable for a period of one year at $1.20 per share. The aggregate fair value of these warrants, calculated pursuant to the Black-Scholes option-pricing

model, was estimated to be $1,300,000, which was charged to operations during the three months ended March 31, 2003.

As of March 31, 2004, the Company did not have any stock options outstanding, and had not adopted a stock option plan.

9. Income Taxes

The Company's Sino-foreign joint ventures 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 enterprises. Two of the Company's Sino-foreign joint ventures, Henglong and Jiulong, were subject to a tax rate of 15% during 2003, and are subject to a tax rate of 15% during 2004. The tax rate for the Company's three other subsidiaries, Shenyang, Zhejiang and Zhejiang, has not been ratified. Certain of the Company's Sino-foreign joint ventures are also entitled to a two-year tax holiday commencing with the first profit-making year.



No provision for Hong Kong profits tax has been made as Ji Long and Great Genesis are investment holding companies and did not have any assessable profits in Hong Kong in 2003.

10. Significant Concentrations and Related Party Transactions

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, 2004, the Company's ten largest customers accounted for 64.6% of the Company's consolidated net sales, with two customers accounting for in excess of 10% of consolidated net sales, with 24.6% and 13.4% of consolidated net sales, or an aggregate of 38.0% of consolidated net sales. At March 31, 2004, approximately 28% of accounts receivable were from trade transactions with the aforementioned two customers.

During the three months ended March 31, 2003, the Company's ten largest customers accounted for 74.4% of the Company's consolidated net sales, with one customer accounting for in excess of 10% of consolidated net sales, with 26.3% of consolidated sales. At March 31, 2003, approximately 20% of accounts receivable were from trade transactions with the aforementioned one customer.

During the three months ended March 31, 2004 and 2003, sales to related parties aggregated $285,069 and $755,066, respectively.

During the three months ended March 31, 2004 and 2003, purchases from related parties aggregated $394,176 and $567,714, respectively.

11. Related Party Transactions

Effective August 2, 2003, the Company entered into a five-year License and Technical Assistance Agreement (the "Agreement") with Sino-American, Inc. ("Sino-American"), a United States company controlled by the Company's Chairman and controlling shareholder. The Agreement provided for total payments of $6,000,000 to enable Sino-American to purchase technical assistance and equipment for use in the Company's business operations in China. During November

2003, $2,000,000 was paid by the Company to Sino-American, which was classified as advance payments in the consolidated balance sheets at March 31, 2004 and December 31, 2003, net of amounts expended through such dates.

This agreement also allowed the Company to transfer funds from China to the United States to fund normal corporate general and administrative expenses.

Through March 31, 2004, Sino-American had paid, on behalf of or for the benefit of the Company, a total of $1,506,324, including a $250,000 initial investment in a joint venture with an unrelated party, $255,000 for equipment and $180,000 for software to unrelated third parties, $250,000 to the Company's Chairman and controlling shareholder as reimbursement for costs incurred by him related to the March 2003 recapitalization, and $516,184 for selling, general and administrative expenses for the benefit of or on behalf of the Company. As this Agreement was terminated effective April 1, 2004, the unexpended funds were repaid to the Company subsequent to that date. The $250,000 payment to the Chairman and controlling shareholder was recorded as a charge to operations during the three months ended March 31, 2003.

During the three months ended March 31, 2004 and 2003, the joint ventures entered into related party transactions with companies with common directors as shown below:



| | Three Months Ended March 31, | |
|---|---|---|
| | 2004 | 2003 |
| Sales | | |
| - received | $ 81,271 | $ 154,441 |
| - receivable | 203,798 | 600,625 |
| Purchases | | |
| - paid | -- | 43,738 |
| - payable | 394,176 | 523,976 |

