

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)

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 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 No

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

Non-accelerated filer (Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

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

Yes No

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

CHINA AUTOMOTIVE SYSTEMS, INC.
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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

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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 Paid-in Capital	Retained Earnings		Deferred stock Compensation	Accumulated Other Comprehensive Income (Loss)	Non-controlling interests	Total
	Shares	Par value		Appropriated	Unappropriated				
Balance at December 31, 2007	23,959,702	\$ 2,396	\$ 30,125,951	\$ 7,525,777	\$ 23,591,275	\$ —	\$ 5,989,463	\$ 23,166,270	\$ 90,401,132
Net income for the year ended December 31, 2008	—	—	—	—	12,435,241	—	—	5,071,408	17,506,649
Foreign currency translation gain	—	—	—	—	—	—	5,138,042	1,432,977	6,571,019
Capital contribution	—	—	—	—	—	—	—	745,723	745,723
Issuance of common stock	3,023,542	302	22,089,698	—	—	—	—	—	22,090,000
Issuance of stock options	—	—	—	—	—	—	—	—	—
Independent directors and management	-	-	845,478	—	—	(500,052)	—	—	345,426
Payment for acquisition of 35.5% of Senglong's equity	-	-	(25,912,921)	—	—	—	—	(6,177,079)	(32,090,000)
Dividend distribution	—	—	—	—	—	—	—	(1,016,733)	(1,016,733)
Balance at December 31, 2008	26,983,244	\$ 2,698	\$ 27,148,206	\$ 7,525,777	\$ 36,026,516	\$ (500,052)	\$ 11,127,505	\$ 23,222,566	\$ 104,553,211
Net income for the year ended March 31, 2009	—	—	—	—	2,258,812	—	—	1,383,697	3,642,509
Foreign currency translation gain (loss)	—	—	—	—	—	—	(10,163)	(4,416)	(14,579)

Dividend										
Distribution										
Balance at										
March 31,										
2009	26,983,244	\$ 2,698	\$ 27,148,206	\$ 7,702,835	\$ 38,108,270	\$ (500,052)	\$ 11,117,342	\$ 23,120,185	\$ 106,699,488	

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.

Name of Entity	Percentage Interest	
	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