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

12. Restatement

In conjunction with the Company's audit of its consolidated financial statements for the year ended December 31, 2003, the Company conducted a review of its 2002 financial statements, as a result of which restated its balance sheet at December 31, 2002 and the 2003 interim periods. A summary of the effect of these adjustments with respect to the statement of operations for the three months ended March 31, 2003 is as follows:

| | |
|---|---|
| Net income, as reported | $ 192,000 |
| Deduct: Costs and expenses not properly recorded at March 31, 2003 | (226,098) |

| | |
|---|---|
| Net loss, as revised | $ (34,098) |
| | ============ |
| Net income per common share - basic and diluted - as reported | $ 0.01 |
| Deduct: Costs and expenses not properly recorded at March 31, 2003 | (0.01) |
| | ------------ |
| Net loss per common share - basic and diluted - as adjusted | $ (0.00) |
| | ============ |
| Weighted average common shares outstanding - | |
| Basic | 21,244,475 |
| Diluted | 21,616,350 |



ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

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

This Quarterly Report on Form 10-QSB for the quarterly period ended March 31, 2004 contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, including statements that include the words "believes", "expects", "anticipates", or similar expressions. These forward-looking statements 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. The forward-looking statements in this Quarterly Report on Form 10-QSB for the quarterly period ended March 31, 2004 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.

General Overview:

Effective March 5, 2003, Visions-In-Glass, Inc., a United States public company incorporated in the State of Delaware ("Visions"), entered into a Share Exchange Agreement to acquire 100% of the shareholder interest in Great Genesis Holding Limited, a company incorporated on January 3, 2003 under The Companies Ordinance in Hong Kong as a limited liability company ("Great Genesis"), as a result of which Great Genesis became a wholly-owned subsidiary of Visions. At the closing, the old directors and officers of Visions resigned, and new directors and officers were appointed. Visions subsequently changed its name to China Automotive Systems, Inc.

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 described below, is engaged in the manufacture and sale of automotive systems and components in the People's Republic of China (the "PRC" or "China") as described below.

Ji Long Enterprise Investment Limited was incorporated on October 8, 1992 under the Companies Ordinance in Hong Kong as a limited liability company ("Ji Long"). Ji Long is an investment holding company. Effective March 4, 2003, all of the shareholders of Ji Long exchanged their 100% shareholder interest for a 100% shareholder interest in Great Genesis, as a result of which Ji Long became a wholly-owned subsidiary of Great Genesis.

In exchange for the acquisition of 100% of the shareholder interest in Great Genesis, the shareholders of Great Genesis were issued 20,914,250 shares of common stock of Visions. In addition, the shareholders of Great Genesis paid $250,000 to the former officer, director and controlling shareholder of Visions for the cancellation of 17,424,750 shares of common stock, and have agreed to pay an additional $70,000, subject to certain conditions.

The acquisition of Great Genesis by the Company was accounted for as a recapitalization of Great Genesis, pursuant to which the accounting basis of Great Genesis continued unchanged subsequent to the transaction date. Accordingly, the pre-transaction financial statements of Great Genesis are the historical financial statements of the Company.

Ji Long owns the following aggregate net interests in five Sino-foreign joint ventures organized in the PRC as of March 31, 2004 and December 31, 2003:



| Name of Entity | Percentage Interest |
|---|---|
| Jingzhou Henglong Automotive Parts Co. Limited ("Henglong") | 42.0% |
| Shashi Jiulong Power Steering Co. Limited ("Jiulong") | 81.0% |
| Shenyang Jinbei Henglong Automotive Steering System Co. Limited ("Shenyang") | 55.0% |
| Zhejiang Henglong & Vie Pump-Manu Co. Limited ("Zhejiang") | 51.0% |
| Jingzhou Henglong Fulida Textile Co., Ltd. ("Jingzhou") | 51.0% |

Henglong and Jiulong are mainly engaged in the production of rack and pinion power steering gears and integral ball and nut power steering gears for cars, light and heavy-duty vehicles. Shenyang and Zhejiang were established in 2002 and are focused on power steering parts and power steering pumps. Jingzhou was formed in 2003 to produce environmental textiles and raw materials. At present, Henglong, Jiulong and Shenyang are the main revenue-generating entities.

At December 31, 2002, the investors in Shenyang were Ji Long, Henglong, Shengyang Automotor Industry Investment Corporation and Shenyang Jinbei Automotor Industry Co., Ltd. On December 12, 2002, according to a decision made at the meeting of the board of directors, 30% of the stock rights in Shenyang held by Henglong were to be transferred to Ji Long, and 17% of the stock rights in Shenyang held by Shenyang Automotor Industry Investment Corporation were to be transferred to Shenyang Jinbei Automotor Industry Co., Ltd. On January 8, 2003, Ji Long and Henglong signed an agreement for the transfer of stock rights, which was approved by the applicable PRC authorities on May 22, 2003. As of December 31, 2002, the Company owned 25% of Shenyang directly and 12.6% of Shenyang indirectly through its ownership in Henglong, for a combined ownership of 37.6%. The Company accounted for this increase in ownership in Shenyang during the three months ended June 30, 2003, with an appropriate adjustment to the minority interest. As of March 31, 2004, the Company owned 55.0% of Shenyang directly.

Jingzhou was formed in February 2003 to produce environmental textiles and raw materials, and is owned 51% by Ji Long and 49% by Cixi City Fulida Synthetic Fibre Co., Ltd. As the minority interest partner has the right to participate in management, the Company accounted for its interest in this Sino-foreign joint venture under the equity method of accounting through September 30, 2003. As a result of the execution of an "Act in Concert" Agreement for Jingzhou during the three months ended December 31, 2003, the Company consolidated Jingzhou as of December 31, 2003 and for the year then ended.

During early 2003, the Directors of the Company and the other joint venturers in the Company's Sino-foreign joint ventures (except for Jingzhou) executed "Act in Concert" agreements, resulting in the Company having voting control in such Sino-foreign joint ventures. The Company is in the process of making application to the relevant PRC authorities for their approval to effect this change through amendments to the respective joint venture agreements. Consequently, effective January 1, 2003, the Company changed from equity accounting to consolidation accounting for its investments in Sino-foreign joint ventures (except for Jingzhou). Prior to January 1, 2003, the Company used the equity method pursuant to Emerging Issues Task Force Issue No. 96-16, which states that if a minority joint venture partner has the right to participate in management, the majority joint venture partner is required to account for its interest in the joint venture under the equity method of accounting.

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In May 2003, Henglong outsourced to Jiulong the production of an integral power steering system. Jiulong sells the related finished product to Henglong, which then sells the product to third parties. All intercompany profit is eliminated on consolidation. The transferred profit due to this transaction has been recorded in the interest account of minority shareholders according to their investment ratios since that date.

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.

Minority interests refer to the percentage of the owner's equity of a subsidiary owned by those investors other than the parent company. Minority interests in the condensed consolidated financial statements means the percentage of the Company's net assets owned by shareholders of the Company's Sino-foreign joint ventures other than the Company, according to their respective investment ratios.

The following critical accounting policies affect the more significant judgments and estimates used in the preparation of the Company's consolidated financial statements.

Revenues:

The Company recognizes revenue when the significant risks and rewards of ownership have been transferred to the customer pursuant to PRC law, including factors such as when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, sales and value added tax laws have been complied with, and collectibility is probable. The Company recognizes product sales generally at the time the product is shipped. Concurrent with the recognition of revenue, the Company reduces revenue for estimated product returns. Shipping and handling costs are included in cost of goods sold. Revenue is presented net of any sales tax and value added tax.

Accounts Receivable:

In order to determine the value of the Company's accounts receivable, the Company records a provision for doubtful accounts to cover estimated credit losses. Management reviews and adjusts this allowance periodically based on historical experience and its evaluation of the collectibility of outstanding accounts receivable. The Company evaluates the credit risk of its customers utilizing historical data and estimates of future performance.

Inventories:

Inventories are stated at the lower of cost or net realizable value. Cost is calculated on the moving-average basis and includes all costs to acquire and other costs incurred in bring the inventories to their present location and condition. The Company evaluates the net realizable value of its inventories on a regular basis and records a provision for loss to reduce the computed moving-average cost if it exceeds the net realizable value.

Income Taxes:

The Company records a tax provision to reflect the expected tax payable on taxable income for the period, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous periods.



Impairment of Long-Lived Assets:

The Company's long-lived assets consist of property and equipment and certain intangible assets. In assessing the impairment of such assets, the Company periodically makes assumptions regarding the estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or the related assumptions indicate that the carrying amount may not be recoverable, the Company records impairment charges for these assets at such

time.

Results of Operations:

Three Months Ended March 31, 2004 and 2003:

Net Sales. Net sales were $12,833,756 for the three months ended March 31, 2004, as compared to $11,102,071 for the three months ended March 31, 2003, an increase of $1,731,685 or 15.6%. The increase in sales in 2004 as compared to 2003 was a result of several factors.

In the first half of 2003, the SARS virus spread through most of China, which had a substantial negative impact on consumer spending and, in particular, automobile sales in China during the nine months ended September 30, 2003. As a parts supplier to the automobile industry, the Company's sales were also affected. As a result, during the three months ended March 31, 2003, the sales of the Company's Henlong, Jiulong and Shenyang Sino-foreign joint ventures were below budgeted sales levels.

During the latter part of 2003, the Company expanded its product lines, which the Company believes contributed to sales increases during 2004 at its Jiulong and Shenyang Sino-foreign joint ventures.

During the three months ended March 31, 2003, the Zhejiang and Jingzhou Sino-foreign joint ventures were in the initial development stage, and were primarily engaged in preparations to begin production. Sustained production and sales commenced during the three months ended December 31, 2003. Incremental net sales from these joint ventures in 2004 as compared to 2003 were approximately $2,200,000, while net sales from the Henglong, Jiulong and Shenyang Sino-foreign joint ventures decreased by an aggregate of approximately $500,000 in 2004 as compared to 2003, resulting in a net increase in sales of approximately $1,700,000 in 2004 as compared to 2003. The decrease in net sales at Henglong, Jiulong and Shenyang in 2004 as compared to 2003 was due to reduced demand by the Chinese automobile industry during the three months ended March 31, 2004 as automobile manufacturers reduced their December 31, 2003 inventory levels. The Company had experienced strong sales growth during the three months ended December 31, 2003, which had resulted in a build-up in automobile manufacturer's inventory levels at December 31, 2003.

Gross Profit. Gross profit was $4,588,006 or 35.7% of net sales for the three months ended March 31, 2004, as compared to $5,199,961 or 46.8% of net sales for the three months ended March 31, 2003.

The decrease in the gross margin in 2004 was consistent with the Company's expectations regarding the impact of rising raw material costs in the latter part of 2003, which the Company anticipated would cause gross margins to decrease to approximately 35% during 2004.

In response, the Company intends to attempt to reduce costs and at the same time continue to improve the quality of its products. The Company believes that high quality products will not only enable the Company to maintain its gross margins, but can also reduce production losses and after-sale service requirements.

The Company also intends to increase its investment in advanced production equipment to improve manufacturing efficiency, while at the same time reducing labor costs. During the year ended December 31, 2003, labor costs accounted for approximately 10% of net sales. Through expanded use of numerical control machines and automatic assembly lines, the Company anticipates reducing labor costs to less than 8% of net sales by the end of 2004.

The Company also intends to optimize product design and its production organization to reduce the consumption of raw materials. During the year ended

December 31, 2003, raw material costs accounted for approximately 40% of net sales. During the three months ended March 31, 2004, the price of steel, the



Company's primary raw material, rose 20% in China. The Company estimates that the average price increase during 2004 will be 15%. The Company will attempt to enhance the processes that control production and optimize the structural design of its products, with the objective being to decrease the use of raw materials and direct material costs up to 3% of net sales. Combined with the above-mentioned two factors, the Company expects that direct material costs will increase to 52% of net sales in 2004.

Selling. Selling expenses were $408,434 for the three months ended March 31, 2004, as compared to $279,791 for the three months ended March 31, 2003, an increase of $128,643 or 46.0%, due to an increased level of operations in 2004. The major components of selling expenses are salaries and wages, supplies, travel, transportation, sales service costs, rent, office expenses and advertising.

General and Administrative. General and administrative expenses were $2,185,072 for the three months ended March 31, 2004, as compared to $1,714,343 for the three months ended March 31, 2003, an increase of $470,729 or 27.5%, primarily as a result of an increased level of business activity and the costs of operating a public company.

Depreciation and Amortization. Depreciation and amortization, excluding depreciation and amortization included in cost of sales, was $118,384 for the three months ended March 31, 2004, as compared to $84,339 for the three months ended March 31, 2003, an increase of $34,045 or 40.4%, as a result of increases to property, plant and equipment.

Stock-Based Compensation. During March 2003, in conjunction with the transaction with Great Genesis described above, the Company issued common stock purchase warrants to three consultants to acquire an aggregate of 550,375 shares of common stock, exercisable for a period of one year at $1.20 per share. The aggregate fair value of these warrants, calculated pursuant to the Black-Scholes option-pricing model, was estimated to be $1,300,000, which was charged to operations during the three months ended March 31, 2003.

Income From Operations. Income from operations was $1,876,116 for the three months ended March 31, 2004, as compared to $1,821,488 for the three months ended March 31, 2003.

Other Non-Operating Income. Other non-operating income was $118,833 for the three months ended March 31, 2004, as compared to $238,476 for the three months ended March 31, 2003.

Financial Expenses. Financial expenses were $84,888 for the three months ended March 31, 2004, as compared to $59,105 for the three months ended March 31, 2003, as a result of increased interest-bearing debt.

Income Before Income Taxes. Income before income taxes was $1,910,061 for the three months ended March 31, 2004, as compared to $2,000,859 for the three months ended March 31, 2003.

Income Taxes. Income tax expense was $312,400 for the three months ended March 31, 2004, as compared to $445,528 for the three months ended March 31, 2003.

Income Before Minority Interest. Income before minority interest was $1,597,661

for the three months ended March 31, 2004, as compared to $1,555,331 for the three months ended March 31, 2003.

Minority Interests. The Company recorded minority interests' share in the earnings of the Sino-foreign joint ventures aggregating $583,872 for the three months ended March 31, 2004, as compared to $1,589,429 for the three months ended March 31, 2003.

The Company owns varying equity interests in five Sino-foreign joint ventures through which it conducts its operations, all of which were consolidated in 2004 and 2003. The Company records the minority interests' share in the earnings of the respective Sino-foreign joint ventures for each period. Since the Company does not own the same equity interest in each Sino-foreign joint venture, a



comparison of the Company's consolidated results of operations for different periods can be significantly affected by the performance mix of the individual joint ventures. The minority interests' aggregate share in the earnings of the Sino-foreign joint ventures decreased in 2004 as compared to 2003 primarily as a result of a decrease in net income from Henglong, a 42%-owned Sino-foreign joint venture, and an increase in net income from Jiulong, an 81%-owned Sino-foreign joint venture.

Net Income (Loss). Net income was $1,013,789 for the three months ended March 31, 2004, as compared to a net loss of $34,098 for the three months ended March 31, 2003.

Financial Condition - March 31, 2004:

Liquidity and Capital Resources:

The Company has relied primarily on cash flow from operations, bank loans and advances and investments from its shareholders for its capital requirements since inception.

Operating. The Company's operations utilized cash of $1,176,454 for the three months ended March 31, 2004, as compared to providing cash of $3,704,271 for the three months ended March 31, 2003. The Company's operations utilized cash in 2004 as a result of cash utilized for advance payments and inventories.

At March 31, 2004, cash and cash equivalents were $14,161,563, as compared to $10,730,882 at December 31, 2003. Working capital was $21,511,665 at March 31, 2004, as compared to $19,944,120 at December 31, 2003, reflecting current ratios of 1.37:1 and 1.39:1, respectively.

The Company anticipates that its working capital resources are adequate to fund anticipated costs and expenditures through the remainder of the year ending December 31, 2004.

Investing. During the three months ended March 31, 2004, the Company expended $2,389,450 in investing activities, consisting of an increase in other receivables of $982,233 and payments to acquire fixed assets of $1,407,217. During the three months ended March 31, 2003, the Company expended $1,920,440 in investing activities, consisting of an increase in other receivables of $1,241,873 and payments to acquire fixed assets of $678,567.

Financing. During the three months ended March 31, 2004, the Company generated $6,996,585 from financing activities, consisting of bank loans of $3,975,904, advances from shareholders/directors of $2,664,289 and contributions to capital

by minority interest holders of $1,561,211, less a decrease in a liability related to the acquisition of joint venture assets of $1,204,819. During the three months ended March 31, 2003, the Company generated $2,280,367 from financing activities, consisting of bank loans of $1,204,819 and advances from shareholders/directors of $1,443,067, less dividends paid of $367,519.

During the three months ended March 31, 2003, amounts due to shareholders/directors aggregating $17,167,000 were cancelled. This transaction was accounted for as a contribution to capital.

Advances from shareholders/directors have been used to fund the Company's investments in joint ventures.

Off-Balance Sheet Arrangements:

At March 31, 2004, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

Commitments and Contingencies:

The Company has the following material contractual obligations and capital expenditure commitments:



During October 2003, Henglong, one of the Company's Sino-foreign joint ventures, signed an agreement with the management council of Wuhu Science and Technology Zone to invest $10,000,000 to develop an industrial enterprise to carry out automobile component projects related to power steering systems. The agreement does not specify a time limit. The Company plans to invest in phases over a five year period. The Company plans to invest approximately $870,000 in the first phase to acquire land rights, which will be completed during 2004. The Company advanced approximately $435,000 during 2003 pursuant to the agreement under the first phase. This new plant is expected to service a large vehicle manufacturer in Wuhu at reduced transportation and storage costs.

During March 2003, Henglong signed a purchase and construction agreement with Wuhan Huazhong Shuguang Software Park Co., Ltd. for $4,820,000 to design and construct a software research and development facility. This facility will design software and other products for the automobile. The Company paid $2,421,300 during 2003. According to the agreement, the Company will pay an additional $952,900 during 2004 and pay off the remaining $1,445,800 after it receives a license for the right to use the land and a building property certificate. This new software research and development facility will be located in an area of Hubei Province that contains ten well-known universities and a large vehicle manufacturer.

On October 29, 2001, Henglong entered into a ten year license agreement with Bishop Steering Technology Limited ("Bishop"), an Australian company engaged in the design of power steering systems. Pursuant to the agreement, Henglong is obligated to pay Bishop an annual technical assistance fee of approximately $200,000 per year during the first two years of the agreement and $110,000 per year during the remaining eight years of the agreement, and a royalty to be determined.

On July 21, 2003, Henglong entered into a five year license and technical assistance agreement with Namyang Industrial Co. Ltd. ("Namyang"), a Korean company engaged in the manufacture of steering columns and universal joint assemblies for automobiles. Pursuant to the agreement, Henglong paid Namyang an initial payment of $100,000 and is further obligated to pay a royalty of 3% of

the sales price of products sold that include the licensed technology.

On October 20, 2003, Henglong entered into a contract to purchase a land use right relating to parcel of land for $3,680,000 and paid a $361,000 deposit. This transaction is expected to close in 2004.

On October 5, 2003, Henglong entered into a letter of intent for a joint venture with Advanced Custom Sensors, Inc. to develop a sensor production facility in Wuhan, China. Pursuant to the letter of intent, Henglong will be responsible for initial loans and payments of $500,000, payable in two installments of $250,000, to be used for the development of related products, the training of personnel, and other operating costs. The first payment of $250,000 was made on February 12, 2004. The Company expects to make the second payment of $250,000 during 2004.

Inflation and Currency Matters:

In the most recent decade, the Chinese economy has experienced periods of rapid economic growth as well as relatively high rates of inflation, which in turn has resulted in the periodic adoption by the Chinese government of various corrective measures designed to regulate growth and contain inflation. The success of the Company depends in substantial part on the continued growth and development of the Chinese economy.

Foreign operations are subject to certain risks inherent in conducting business abroad, including price and currency exchange controls, and fluctuations in the relative value of currencies. The Company conducts virtually all of its business in China and, accordingly, the sale of its products is settled primarily in RMB. As a result, devaluation or currency fluctuation of the RMB against the USD would adversely affect the Company's financial performance when measured in USD.

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Although prior to 1994 the RMB experienced significant devaluation against the USD, the RMB has remained fairly stable since then. In addition, the RMB is not freely convertible into foreign currencies, and the ability to convert the RMB is subject to the availability of foreign currencies. Effective December 1, 1998, all foreign exchange transactions involving the RMB must take place through authorized banks or financial institutions in China at the prevailing exchange rates quoted by the People's Bank of China.

As China has recently been admitted as a member of the World Trade Organization, the central government of China is expected to adopt a more rigorous approach to partially deregulate currency conversion restrictions, which may in turn increase the exchange rate fluctuation of the RMB. Should there be any major change in the central government's currency policies, the Company does not believe that such an action would have a detrimental effect on the Company's operations, since the Company conducts virtually all of its business in China, and the sale of its products is settled in RMB.

Although prior to 1994 the RMB experienced significant devaluation against the USD, the RMB has remained fairly stable since then. The exchange rate was approximately US$1.00 to RMB 8.30 at December 31, 2002 and 2003.

Quantitative and Qualitative Disclosures about Market Risk:

The Company does not have any market risk with respect to such factors as commodity prices, equity prices, and other market changes that affect market

risk sensitive investments. A 10 point basis change in the Company's average debt interest rate would not have a material effect on the Company's results of operations.

With respect to foreign currency exchange rates, the Company does not believe that a devaluation or fluctuation of the RMB against the USD would have a detrimental effect on the Company's operations, since the Company conducts virtually all of its business in China, and the sale of its products and the purchase of raw materials and services are settled in RMB. The effect of a devaluation or fluctuation of the RMB against the USD would affect the Company's results of operations, financial position and cash flows, when presented in USD (based on a current exchange rate) as compared to RMB.

As the Company's debt obligations are primarily short-term in nature, with fixed interest rates, the Company does not have any risk from an increase in market interest rates. However, to the extent that the Company arranges new borrowings in the future, an increase in market interest rates would cause a commensurate increase in the interest expense related to such borrowings.



ITEM 3. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports filed or submitted under the Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports filed under the Exchange Act of 1934 is accumulated and communicated to management, including its principal executive and financial officers, as appropriate, to allow timely decisions regarding required disclosure.

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its principal executive and financial officers, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered

by this report. Based upon and as of the date of that evaluation, the Company's principal executive and financial officers concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports the Company files and submits under the Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

(b) Changes in Internal Controls

There were no changes in the Company's internal controls or in other factors that could have significantly affected those controls subsequent to the date of the Company's most recent evaluation.



PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

A list of exhibits required to be filed as part of this report is set forth in the Index to Exhibits, which immediately precedes such exhibits, and is incorporated herein by reference.

(b) Reports on Form 8-K

Three Months Ended March 31, 2004: None



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.
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(Registrant)

DATE: May 19, 2004

By: /s/ HANLIN CHEN
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Hanlin Chen
President and Chief
Executive Officer

DATE: May 19, 2004

By: /s/ DAMING HU
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Daming Hu
Chief Financial Officer



INDEX TO EXHIBITS

| Exhibit Number | Description of Document |
|---|---|
| 31.1 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Hanlin Chen |
| 31.2 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Daming Hu |
| 32 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |