

CHINA AUTOMOTIVE SYSTEMS INC
Form 10-Q
August 10, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

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

For the quarterly period ended June 30, 2006

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

(IRS 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 June 30, 2006, the Company had 23,274,495 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 June 30, | |
|---|------------------------------------|---------------|
| | 2006 | 2005 |
| Net sales from continued operations, including \$794,200 and \$544,935 to related parties at June 30, 2006 and 2005, respectively | \$ 24,747,912 | \$ 16,763,309 |
| Cost of sales, including \$674,207 and \$490,032 purchased from related parties at June 30, 2006 and 2005, respectively | 15,476,767 | 10,796,558 |
| Gross profit | 9,271,145 | 5,966,751 |
| Costs and expenses: | | |
| Selling | 1,699,118 | 1,716,305 |
| General and administrative (See Note 15) | 3,039,936 | 1,602,040 |
| R&D expenses (See Note 15) | 251,394 | 138,239 |
| Depreciation and amortization (See Note 15) | 1,253,604 | 769,950 |
| Stock-Based Compensation | — | 68,850 |
| Total costs and expenses | 6,244,052 | 4,295,384 |
| Income from operations | 3,027,093 | 1,671,367 |
| Other income (expenses): | | |
| Other non-operating income | 117,887 | 31,702 |
| Financial expenses | (177,477) | (324,368) |
| Other income (loss), net | (59,590) | (292,666) |
| Income before income taxes | 2,967,503 | 1,378,701 |
| Income taxes | 850,739 | 302,361 |
| Income before minority interests | 2,116,764 | 1,076,340 |
| Minority interests | 1,365,128 | 574,286 |
| Net income | \$ 751,636 | \$ 502,054 |
| Basic | \$ 0.03 | \$ 0.02 |
| Diluted | \$ 0.03 | \$ 0.02 |
| Weighted average number of common shares outstanding - | | |
| Basic | 23,254,121 | 22,574,542 |
| Diluted | 23,267,235 | 22,577,958 |

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

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

| | Six Months Ended June 30, | |
|---|----------------------------------|---------------|
| | 2006 | 2005 |
| Net sales from continued operations, including \$1,377,739 and \$999,860 to related parties at June 30, 2006 and 2005, respectively | \$ 45,712,364 | \$ 30,739,759 |
| Cost of sales, including \$1,330,202 and \$895,788 purchased from related parties at June 30, 2006 and 2005, respectively | 29,496,022 | 19,742,667 |
| Gross profit | 16,216,342 | 10,997,092 |
| Costs and expenses: | | |
| Selling | 2,608,970 | 2,390,373 |
| General and administrative (See Note 15) | 5,660,110 | 3,372,325 |
| R&D expenses (See Note 15) | 441,141 | 495,948 |
| Depreciation and amortization (See Note 15) | 1,942,094 | 1,384,771 |
| Stock-Based Compensation | — | 68,850 |
| Total costs and expenses | 10,652,315 | 7,712,267 |
| Income from operations | 5,564,027 | 3,284,825 |
| Other income (expenses): | | |
| Other non-operating income | 201,227 | 57,021 |
| Financial expenses | (511,863) | (607,601) |
| Other income (loss), net | (310,636) | (550,580) |
| Income before income taxes | 5,253,391 | 2,734,245 |
| Income taxes | 1,051,450 | 553,323 |
| Income before minority interests | 4,201,941 | 2,180,922 |
| Minority interests | 2,355,907 | 812,685 |
| Net income | \$ 1,846,034 | \$ 1,368,237 |
| Basic | \$ 0.08 | \$ 0.06 |
| Diluted | \$ 0.08 | \$ 0.06 |
| Weighted average number of common shares outstanding - | | |
| Basic | 22,969,051 | 22,574,542 |
| Diluted | 22,987,095 | 22,594,005 |

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

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

| | Three Months Ended June 30, | |
|-----------------------------------|------------------------------------|--------------|
| | 2006 | 2005 |
| Net income | \$ 751,636 | \$ 502,054 |
| Other comprehensive income: | | |
| Foreign currency translation gain | — | — |
| Comprehensive income | \$ 751,636 | \$ 502,054 |
| | Six Months Ended June 30, | |
| | 2006 | 2005 |
| Net income | \$ 1,846,034 | \$ 1,368,237 |
| Other comprehensive income: | | |
| Foreign currency translation gain | 601,399 | — |
| Comprehensive income | \$ 2,447,433 | \$ 1,368,237 |

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

China Automotive Systems, Inc.
Condensed Consolidated Balance Sheets

| | June 30, 2006 (Unaudited) | December 31, 2005 |
|---|---------------------------------|-----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 19,792,500 | \$ 12,374,944 |
| Pledged cash deposits | 1,847,417 | 1,185,660 |
| Accounts and notes receivable, including \$3,674,374 and \$1,829,075 from related parties at June 30, 2006 and December 31, 2005, respectively, net of an allowance for doubtful accounts of \$3,266,725 and \$2,856,025 at June 30, 2006 and December 31, 2005, respectively | 53,019,759 | 41,580,320 |
| Advance payments, including \$898,528 and \$911,765 to related parties at June 30, 2006 and December 31, 2005, respectively | 3,193,548 | 2,126,013 |
| Inventories | 14,752,795 | 12,385,833 |
| Total current assets | 92,606,019 | 69,652,770 |
| Long-term Assets: | | |
| Property, plant and equipment | 52,961,939 | 52,081,669 |
| Less: Accumulated depreciation | (15,074,532) | (12,285,636) |
| | 37,887,407 | 39,796,033 |
| Intangible assets, net | 3,226,153 | 3,503,217 |
| Other receivables, including \$5,971,220 and \$3,966,509 from related parties at June 30, 2006 and December 31, 2005, respectively, net of an allowance for doubtful accounts of \$1,936,790 and \$1,040,169 at June 30, 2006 and December 31, 2005, respectively | 5,467,643 | 6,503,629 |
| Long-term investments | 74,074 | 74,074 |
| Total assets | \$ 139,261,296 | \$ 119,529,723 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Bank loans | \$ 16,229,713 | \$ 14,814,815 |
| Accounts and notes payable, including \$331,359 and \$383,578 to related parties at June 30, 2006 and December 31, 2005, respectively | 35,496,530 | 31,375,599 |
| Customer deposits | 766,968 | 157,919 |
| Accrued payroll and related costs | 1,466,593 | 1,418,093 |
| Accrued expenses and other payables | 6,113,482 | 5,191,617 |
| Accrued pension costs | 2,833,938 | 2,653,064 |
| Taxes payable | 5,248,377 | 4,172,212 |
| Amounts due to shareholders/directors | 315,504 | 766,642 |
| Total current liabilities | 68,471,105 | 60,549,961 |
| Long-term liabilities: | | |
| Advances payable | 301,552 | 301,614 |

| | | | | |
|---|----|-------------|----|-------------|
| Total liabilities | \$ | 68,772,657 | \$ | 60,851,575 |
| Minority interests | | 26,150,442 | | 21,751,043 |
| 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- | | | | |
| 23,274,495 shares and 22,574,543 shares at June 30, 2006 and December | | | | |
| 31, 2005, respectively | | 2,327 | | 2,257 |
| Additional paid-in capital | | 23,110,311 | | 18,146,722 |
| Retained earnings- | | | | |
| Appropriated | | 5,078,584 | | 4,923,262 |
| Unappropriated | | 14,212,892 | | 12,522,180 |
| Accumulated other comprehensive income | | 1,934,083 | | 1,332,684 |
| Total stockholders' equity | | 44,338,197 | | 36,927,105 |
| Total liabilities and stockholders' equity | \$ | 139,261,296 | \$ | 119,529,723 |

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

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

| | Three Months Ended June 30, | |
|--|------------------------------------|--------------------|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net income | \$ 751,636 | \$ 502,054 |
| Adjustments to reconcile net income from continuing operations to net cash provided by operating activities: | | |
| Minority interests | 1,365,128 | 574,286 |
| Stock-based compensation | — | 68,850 |
| Depreciation and amortization | 1,880,846 | 1,234,198 |
| Allowance for doubtful accounts | 576,977 | 103,760 |
| Changes in operating assets and liabilities: | | |
| Increase (decrease) in: | | |
| Pledged cash deposits | 1,679,246 | (139,423) |
| Accounts and notes receivable | (6,743,654) | 1,949,942 |
| Advance payments | (910,362) | (936,827) |
| Inventories | (1,158,465) | (2,112,833) |
| Increase (decrease) in: | | |
| Accounts and notes payable | (5,627,862) | 2,626,270 |
| Customer deposits | 550,332 | (129,414) |
| Accrued payroll and related costs | (84,044) | 21,757 |
| Accrued expenses and other payables | 717,862 | 314,563 |
| Accrued pension costs | 65,310 | 402,908 |
| Taxes payable | 201,171 | (465,907) |
| Advances payable | (62) | — |
| Net cash provided by (used in) operating activities | (6,735,941) | 4,014,184 |
| Cash flows from investing activities: | | |
| (Increase) decrease in other receivables | 1,726,035 | (1,123,711) |
| Cash paid to acquire property, plant and equipment | (299,718) | (1,674,042) |
| Cash paid to acquire intangible assets | (1,224) | (118,527) |
| Cash received from other investing activities | 3,920 | — |
| Net cash provided by (used in) investing activities | 1,429,013 | (2,916,280) |
| Cash flows from financing activities: | | |
| Increase (decrease) in proceeds from bank loans | 2,496,879 | (3,012,048) |
| Dividends be paid to the minority interest holders of Joint-venture companies | (614,742) | — |
| Increase (decrease) in amounts due to shareholders/directors | (365,120) | (3,060) |
| Proceeds from issuance of common stock | 19,740 | — |
| Capital Contribution from the minority interest holders of Joint-venture companies | 1,422,075 | — |
| Net cash provided by (used in) financing activities | 2,958,832 | (3,015,108) |

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| | | |
|--|---------------|---------------|
| Increase (decrease) in cash and cash equivalents | (2,348,096) | (1,917,204) |
| Cash and cash equivalents at beginning of period | 22,140,596 | 12,972,439 |
| Cash and cash equivalents at end of period | \$ 19,792,500 | \$ 11,055,235 |

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

| | Three Months Ended June 30, | |
|--|------------------------------------|-------------|
| | 2006 | 2005 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | \$ 154,787 | \$ 95,905 |
| Cash paid for income taxes | \$ 556,212 | \$ 457,845 |

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

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

| | Six Months Ended June 30, | |
|--|----------------------------------|--------------|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net income | \$ 1,846,034 | \$ 1,368,237 |
| Adjustments to reconcile net income from continuing operations to net cash provided by operating activities: | | |
| Minority interests | 2,355,907 | 812,685 |
| Stock-based compensation | — | 68,850 |
| Depreciation and amortization | 3,334,319 | 2,292,439 |
| Allowance for doubtful accounts | 1,263,545 | 197,321 |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in: | | |
| Pledged deposits | (661,757) | (1,023,340) |
| Accounts and notes receivable | (11,818,049) | 3,874,257 |
| Advance payments | (1,067,535) | (2,508,300) |
| Inventories | (2,366,961) | (2,028,977) |
| Increase (decrease) in: | | |
| Accounts and notes payable | 4,120,931 | 1,771,307 |
| Customer deposits | 609,049 | (74,350) |
| Accrued payroll and related costs | 48,500 | 21,493 |
| Accrued expenses and other payables | 2,282,869 | (312,355) |
| Accrued pension costs | 180,874 | 654,136 |
| Taxes payable | 1,076,165 | (200,424) |
| Advances payable | (62) | (156) |
| Net cash provided by (used in) operating activities | 1,203,829 | 4,912,823 |
| Cash flows from investing activities: | | |
| (Increase) decrease in other receivables | 94,383 | (1,265,964) |
| Cash paid to acquire property, plant and equipment | (952,502) | (2,226,932) |
| Cash paid to acquire intangible assets | (139,462) | (194,145) |
| Cash received from other investing activities | 3,920 | — |
| Net cash provided by (used in) investing activities | (993,661) | (3,687,041) |
| Cash flows from financing activities: | | |
| Increase (decrease) in proceeds from bank loans | 1,414,898 | (602,410) |
| Dividends be paid to the minority interest holders of Joint-venture companies | (739,586) | (787,321) |
| Increase (decrease) in amounts due to shareholders/directors | (451,138) | 54,545 |
| Proceeds from issuance of common stock | 4,959,740 | — |
| Capital Contribution from the minority interest holders of Joint-venture companies | 1,422,075 | — |
| Net cash provided by (used in) financing activities | 6,605,989 | (1,335,186) |
| Effect of exchange rate fluctuations on cash and cash equivalents | 601,399 | — |

| | | |
|--|---------------|---------------|
| Increase (decrease) in cash and cash equivalents | 7,417,556 | (109,404) |
| Cash and cash equivalents at beginning of period | 12,374,944 | 11,164,639 |
| Cash and cash equivalents at end of period | \$ 19,792,500 | \$ 11,055,235 |

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

| | Six Months Ended June 30, | |
|---|----------------------------------|-------------|
| | 2006 | 2005 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | \$ 347,886 | \$ 381,283 |
| Cash paid for income taxes | \$ 686,927 | \$ 673,345 |
| SUPPLEMENTAL DISCLOSURE OF INVESTING AND FINANCING ACTIVITIES ON A CASHLESS BASIS: | | |
| Issuance of common shares on a cashless basis | \$ 4 | \$ — |
| Financing services fee related to issuance of common shares | \$ (4) | \$ — |
| Increase in capital by minority shareholder of Joint-venture | \$ 921,784 | \$ — |

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

China Automotive Systems, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2006

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization - Effective March 5, 2003, Visions-In-Glass, Inc., a United States 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 former 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 \$320,000 to the former officer, director and controlling shareholder of Visions in two installments for the cancellation of 17,424,750 shares of common stock.

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 remained unchanged subsequent to the transaction date. Accordingly, the pre-transaction financial statements of Great Genesis are the historical financial statements of the Company.

As of June 30, 2006 and 2005, Great Genesis owns the following aggregate net interests in seven Sino-foreign Joint-ventures organized in the PRC:

| Name of Entity | Percentage Interest | |
|--|---------------------|-------|
| | 2006 | 2005 |
| Shashi Jiulong Power Steering Co. Limited ("Jiulong") | 81.0% | 81.0% |
| Jingzhou Henglong Automotive Parts Co. Limited ("Henglong") | 44.5% | 44.5% |
| Shenyang Jinbei Henglong Automotive Steering System Co. Limited ("Shenyang") | 70.0% | 70.0% |
| Zhejiang Henglong & Vie Pump-Manu Co. Limited ("Zhejiang") | 51.0% | 51.0% |
| Universal Sensor Application, Inc. ("USAI") | 60.0% | 60% |

| | | |
|---|--------|---|
| Wuhan Jielong Electric Power Steering Co., Ltd. (“Jielong”) | 85.0% | — |
| Wuhu HengLong Auto Steering System Co., Ltd. (“Wuhu”) | 77.33% | — |

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

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

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.

On April 12, 2005, the wholly-owned subsidiary of the company, Great Genesis entered into a Joint-venture agreement with Shanghai Hongxi Investment Inc., "Hongxi", a company controlled by Mr. Hanlin Chen, the Company's Chairman, and Sensor System Solution Inc., "Sensor", to establish a joint venture, Universal Sensor Application Inc., "USAI", in the Wuhan East Lake development zone. The registered capital of the Joint-venture is \$10 million. Great Genesis and Hongxi will invest \$6 million and \$1 million, respectively, including cash and land and building, which will account for 60% and 10% of the total registered capital, respectively. Sensor invested \$3 million in technology, accounting for 30% of the total registered capital. The registered capital is required to be paid in three installments within one year after signing of the Joint-venture agreement, April 12, 2005. As of June 30, 2006, Great Genesis and Sensor have contributed \$900,337, the equivalent of RMB7,200,000 and \$3,000,000 respectively, including cash and technology. Hongxi has contributed \$436,954 in cash, the equivalent of RMB3,500,000.

On April 14, 2006, the wholly-owned subsidiary of the company, Great Genesis entered into a Joint-venture agreement with Hong Kong Tongda, "Tongda", to establish a joint venture, Wuhan Jielong Electric Power Steering Co., Ltd., "Jielong", in the Wuhan East Lake development zone. Jielong is mainly engaged in the production and sales of electric power steering, "EPS". The registered capital of the Joint-venture is \$6 million, the equivalent of RMB48,000,000. Great Genesis and Tongda will invest \$5,100,000 and \$900,000, respectively, amounting to 85% and 15% of the total registered capital, respectively. As of June 30, 2006, Great Genesis and Tongda have contributed \$766,146 and \$135,034 in cash, the equivalent of RMB6,120,000 and RMB1,080,000 respectively.

On March 31, 2006, as amended on May 2, 2006, Great Genesis, the wholly-owned subsidiary of the Company, entered into a Joint-venture agreement with Wuhu Chery Technology Co., Ltd., "Chery Technology", to establish a Joint-venture, Wuhu Henglong Automotive Steering System Co., Ltd in the Wuhu Technological Development Zone. Wuhu is mainly engaged in the production and sales of automobile steering system. The registered capital of the Joint-venture is \$3,750,387, the equivalent of RMB30,000,000. Great Genesis and Chery Technology will invest \$2,900,300 and \$850,087, respectively, which will account for 77.33% and 22.67% of the total registered capital, respectively. As of June 30, 2006, the capital of \$3,750,387, the equivalent of RMB30,000,000, has been totally contributed in Wuhu.

Basis of Presentation - For the three months ended June 30, 2006 and 2005, the accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. The subsidiaries include the seven Sino-foreign Joint-ventures mentioned in Note 1. Significant inter-company balances and transactions have been eliminated upon consolidation. The 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 (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.

Exchange rate used in translating the financial statements of the Company from its functional currency, "Renminbi", into its reporting currency, "US Dollars":

| Reporting Period | Renminbi | US Dollars |
|--|-----------------|-------------------|
| Prior to July 1, 2005 | 1 | 0.1205 |
| From July 1, 2005 to December 31, 2005 | 1 | 0.1233 |
| From January 1, 2006 to June 30, 2006 | 1 | 0.1248 |

Comments - The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of management of the Company, contain all adjustments, which include normal recurring adjustments, necessary to present fairly the financial position, the results of operations and cash flows for the three months and six months ended June 30, 2006.

The consolidated balance sheet as of December 31, 2005 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 2005 Annual Report on Form 10-K, 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 and six months ended June 30, 2006 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2006.

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 assuming the issuance of common shares, if dilutive, resulting from the exercise of warrants.

Actual weighted average shares outstanding used in calculating basic and diluted earnings (loss) per share were:

| | Three Months Ended June 30, | |
|-------------------------------------|------------------------------------|-------------|
| | 2006 | 2005 |
| Weighted average shares outstanding | 23,254,121 | 22,574,542 |
| Effect of dilutive securities | 13,114 | 3,416 |
| Diluted shares outstanding | 23,267,235 | 22,577,958 |

| | Six Months Ended June 30, | |
|-------------------------------------|----------------------------------|-------------|
| | 2006 | 2005 |
| Weighted average shares outstanding | 22,969,051 | 22,574,542 |
| Effect of dilutive securities | 18,044 | 19,463 |
| Diluted shares outstanding | 22,987,095 | 22,594,005 |

The 156,250 shares underlying warrants issued to Cornell Capital Partners, LP on March 20, 2006 has not been included in the computation of diluted earnings (loss) per share because such inclusion would have had an anti-dilutive effect:

| | Three Months Ended June 30, | |
|--------------------------|------------------------------------|-------------|
| | 2006 | 2005 |
| Anti-dilutive securities | 119,389 | — |

| | Six Months Ended June 30, | |
|--------------------------|----------------------------------|-------------|
| | 2006 | 2005 |
| Anti-dilutive securities | 109,206 | — |

Stock-Based Compensation - 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.

A summary of option activities under the plans to June 30, 2006 was as follows:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Contractual Term (years) |
|---|---------|------------------------------------|---|
| Granted to independent directors, July 21, 2004 | 22,500 | \$ 4.50 | 2 |
| Balance, December 31, 2004 | 22,500 | \$ 4.50 | 2 |
| Granted to independent directors, June 28, 2005 | 22,500 | \$ 6.83 | 5 |
| Balance, December 31, 2005 | 45,000 | \$ 5.67 | 3.5 |
| Granted to investors, March 20, 2006 | 86,806 | \$ 14.40 | 3 |
| Granted to investors, March 20, 2006 | 69,444 | \$ 18.00 | 3 |
| Exercised, May 17, 2006 | (7,500) | \$ 4.50 | — |
| Balance, June 30, 2006 | 193,750 | \$ 14.04 | 3.2 |

The characteristics of outstanding stock options at June 30, 2006 were as follows:

| Exercise Price | Outstanding Options Remaining Life | | Exercisable Options | |
|----------------|--|---------|---------------------|----------------|
| | Shares | (Years) | Shares | Exercise Price |
| \$ 4.50 | 15,000 | 0.06 | 15,000 | \$ 4.50 |
| 6.83 | 22,500 | 3.99 | 22,500 | 6.83 |
| 14.40 | 86,806 | 2.22 | — | — |
| \$ 18.00 | 69,444 | 2.22 | — | \$ — |

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 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.

The weighted-average fair value of options granted during the periods 2006, 2005 and 2004 was \$5.30, \$3.06 and \$2.45, respectively. The fair value of each option grant was estimated on the date of grant using option valuation model and assumptions noted in the table:

| | 2006 | 2005 | 2004 |
|-----------------------|-------|-------|--------|
| Expected volatility | 82.0% | 46.0% | 121.6% |
| Risk-free rate | 4.7% | 3.6% | 4.0% |
| Expected term (years) | 3 | 5 | 2 |
| Dividend yield | 0.0% | 0.0% | 0.0% |

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.

On March 20, 2006, the Company issued 37,863 shares of common stock to Cornell Capital Partners, LP and a placement agent, collectively at an exercise price of \$11.885 per share as a commitment fee and a placement agent fee in connection with the establishment of a \$15,000,000 equity line of credit under a Standby Equity Distribution Agreement with Cornell Capital Partners, LP.

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.

For the three months and six months ended June 30, 2006, the Company's only component of other comprehensive income is foreign currency translation gain of \$0 and \$601,399. These amounts have been recorded as a separate component of stockholders' equity. The Company did not have any other comprehensive income during three months and six months ended June 30, 2005.

Reclassifications —certain reclassifications have been made to the Consolidated Statement of Operations for the three months and six months ended June 30, 2005 to conform to the current year presentation. (See Note 15)

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.

The economy of the PRC differs significantly from the economies of the “western” industrialized nations in 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 the 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 been, for many years, 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 such as the level of exchange rate, 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 RMB against the United States dollar would 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 July 21, 2005, the People's Bank of China changed its exchange rate system from its previous fixed exchange rate announced on January 1, 1994 to a unitary and well-managed floating exchange rate based on market supply and demand. No representation is made that the RMB amounts could be freely converted into 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 submission of a payment application form together with suppliers' invoices, shipping documents and signed contracts.

3. RECENT ACCOUNTING PRONOUNCEMENTS

In 2003, the FASB issued SFAS No. 132R, "Employers' Disclosures about Pensions and Other Postretirement Benefits (Revised in December 2003)"—an amendment of FASB Statements No. 87, 88, and 106 (Issued 12/03). This Statement revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by FASB Statements No. 87, Employers' Accounting for Pensions, No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, and No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions. SFAS 132R is effective for fiscal years beginning after December 15, 2003. The adoption of SFAS No. 132R did not have a significant effect on the Company's financial statement presentation or disclosures.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs—An Amendment of Accounting Research Bulletin No. 43, Chapter 4" (SFAS 151). SFAS 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be expensed as incurred and not included in overhead as an inventory cost. The new statement also requires that allocation of fixed production overhead costs to conversion costs should be based on normal capacity of the production facilities. The provisions in SFAS 151 must be applied prospectively and became effective for the Company beginning January 1, 2006. The Company adopted this statement beginning in the first quarter of 2006.

In December 2004, the FASB issued SFAS No. 152 "Accounting for Real Estate Time-Sharing Transactions - an amendment of FASB Statements No. 66 and 67" ("SFAS 152"). This statement amends FASB Statement No. 66 "Accounting for Sales of Real Estate" to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in AICPA Statement of Position 04-2 "Accounting for Real Estate Time-Sharing Transactions" ("SOP 04-2"). SFAS 152 also amends FASB Statement No. 67 "Accounting for Costs and Initial Rental operations of Real Estate Projects" to state that the guidance for incidental operations and costs incurred to sell real estate projects does not apply to real estate time-sharing transactions, with the accounting for those operations and costs being subject to the guidance in SOP 04-2. The provisions of SFAS 152 are effective in fiscal years beginning after June 15, 2005. The Company adopted this statement beginning in the first quarter of 2006.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), "Share-Based Payment" (SFAS 123R). This statement requires financial statement recognition of compensation cost related to share-based payment transactions. Share-based payment transactions within the scope of SFAS 123R include stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee share purchase plans. The provisions of SFAS 123R are effective for the first fiscal year beginning after June 15, 2005. However, in April 2005, the SEC deferred the effective date of SFAS 123R for SEC registrants to the first interim period beginning after June 15, 2005. Accordingly, the Company adopted this statement beginning in the first quarter of 2006.

In December 2004, the FASB issued SFAS No. 153 "Exchanges of Nonmonetary Assets, an amendment of Accounting Principles Board Opinion No. 29" (SFAS 153). This statement amends Accounting Principles Board Opinion (APB) No. 29, "Accounting for Nonmonetary Transactions" to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that have no commercial substance. Under SFAS 153, if a nonmonetary exchange of similar productive assets meets a commercial-substance criterion and fair value is determinable, the transaction must be accounted for at fair value resulting in recognition of any gain or loss. SFAS 153 was effective for nonmonetary transactions in fiscal periods beginning after June 15, 2005. The Company adopted this statement beginning in the first quarter of 2006.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143" (FIN 47). Under FIN 47, we are required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Any uncertainty about the amount and/or timing of future settlement should be factored into the measurement of the liability when sufficient information exists. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value. The provisions of FIN 47 were required to be applied no later than the end of fiscal years ending after December 15, 2005. The Company adopted this statement beginning in the first quarter of 2006.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3" (SFAS 154). This statement changes the requirements for the accounting for and reporting of a change in accounting principle and applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. APB No. 20 required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. This statement requires retrospective application to prior period financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The provisions of SFAS 154 are effective for fiscal years beginning after December 15, 2005. The Company adopted this statement beginning in the first quarter of 2006.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments". This Statement amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. It also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company has not yet determined the impact of the adoption of SFAS No. 155 on its financial statements, if any.

In 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets". This Statement amends FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in indicated situations; requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; permits an entity to choose relevant subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value; and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. The adoption of SFAS No. 156 did not have a material impact on our Consolidated Financial Statements.

4. ACCOUNTS AND NOTES RECEIVABLE

The Company's accounts and notes receivable at June 30, 2006 (unaudited) and December 31, 2005 are summarized as follows:

| | June 30, 2006 | December 31, 2005 |
|---------------------------------------|--------------------------|------------------------------|
| Accounts receivable | \$ 37,729,888 | \$ 31,866,156 |
| Notes receivable | 18,556,596 | 12,570,189 |
| | 56,286,484 | 44,436,345 |
| Less: allowance for doubtful accounts | (3,266,725) | (2,856,025) |
| | \$ 53,019,759 | \$ 41,580,320 |

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

5. OTHER RECEIVABLES

The Company's other receivable at June 30, 2006 (unaudited) and December 31, 2005 are summarized as follows:

| | June 30, 2006 | December 31, 2005 |
|---|--------------------------|------------------------------|
| Other receivable, including \$5,971,220 and \$3,966,509 from related parties at June 30, 2006 and December 31, 2005, respectively | \$ 7,404,433 | \$ 7,543,798 |
| Less: allowance for doubtful accounts | (1,936,790) | (1,040,169) |
| | \$ 5,467,643 | \$ 6,503,629 |

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.

Included in other receivable from related parties as of June 30, 2006 were the following:

| Description | Advances Receivable |
|--|--------------------------------|
| Amounts advanced to related parties, controlled by Mr. Hanlin Chen, the Company's Chairman | \$ 4,488,910* |
| Amounts advanced to investee of Jiulong | 553,494** |
| Amounts advanced to minority shareholder of Joint-venture Companies | 928,816*** |
| Total | \$ 5,971,220 |

* This balance is non-interest bearing and will be due on demand on or before December 31, 2006.

**This amount is deemed uncollectible and the company has recorded an appropriate allowance for doubtful accounts.

*** This balance is non-interest bearing and will be due on demand on or before December 31, 2006.

6. INVENTORIES

Inventories at June 30, 2006 (Unaudited) and December 31, 2005 consisted of the following:

| | June 30, 2006 | December 31, 2005 |
|--------------------------|--------------------------|------------------------------|
| Raw materials | \$ 4,243,510 | \$ 3,025,467 |
| Work-in-process | 2,796,097 | 2,559,626 |
| Finished goods | 8,279,043 | 7,295,082 |
| | 15,318,650 | 12,880,175 |
| Less: provision for loss | (565,855) | (494,342) |
| | \$ 14,752,795 | \$ 12,385,833 |

7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 2006 (unaudited) and December 31, 2005 are summarized as follows:

| | June 30, 2006 | December 31, 2005 |
|--------------------------------|--------------------------|--------------------------|
| Land use rights and buildings | \$ 17,065,896 | \$ 16,825,598 |
| Machinery and equipment | 31,553,903 | 30,980,053 |
| Electronic equipment | 2,115,455 | 2,023,457 |
| Motor vehicles | 2,114,340 | 2,179,161 |
| Construction in progress | 112,345 | 73,400 |
| | 52,961,939 | 52,081,669 |
| Less: Accumulated depreciation | (15,074,532) | (12,285,636) |
| | \$ 37,887,407 | \$ 39,796,033 |

8. INTANGIBLE ASSETS

The activities in the Company's intangible asset account at June 30, 2006 (unaudited) and December 31, 2005 are summarized as follows:

| | June 30, 2006 | December 31, 2005 |
|--------------------------------------|--------------------------|------------------------------|
| Balance at beginning of year, | \$ 3,503,217 | \$ 392,552 |
| Add: Additions during the period - | | |
| Management software license | 61,798 | 3,147,867 |
| Mapping design software license | 38,301 | 93,827 |
| Foreign currency translation gain | 39,362 | 9,693 |
| | 3,642,678 | 3,643,939 |
| Less: Amortization during the period | (416,525) | (140,722) |
| Balance at the end of the period | \$ 3,226,153 | \$ 3,503,217 |

9. ACCOUNTS AND NOTES PAYABLE

Accounts and notes payable at June 30, 2006 (unaudited) and December 31, 2005 are summarized as follows:

| | June 30, 2006 | December 31, 2005 |
|------------------|--------------------------|------------------------------|
| Accounts payable | \$ 20,993,263 | \$ 15,615,402 |
| Notes payable | 14,503,267 | 15,760,197 |
| | \$ 35,496,530 | \$ 31,375,599 |

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

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

10. BANK LOANS

At June 30, 2006, the Company through its Sino-foreign Joint-ventures had outstanding fixed-rate short-term bank loans of \$16,229,713. The weighted average interest rate for the six months ended June 30, 2006 was 5.90% per annum. Henglong, one of the Company's joint ventures, provided Jiulong, another of the Company's Joint-ventures, with loan guarantees covering bank loans of \$6,242,197. The remaining bank loan of \$9,987,516 was secured by mortgages on certain plant and equipment of the Company.

At December 31, 2005, the Company through its Sino-foreign Joint-ventures had outstanding fixed-rate short-term bank loans of \$14,814,815. The weighted average interest rate for the year ended December 31, 2005 was 5.92% per annum. Jiulong, one of the Company's Joint-ventures, provided Henglong, another of the Company's Joint-ventures, with loan guarantees covering bank loans of \$3,086,420. Henglong provided Jiulong with loan guarantees covering bank loans of \$4,938,272. The remaining bank loan of \$6,790,123 was secured by mortgages on certain plant and equipment of the Company.

11. AMOUNTS DUE TO SHAREHOLDERS/DIRECTORS

The activities in the amounts due to shareholders/directors at June 30, 2006 (unaudited) and December 31, 2005 are summarized as follows:

| | |
|---------------------------------|------------|
| Balance, December 31, 2004 | \$ 589,594 |
| Cash advances from shareholders | 177,048 |
| Balance, December 31, 2005 | \$ 766,642 |
| Cash repaid to shareholder | (451,138) |
| Balance, June 30, 2006 | \$ 315,504 |

As of June 30, 2006 and December 31, 2005, the amounts due to shareholders/directors were unsecured, interest-free and repayable on demand.

12. MINORITY INTERESTS

The activities in respect of the amounts of the minority interests' equity at June 30, 2006 (unaudited) and December 31, 2005 are summarized as follows:

| | |
|---|---------------|
| Balance, December 31, 2004 | \$ 17,571,838 |
| Add: contribution by minority shareholders | 3,066,000 |
| Minority interests' income | 2,680,318 |
| Additional interest to the minority interest holders in connection with disposal of property, plant and equipment | \$ 93,168 |
| Less: dividends declared to the minority stockholders' equity of Joint-venture companies | (1,660,281) |
| Balance, December 31, 2005 | \$ 21,751,043 |
| Add: contribution by minority shareholders | 2,343,859 |
| Minority interests' income | 2,355,907 |
| Less: dividends paid to the minority stockholders' equity of Joint-venture companies | (300,367) |
| Balance, June 30, 2006 | \$ 26,150,442 |

On February 25, 2006, Jiulong, one of the Joint-ventures of the Company, held a meeting of the board and approved an increase in its capital stock of \$1,897,628, the equivalent of RMB15,200,000, of which the Company subscribed \$1,537,079, the equivalent of RMB12,312,000, and capital stock of \$360,548, the equivalent of RMB2,888,000, subscribed by the minority shareholder was deducted from dividends payable.

On February 25, 2006, Henglong, one of the Joint-ventures of the Company, held a meeting of the board and approved an increase in its capital stock of \$1,011,236, the equivalent of RMB8,100,000, of which the Company subscribed \$450,000, the equivalent of RMB3,604,500, and the capital stock of \$561,236, the equivalent of RMB4,495,500 subscribed by the minority shareholder was deducted from dividends payable.

On February 20, 2006, Shengyang, one of the Joint-ventures of the Company, held a meeting of the board and approved distribution of dividends of \$1,001,223, the equivalent of RMB 8,019,803, of which \$700,856, the equivalent of RMB4,900,599, was distributed to the Company and \$300,367, the equivalent of RMB3,119,204, was distributed to the minority shareholder.

On April 6, 2006, USAI, one of the Joint-ventures of the Company, its minority stockholders distributed capital stock of \$436,954 in cash, the equivalent of RMB3,500,000.

On April 14, 2006, the wholly-owned subsidiary of the company, Great Genesis entered into a Joint-venture agreement with Hong Kong Tongda, "Tongda", to establish a joint venture, Wuhan Jielong Electric Power Steering Co., Ltd., "Jielong", in the Wuhan East Lake development zone. As of June 30, 2006, Great Genesis and Tongda have contributed \$766,146 and \$135,034 in cash, the equivalent of RMB 6,120,000 and RMB 1,080,000 respectively.

On March 31, 2006, as amended on May 2, 2006, Great Genesis, the wholly-owned subsidiary of the Company, entered into a Joint-venture agreement with Wuhu Chery Technology Co., Ltd., "Chery Technology", to establish a Joint-venture, Wuhu Henglong Automotive Steering System Co., Ltd in the Wuhu Technological Development Zone. As of June 30, 2006, Great Genesis and minority stockholders have contributed \$2,900,300 and \$850,087 in cash, the equivalent of RMB23,200,000 and RMB6,800,000 respectively.

13. STOCKHOLDERS' EQUITY

The activities in respect of the amounts of the stockholders' equity at June 30, 2006 (unaudited) and December 31, 2005 are summarized as follows:

| | Common Stock Shares | Par Value | Preferred Stock Shares | Par Value | Additional Paid- in Capital |
|---|------------------------|-----------|---------------------------|-----------|--------------------------------|
| Balance, December 31, 2004 | 22,574,543 | \$ 2,257 | — | \$ — | —\$ 18,003,168 |
| Foreign currency translation gain | — | — | — | — | — |
| Deemed distribution to shareholders | — | — | — | — | 74,704 |
| Issuance of options for independent directors | — | — | — | — | 68,850 |
| Net income for the year ended December, 31, 2005 | — | — | — | — | — |
| Appropriation of retained earnings | — | — | — | — | — |
| Balance, December 31, 2005 | 22,574,543 | \$ 2,257 | — | \$ — | —\$ 18,146,722 |
| Issuance of common stock | 662,089 | 66 | — | — | 4,959,673 |
| Issuance of common shares related to financing services | 37,863 | 4 | — | — | (4) |
| Foreign currency translation gain | — | — | — | — | 3,920 |
| Net income for the period ended June 30, 2006 | — | — | — | — | — |

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| | | | | | | | | |
|------------------------|------------|----|-------|---|----|---|----|------------|
| Balance, June 30, 2006 | 23,274,495 | \$ | 2,327 | — | \$ | — | \$ | 23,110,311 |
|------------------------|------------|----|-------|---|----|---|----|------------|

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| | Retained Earnings | | Accumulated Other Comprehensive | Total |
|---|-------------------|----------------|---------------------------------------|---------------|
| | Appropriated | Unappropriated | Income (Loss) | |
| Balance, December 31, 2004 | \$ 4,396,339 | \$ 9,733,625 | \$ 3,060 | \$ 32,138,449 |
| Foreign currency translation gain | — | — | 1,329,624 | 1,329,624 |
| Deemed distribution to shareholders | — | — | — | 74,704 |
| Issuance of options for independent directors | — | — | — | 68,850 |
| Net income for the year ended December, 31, 2005 | — | 3,315,478 | — | 3,315,478 |
| Appropriation of retained earnings | 526,923 | (526,923) | — | — |
| Balance, December 31, 2005 | \$ 4,923,262 | \$ 12,522,180 | \$ 1,332,684 | \$ 36,927,105 |
| Sale of common stock | — | — | — | 4,959,740 |
| Issuance of common shares related to financing services | — | — | — | — |
| Foreign currency translation gain | — | — | 601,399 | 605,319 |
| Net income for the period ended June 30, 2006 | — | 1,846,034 | — | 1,846,034 |
| Appropriation of retained earnings | 155,322 | (155,322) | — | — |
| Balance, June 30, 2006 | \$ 5,078,584 | \$ 14,212,892 | \$ 1,934,083 | \$ 44,338,198 |

14. INCOME TAXES

The Company's Sino-foreign Joint-ventures are subject to PRC state and local income taxes at the applicable tax rate on the taxable income as reported in their PRC statutory financial statements in accordance with the relevant income tax laws applicable to foreign invested enterprises. In accordance with the Income Tax Law of the PRC for Enterprises with Foreign Investments and Foreign Enterprises, enterprises with foreign investments and foreign enterprises meeting certain criteria are entitled to full exemption from income tax for the first two years and a 50% reduction for the next three years, commencing from the first profit-making year after offsetting all tax losses carried forward from the previous five years.

Two of the Company's Sino-foreign Joint-ventures, Henglong and Jiulong, were subject to a tax rate of 15% during 2005 and 2006. Shenyang was entitled to and was certified for a two-year tax holiday commencing in 2003, the first profit-making year. Therefore, Shenyang was income tax exempted in 2004 and is subject to a tax rate of 7.5% in 2005 and 2006. The tax rate for Zhejiang has not yet been approved by tax authorities, but in accordance with the relevant income tax laws as mentioned above, Zhejiang is also entitled to two-year tax exemption in 2004 and 2005, and is subject to a tax rate of 16.5% in 2006. USAI, Jielong and Wuhu did not have any operating income in 2006.

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 during three months and six months ended June 30, 2006 and 2005.

No provision for U.S income taxes has been made as the Company did not have any assessable profits in United States during three months and six months ended June 30, 2006 and 2005.

15. RECLASSIFICATIONS

Certain reclassifications have been made to the Consolidated Statement of Operations for the three months and six months ended June 30, 2005 to conform to the current year presentation.

| Item | Three months ended June 30, 2005 | |
|-------------------------------------|----------------------------------|------------------------|
| | Original Classification | Present Classification |
| General and administrative expenses | \$ 2,337,603 | \$ 1,602,040 |
| R&D expenses | — | \$ 138,239 |
| Depreciation and amortization | \$ 172,626 | \$ 769,950 |

| Item | Six months ended June 30, 2005 | |
|-------------------------------------|--------------------------------|------------------------|
| | Original Classification | Present Classification |
| General and administrative expenses | \$ 4,899,754 | \$ 3,372,325 |
| R&D expenses | — | \$ 495,948 |
| Depreciation and amortization | \$ 353,290 | \$ 1,384,771 |

16. SIGNIFICANT CONCENTRATIONS

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

During the three months ended June 30, 2006, the Company's ten largest customers accounted for 79.3% of the Company's consolidated net sales, with each of three customers individually accounting for more than 10% of consolidated net sales, i.e. 18.2%, 15.7% and 13.1% individually, or an aggregate of 46.9%. At June 30, 2006, approximately 29.7% of accounts receivable were from trade transactions with the aforementioned three customers.

During the six months ended June 30, 2006, the Company's ten largest customers accounted for 75.3% of the Company's consolidated net sales, with each of four customers individually accounting for more than 10% of consolidated net sales, i.e. 16.2%, 14.1%, 12.3% and 11.1% individually, or an aggregate of 53.7%. At June 30, 2006, approximately 36.0% of accounts receivable were from trade transactions with the aforementioned four customers.

During the three months ended June 30, 2005, the Company's ten largest customers accounted for 85.4% of the Company's consolidated net sales, with four customers individually accounting for more than 10% of consolidated net sales, i.e. 17.5%, 16.3%, 12.2% and 10.8% individually, or an aggregate of 56.8%. At June 30, 2005, approximately 38.5% of accounts receivable were from trade transactions with the aforementioned four customers.

During the six months ended June 30, 2005, the Company's ten largest customers accounted for an aggregate of 77.9% of its consolidated net sales, with four customers individually accounting for more than 10% of consolidated net sales, i.e. 15.6%, 13.0%, 12.6% and 11.9% individually, or an aggregate of 53.1%. At June 30, 2005, approximately 38.5% of accounts receivable were from trade transactions with the aforementioned four customers.

17. RELATED PARTY TRANSACTIONS

During early 2004, the Company commenced construction of seven buildings dedicated to research and administrative for its operations in Wuhan. In December 2005, the Company disposed two of the seven buildings to Wuhan Geological University Information S&T Development Co., Ltd., "WuHan Information", a Chinese company controlled by Mr. Hanlin Chen, the Chairman of the Company, at fair market value of \$2,636,444, which was determined by an independent appraisal firm. As of June 30, 2006, such amount together with its conventional bank interest has not been repaid.

During the three months and six months ended June 30, 2006 and 2005, the Joint-ventures entered into related party transactions with companies with common directors as shown below:

| | Three Months Ended June 30, | |
|-----------|------------------------------------|-------------|
| | 2006 | 2005 |
| Sales | \$ 794,200 | \$ 544,935 |
| Purchases | \$ 674,207 | \$ 490,032 |
| | Six Months Ended June 30, | |
| | 2006 | 2005 |
| Sales | \$ 1,377,739 | \$ 999,860 |
| Purchases | \$ 1,330,202 | \$ 895,788 |

18. OFF-BALANCE SHEET ARRANGEMENTS

At June 30, 2006 and 2005, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

19. COMMITMENTS AND CONTINGENCIES:

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

| Date | Parties Involved | Description of Commitments and Contingencies |
|-------------------------|---|--|
| October 30, 2001 | Henglong & Bishop Steering Technology Limited, "Bishop", an Australian company | Ten year license agreement for the design of power steering systems. Henglong is obligated to pay Bishop a technical assistance fee of approximately \$200,000 per year during the first two years and \$110,000 per year during the remaining eight years of the agreement. |
| July 21, 2003 | Henglong & Namyang Industrial Co. Ltd., "Namyang", a Korean manufacturer of steering assemblies for automobiles | Five year license and technical assistance 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, which includes the licensed columns and universal joint technology. |
| March to December, 2004 | Henglong & some equipment manufacturers | Have entered into equipment contracts with total value approximately \$4,719,967. Henglong paid \$1,743,201 and \$2,606,332 during 2004 and 2005. The Company paid \$130,542 in the six months ended June 30, 2006 and \$239,892 remains outstanding. The Company will pay \$146,265 and \$93,627 in the six months ended December 31, 2006 and in 2007, respectively. |
| March to December, 2004 | Jiulong & some equipment manufacturers | Have entered into equipment contracts with total value of approximately \$2,752,479. Jiulong paid \$1,021,021 and \$1,117,318 during 2004 and 2005. The Company paid \$92,658 in the six months ended June 30, 2006 and \$521,482 remains outstanding. The Company will pay \$279,940 and \$241,542 in the six months ended December 31, 2006 and in 2007, respectively. |
| April to December, 2005 | Henglong & some equipment manufacturers | Have entered into equipment contracts with total value approximately \$1,163,650. Henglong paid \$1,039,442 in 2005 and \$7,388 in the six months ended June 30, 2006, respectively, and \$116,820 remains outstanding. The Company will pay \$110,916 and \$5,904 in the six months ended December 31, 2006 and in 2007, respectively. |
| April to December, 2005 | Jiulong & some equipment manufacturers | Have entered into equipment contracts with total value approximately \$637,108. Jiulong paid |

\$350,542 in 2005 and \$30,723 in the six months ended June 30, 2006, respectively, and \$255,843 remains outstanding. The Company will pay \$232,157 and \$23,686 in the six months ended December 31, 2006 and in 2007, respectively.

| | | |
|----------------------------|--|--|
| April to December, 2005 | USAI & some equipment manufacturers | Have entered into equipment contracts with total value approximately \$238,577 in 2005. USAI paid \$141,346 in 2005 and \$45,277 in the six months ended June 30, 2006, respectively, and will pay off the remaining \$51,954 during the six months ended December 31, 2006. |
|----------------------------|--|--|

20. OPERATING INFORMATION OF THE COMPANY'S SINO-FOREIGN JOINT-VENTURES

The Company has no operations independent of those of Great Genesis and its subsidiaries, and the principal assets are its investments in Great Genesis and its subsidiaries. The operational results of Company's Sino-foreign Joint-ventures for the three months and six months ended June 30, 2006 and 2005 were summarized as follows:

| | Parent Company | | Henglong | |
|---|--|-------------|-----------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| | Three Months Ended June 30, | | | |
| | (Unit: US Dollars, except ownership percentage) | | | |
| Proportionate ownership interest at end of year | 100% | 100% | 44.5% | 44.5% |
| Net sales | — | — | 14,103,726 | 9,038,423 |
| Cost of sales and operating expenses | 718,917 | 197,087 | 11,593,529 | 8,076,493 |
| Operating earnings (losses) | (718,917) | (197,087) | 2,510,197 | 961,930 |
| Other income (expenses), net | 15,029 | (932) | (70,388) | (145,990) |
| Pretax earnings | (703,888) | (198,019) | 2,439,809 | 815,940 |
| Income tax | — | — | 506,831 | 188,000 |
| Income (expenses) before minority interest | (703,888) | (198,019) | 1,932,978 | 627,940 |
| Minority interest income (expenses) | — | — | 1,056,258 | 349,545 |
| Net earnings (expenses) | (703,888) | (198,019) | 876,720 | 278,395 |

| | Jiulong | | Shenyang | |
|---|--|-------------|-----------------|-------------|
| | Three Months Ended June 30, | | | |
| | (Unit: US Dollars, except ownership percentage) | | | |
| | 2006 | 2005 | 2006 | 2005 |
| Proportionate ownership interest at end of year | 81% | 81% | 70% | 70% |
| Net sales | 7,199,830 | 5,789,758 | 4,330,357 | 3,322,133 |
| Cost of sales and operating expenses | 6,902,731 | 5,417,938 | 3,793,943 | 2,815,240 |
| Operating earnings (losses) | 297,099 | 371,820 | 536,414 | 506,893 |
| Other income (expenses), net | (18,372) | (141,819) | 7,875 | 8,625 |
| Pretax earnings | 278,727 | 230,001 | 544,289 | 515,518 |
| Income tax | 132,323 | 69,202 | 43,674 | 45,159 |
| Income (expenses) before minority interest | 146,404 | 160,799 | 500,615 | 470,359 |
| Minority interest income (expenses) | 51,937 | 1,089 | 150,184 | 141,109 |
| Net earnings (expenses) | 94,467 | 159,710 | 350,431 | 329,250 |

| | Zhejiang | | USAI | |
|---|--|-------------|-------------|-------------|
| | Three Months Ended June 30, | | | |
| | (Unit: US Dollars, except ownership percentage) | | | |
| | 2006 | 2005 | 2006 | 2005 |
| Proportionate ownership interest at end of year | 51% | 51% | 60% | 0% |
| Net sales | 2,948,212 | 1,672,660 | 109,456 | — |
| Cost of sales and operating expenses | 2,238,701 | 1,491,652 | 514,186 | — |
| Operating earnings (losses) | 709,511 | 181,008 | (404,730) | — |
| Other income (expenses), net | 6,247 | (12,550) | 19 | — |
| Pretax earnings | 715,758 | 168,458 | (404,711) | — |
| Income tax | 167,911 | — | — | — |
| Income (expenses) before minority interest | 547,847 | 168,458 | (404,711) | — |
| Minority interest income (expenses) | 268,633 | 82,543 | (161,884) | — |
| Net earnings (expenses) | 279,214 | 85,915 | (242,827) | — |

| | Elimination | | Total | |
|---|--|-------------|--------------|-------------|
| | Three Months Ended June 30, | | | |
| | (Unit: US Dollars, except ownership percentage) | | | |
| | 2006 | 2005 | 2006 | 2005 |
| Proportionate ownership interest at end of year | | | | |
| Net sales | 3,943,669 | 3,059,665 | 24,747,912 | 16,763,309 |
| Cost of sales and operating expenses | 4,041,188 | 2,906,468 | 21,720,819 | 15,091,942 |
| Operating earnings (losses) | (97,519) | 153,197 | 3,027,093 | 1,671,367 |
| Other income (expenses), net | — | — | (59,590) | (292,666) |
| Pretax earnings | (97,519) | 153,197 | 2,967,503 | 1,378,701 |
| Income tax | — | — | 850,739 | 302,361 |
| Income (expenses) before minority interest | (97,519) | 153,197 | 2,116,764 | 1,076,340 |
| Minority interest income (expenses) | — | — | 1,365,128 | 574,286 |
| Net earnings (expenses) | (97,519) | 153,197 | 751,636 | 502,054 |

For the three months ended June 30, 2006, two of the subsidiary companies, Jielong and Wuhu has not conducted any business.

| | Parent Company | | Henglong | |
|---|--|-------------|-----------------|-------------|
| | Six Months Ended June 30, | | | |
| | (Unit: US Dollars, except ownership percentage) | | | |
| | 2006 | 2005 | 2006 | 2005 |
| Proportionate ownership interest at end of year | 100% | 100% | 44.5% | 44.5% |
| Net sales | — | — | 25,618,111 | 16,393,536 |
| Cost of sales and operating expenses | 968,612 | 350,386 | 21,417,904 | 15,151,835 |
| Operating earnings (losses) | (968,612) | (350,386) | 4,200,207 | 1,241,701 |
| Other income (expenses), net | 700,216 | (2,624) | (203,487) | (302,930) |
| Pretax earnings | (268,396) | (353,010) | 3,996,720 | 938,771 |
| Income tax | — | — | 785,126 | 238,965 |
| Income (expenses) before minority interest | (268,396) | (353,010) | 3,211,594 | 699,806 |
| Minority interest income (expenses) | — | — | 1,812,079 | 379,935 |
| Net earnings (expenses) | (268,396) | (353,010) | 1,399,515 | 319,871 |

| | Jiulong | | Shenyang | |
|---|--|-------------|-----------------|-------------|
| | Six Months Ended June 30, | | | |
| | (Unit: US Dollars, except ownership percentage) | | | |
| | 2006 | 2005 | 2006 | 2005 |
| Proportionate ownership interest at end of year | 81% | 81% | 70% | 70% |
| Net sales | 12,820,677 | 12,252,922 | 7,869,898 | 5,859,231 |
| Cost of sales and operating expenses | 12,037,546 | 10,896,165 | 7,076,396 | 4,873,157 |
| Operating earnings (losses) | 783,131 | 1,356,757 | 793,502 | 986,075 |
| Other income (expenses), net | (131,602) | (246,564) | 18,181 | 14,784 |
| Pretax earnings | 651,529 | 1,110,193 | 811,683 | 1,000,858 |
| Income tax | (46,850) | 232,829 | 83,577 | 81,529 |
| Income (expenses) before minority interest | 698,379 | 877,364 | 728,106 | 919,329 |
| Minority interest income (expenses) | 153,968 | 99,942 | 218,431 | 275,800 |
| Net earnings (expenses) | 544,411 | 777,422 | 509,675 | 643,529 |

| | Zhejiang | | USAI | |
|---|--|-------------|-------------|-------------|
| | Six Months Ended June 30, | | | |
| | (Unit: US Dollars, except ownership percentage) | | | |
| | 2006 | 2005 | 2006 | 2005 |
| Proportionate ownership interest at end of year | 51% | 51% | 60% | 0% |
| Net sales | 4,975,901 | 2,459,655 | 109,919 | — |
| Cost of sales and operating expenses | 3,993,126 | 2,330,065 | 612,893 | — |
| Operating earnings (losses) | 982,775 | 129,590 | (502,974) | — |
| Other income (expenses), net | 6,757 | (13,246) | 156 | — |
| Pretax earnings | 989,532 | 116,344 | (502,818) | — |
| Income tax | 229,597 | — | — | — |
| Income (expenses) before minority interest | 759,935 | 116,344 | (502,818) | — |
| Minority interest income (expenses) | 372,556 | 57,008 | (201,127) | — |
| Net earnings (expenses) | 387,379 | 59,336 | (301,691) | — |

| | Elimination | | Total | |
|---|--|-------------|--------------|-------------|
| | Six Months Ended June 30, | | | |
| | (Unit: US Dollars, except ownership percentage) | | | |
| | 2006 | 2005 | 2006 | 2005 |
| Proportionate ownership interest at end of year | | | | |
| Net sales | 5,682,142 | 6,225,585 | 45,712,364 | 30,739,759 |
| Cost of sales and operating expenses | 5,958,140 | 6,146,674 | 40,148,337 | 27,454,934 |

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| | | | | |
|--|-----------|--------|-----------|-----------|
| Operating earnings (losses) | (275,998) | 78,911 | 5,564,027 | 3,284,825 |
| Other income (expenses), net | 700,857 | — | (310,636) | (550,580) |
| Pretax earnings | 424,859 | 78,911 | 5,253,391 | 2,734,245 |
| Income tax | — | — | 1,051,450 | 553,323 |
| Income (expenses) before minority interest | 424,859 | 78,911 | 4,201,941 | 2,180,922 |
| Minority interest income (expenses) | — | — | 2,355,907 | 812,685 |
| Net earnings (expenses) | 424,859 | 78,911 | 1,846,034 | 1,368,237 |

For the six months ended June 30, 2006, two of the subsidiary companies, Jielong and Wuhu has not conducted any business.

21. SUBSEQUENT EVENTS

None

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

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

This Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. Generally, the words "believes", "anticipates," "may," "will," "should," "expect," "intend," "estimate," "continue," and similar expressions or the negative thereof or comparable terminology are intended to identify forward-looking statements which include, but are not limited to, statements concerning the Company's expectations regarding its working capital requirements, financing requirements, business prospects, and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. Such statements are subject to certain risks and uncertainties, including the matters set forth in this Quarterly Report or other reports or documents the Company files with the Securities and Exchange Commission from time to time, which could cause actual results or outcomes to differ materially from those projected. Undue reliance should not be placed on these forward-looking statements which speak only as of the date hereof. The Company undertakes no obligation to update these forward-looking statements. In addition, the forward-looking statements in this Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 involve known and unknown risks, uncertainties and other factors that could cause the actual results, performance or achievements of the Company to differ materially from those expressed in or implied by the forward-looking statements contained herein. Please see the discussion on risk factors in Item 1A of Part II of this quarterly report on Form 10-Q.

GENERAL OVERVIEW:

Organization - Effective March 5, 2003, Visions-In-Glass, Inc., a United States 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 \$320,000 to the former officer, director and controlling shareholder of Visions in two installments for the cancellation of 17,424,750 shares of common stock

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.

As of June 30, 2006 and 2005, Great Genesis owns the following aggregate net interests in seven Sino-foreign Joint-ventures organized in the PRC:

| Name of Entity | Percentage Interest June 30, | |
|--|---------------------------------|-------|
| | 2006 | 2005 |
| Shashi Jiulong Power Steering Co. Limited ("Jiulong") | 81.0% | 81.0% |
| Jingzhou Henglong Automotive Parts Co. Limited ("Henglong") | 44.5% | 44.5% |
| Shenyang Jinbei Henglong Automotive Steering System Co. Limited ("Shenyang") | 70.0% | 70.0% |
| Zhejiang Henglong & Vie Pump-Manu Co. Limited ("Zhejiang") | 51.0% | 51.0% |
| Universal Sensor Application, Inc. ("USAI") | 60.0% | 60% |
| Wuhan Jielong Electric Power Steering Co., Ltd. ("Jielong") | 85.0% | — |
| Wuhu HengLong Auto Steering System Co., Ltd. ("Wuhu") | 77.33% | — |

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

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

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.

On April 12, 2005, the wholly-owned subsidiary of the company, Great Genesis entered into a Joint-venture agreement with Shanghai Hongxi Investment Inc., "Hongxi", a company controlled by Mr. Hanlin Chen, the Company's Chairman, and Sensor System Solution Inc., "Sensor", to establish a joint venture, Universal Sensor Application Inc., "USAI", in the Wuhan East Lake development zone. The registered capital of the Joint-venture is \$ 10 million. Great Genesis and Hongxi will invest \$ 6 million and \$1 million, respectively, including cash and land and building, which will account for 60% and 10% of the total registered capital, respectively. Sensor invested \$3 million in technology, accounting for 30% of the total registered capital. The registered capital is required to be paid in three installments within one year after signing of the Joint-venture agreement, April 12, 2005. As of June 30, 2006, Great Genesis and Sensor have contributed \$900,337, the equivalent of RMB 7,200,000 and \$3,000,000 respectively, including cash and technology. Hongxi has contributed \$436,954 in cash, the equivalent of RMB 3,500,000.

On April 14, 2006, the wholly-owned subsidiary of the company, Great Genesis entered into a Joint-venture agreement with Hong Kong Tongda, "Tongda", to establish a joint venture, Wuhan Jielong Electric Power Steering Co., Ltd., "Jielong", in the Wuhan East Lake development zone. Jielong is mainly engaged in the production and sales of electric power steering, "EPS". The registered capital of the Joint-venture is \$ 6 million, the equivalent of RMB 48,000,000. Great Genesis and Tongda will invest \$5,100,000 and \$900,000, respectively, which is account for 85% and 15% of the total registered capital, respectively. As of June 30, 2006, Great Genesis and Tongda have contributed \$766,146 and \$135,034 in cash, the equivalent of RMB 6,120,000 and RMB 1,080,000 respectively.

On March 31, 2006, as amended on May 2, 2006, Great Genesis, the wholly-owned subsidiary of the Company, entered into a Joint-venture agreement with Wuhu Chery Technology Co., Ltd., "Chery Technology", to establish a Joint-venture, Wuhu Henglong Automotive Steering System Co., Ltd in the Wuhu Technological Development Zone. Wuhu is mainly engaged in the production and sales of automobile steering system. The registered capital of the Joint-venture is \$3,750,387, the equivalent of RMB 30,000,000. Great Genesis and Chery Technology will invest \$2,900,300 and \$850,087, respectively, which is account for 77.33% and 22.67% of the total registered capital, respectively. As of June 30, 2006, the capital of \$3,750,387, the equivalent of RMB 30,000,000 has completely contributed in Wuhu.

CRITICAL ACCOUNTING POLICIES

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

MINORITY INTERESTS

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.

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 an allowance 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 bringing 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 JUNE 30, 2006 AND 2005:

NET SALES

Net sales were \$24,747,912 for the three months ended June 30, 2006, as compared to \$16,763,309 for the three months ended June 30, 2005, an increase of \$7,984,603 or 47.6%. The increase in net sales in 2006 as compared to 2005 was a result of the following factors:

- (1) Primarily, the increase in sales was due to an increase in sales of domestic passenger vehicles. As a result of increasing demands for domestic passenger vehicles which commenced at the beginning of 2005, the Company has adjusted its marketing strategies accordingly and concentrated on manufacturing and selling steering gears for domestic passenger vehicles and steering pumps, which led to sales from steering gears and pumps for the three months ended June 30, 2006 increasing 30.5% and 92.4% over the same periods of 2005, respectively.
- (2) In the second quarter of 2006, sales of steering gears and accessories for commercial vehicles increased by 87.8% as compared to the same period of 2005. Sales for the three months ended June 30, 2005 were affected adversely by state macro-controls and were reduced to \$3,215,748 as compared to normal sales, an historical low. Sales of steering gears and accessories for commercial vehicles were \$6,040,117 and recovered to normal sales during three months ended June 30, 2006.

GROSS PROFIT

For the three months ended June 30, 2006, gross profit was \$9,271,145, as compared to \$5,966,751 for the three months ended June 30, 2005, an increase of \$3,304,394 or 55.4%. The increase in unit sales contributed to an increase of \$2,736,585 in gross profit, a decrease in unit cost resulted in an increase of \$1,938,545 in gross profit, which was partially offset by a decrease in selling prices resulting in a decrease of \$1,370,736 in gross profit.

Gross margin was 37.5% for the three months ended June 30, 2006, an increase of 1.9% from 35.6% for the same period of 2005. The increase reflects a decrease in cost which was partially offset by a decrease in selling prices during the second quarter of 2006. The Company plans to take the following measures in the remaining six months of 2006 to reduce costs and to meet its yearly gross margin target of not less than 30%:

- (1) Reduce labor costs. The Company has purchased certain advanced production equipment, which optimizes manufacturing cycles, and further improves productivity capacity and efficiency. The Company estimates that its labor costs will be reduced by 3% as compared to 2005 as a result of the advantages of its optimized manufacturing cycles and reduced standard labor hours.
- (2) Reduce the cost of raw materials. In 2006, the Company plans to continue to control the costs of raw materials in two ways: Firstly, volume purchase of major raw materials will be made through a bidding process, and for purchases of other smaller quantities of non major materials, "target prices" will be set to guide such purchases. Secondly, technical personnel have been encouraged to reevaluate the product structure and production techniques so as to optimize product design, reduce the weight of parts and wastage in the production process, and thus reduce the cost of raw materials. The Company estimates that its material cost will be reduced by 2% as a result of these measures.
- (3) Reduce manufacturing expenses. In 2006, the Company will reexamine the standard material consumption rates, and regulate the program of approval and usage for supplementary materials, such as oil, cutting tools, dies and other supplies. It is estimated that the Company's manufacturing expenses would be reduced by 1% through these measures.

SELLING EXPENSES

Selling expenses were \$1,699,118 for the three months ended June 30, 2006, as compared to \$1,716,305 for the same period of 2005, a decrease of \$17,187 or 1.0%. The decreased selling expenses in the second quarter of 2006 were mainly due to the following factors:

- (1) Decreased after-sales expenses. The Company recorded \$601,918 of after-sales expenses for the three months ended June 30, 2006, as compared to \$921,913 for the same period of 2005, a decrease of \$319,995 or 34.7%, this was mainly due to the company having introduced certain policies to control the cost of after-sales, including recycling used parts.

(2) Decreased provision for market development: At the beginning of 2005, the Company began to strengthen its market development and instituted a policy for the establishment of a fund for market development expenditures. For the three months ended June 30, 2006, the Company recorded a provision of \$111,284 for market development expenses based on its historical experience, as compared to \$198,795 for the same period of 2005, a decrease of \$87,511 or 44.0%.

(3) Increased transportation expenses. The Company recorded \$524,661 of transportation expenses for the three months ended June 30, 2006, as compared to \$303,294 for the same period of 2005, an increase of \$221,367 or 73.0%, resulting from increased transportation volume.

(4) Increased salaries and wages. The Company recorded \$103,517 of salaries and wages for the three months ended June 30, 2006, as compared to \$70,935 for the same period of 2005, an increase of \$32,582 or 45.9%, as a result of increased sales.

(5) Increased traveling allowance. The Company recorded \$260,808 of traveling allowance for the three months ended June 30, 2006, as compared to \$130,847 for the same period of 2005, an increase of \$129,961 or 99.3%, as a result of increased sales.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses were \$3,039,936 for the three months ended June 30, 2006, as compared to \$1,602,040 for the same period of 2005, an increase of \$1,437,896 or 89.8%.

Significant expense items that had increased on a comparable basis were salaries and wages, listing expenses, provision for doubtful accounts and warranty. Significant expense items that had decreased on a comparable basis were labor insurance. They are explained as follows:

(1) Salaries and wages were \$872,558 in the second quarter of 2006, as compared to \$338,484 for the same period of 2005, an increase of \$534,074 or 157.8%, this was mainly due to increased production in 2006 which led to an increase of workload for management.

(2) Listing expenses were \$217,399 for the three months ended June 30, 2006, as compared to \$108,612 for the same period of 2005, an increase of \$108,787 or 100.2%, this was primarily due to increased share trading and professional services fees.

(3) Provision for doubtful accounts was \$575,505 in the second quarter of 2006, as compared to an offset of \$69,788 for the same period of 2005, an increase of \$645,293. The Company's accounts receivable increased during the three months ended June 30, 2006 as a result of increased sales volume. Management believes that the Company should record a higher provision for doubtful accounts to cover estimated credit losses.

(4) Warranty provision was \$687,784 in the second quarter of 2006 as compared to \$150,870 for the same period of 2005, an increase of \$536,914 or 355.9%. Management believes that the Company shall record higher reserves for warranty expenses to provide for the risks of product claims as increased market share.

(5) Labor insurance was \$34,164 in the second quarter of 2006, as compared to \$443,891 for the same period of 2005, a decrease of \$409,727 or 92.3%. The decrease in labor insurance expenses was due to each of the Company's subsidiaries changing their respective calculation base for endowment insurance expenses set by local government policy, which was 20% of the minimum salary ratified by the authority in 2006. In 2005 the endowment insurance expenses were recorded as 20% of the salary actually paid.

DEPRECIATION AND AMORTIZATION EXPENSES

For the three months ended June 30, 2006, the depreciation and amortization expenses excluding those recorded in cost of sales were \$1,253,604, as compared to \$769,950 for the three months ended March 31, 2005, an increase of \$483,654 or 62.8%, as a result of USAI, one of the Joint-ventures of the Company, amortizing intangible assets for the three months ended June 30, 2006, while there were no such expenses for the same period of 2005.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were \$251,394 for the three months ended June 30, 2006, as compared to \$138,239 for the three months ended March 31, 2005, an increase of \$113,155 or 81.9%, as a result of increased research and development expenses on new products initiatives for the purpose of expanding the markets abroad.

STOCK-BASED COMPENSATION

As of June 28, 2005, the Company issued common stock options to three independent directors to purchase 22,500 shares of common stock at \$6.83 per share over a period of five years. The aggregated fair value of these options, calculated pursuant to the Black-Scholes option-pricing model, was estimated to be \$68,850, which was charged to operations during the three months ended June 30, 2005.

INCOME FROM OPERATIONS

Income from operations was \$3,027,093 for the three months ended June 30, 2006, as compared to \$1,671,367 for the three months ended June 30, 2005, an increase of \$1,355,726 or 81.1%, as a result of an increase of \$3,304,394 or 55.4% in gross profit and an increase of \$1,948,668 or 45.4% in operating expenses.

OTHER NON-OPERATING INCOME

Other non-operating income was \$117,887 for the three months ended June 30, 2006, as compared to \$31,702 for the three months ended June 30, 2005, an increase of \$86,185 or 271.9%, as a result of increased materials sold during the six months ended June 30, 2006.

FINANCIAL EXPENSES

Financial expenses were \$177,477 for the three months ended June 30, 2006, as compared to \$324,368 for the three months ended June 30, 2005, a decrease of \$146,891 or 45.3%, primarily due to decreased interest expenses resulting from decreased average balances of bank loans and decreased discount expenses resulting from the decreased volume of bills discounted.

INCOME BEFORE INCOME TAXES

Income before income taxes was \$2,967,503 for the three months ended June 30, 2006, as compared to \$1,378,701 for the three months ended June 30, 2005, an increase of \$1,588,802 or 115.2%, as a result of an increase in income from operations of \$1,355,726 or 81.1%, an increase in other non-operating income of \$86,185 or 271.9%, and a decrease in financial expenses of \$146,891 or 45.3%.

INCOME TAXES

Income taxes expense was \$850,739 for the three months ended June 30, 2006, as compared to \$302,361 for the three months ended June 30, 2005, an increase of \$548,378 or 181.4%. The increase was primarily due to an increase in income before income taxes. Furthermore, Zhejiang, one of the Company's Sino-foreign Joint-ventures, has ended its two-year tax holiday as of December 2005 and has begun to pay income tax in 2006.

INCOME BEFORE MINORITY INTERESTS

Income before minority interests was \$2,116,764 for the three months ended June 30, 2006, as compared to \$1,076,340 for the three months ended June 30, 2005, an increase of \$1,040,424 or 96.7%, as a result of an increase in income before income taxes of \$1,588,802 or 115.2%, and an increase in income taxes of \$548,378 or 181.4%.

MINORITY INTERESTS

Minority interests in the earnings of the Sino-foreign Joint-ventures amount to \$1,365,128 for the three months ended June 30, 2006, as compared to \$574,286 for the three months ended June 30, 2005, an increase of \$790,842 or 137.7%. The increase was primarily due to an increase in net income for Henglong and Zhejian, two of the Company's Sino-foreign Joint-ventures. The minority shareholders own 55.5% of Henglong's equity and 49% of Zhejiang's equity during the three months ended June 30, 2006, respectively.

NET INCOME

Net income was \$751,636 for the three months ended June 30, 2006, as compared to a net income of \$502,054 for the three months ended June 30, 2005, an increase of \$249,582 or 49.7%, as a result of an increase in income before minority interests of \$1,040,424 or 96.7%, and an increase in minority interests of 790,842 or 137.7%.

RESULTS OF OPERATIONS—SIX MONTHS ENDED JUNE 30, 2006 AND 2005:

NET SALES

Net sales were \$45,712,364 for the six months ended June 30, 2006, as compared to \$30,739,759 for the six months ended June 30, 2005, an increase of \$14,972,605 or 48.7%. The increase in net sales in 2006 as compared to 2005 was a result of the following factors:

(1) Primarily, the increase in sales was due to an increase in sales of domestic passenger vehicles. As a result of increasing demands for domestic passenger vehicles which commenced at the beginning of 2005, the Company has adjusted its marketing strategies accordingly and concentrated on manufacturing and selling steering gears for domestic passenger vehicles and steering pumps, which led to sales from steering gears and pumps for the six months ended June 30, 2006 increasing 76.1% and 128.3% over the same periods of 2005, respectively.

(2) For the six months ended June 30, 2006, sales of steering gears and accessories for commercial vehicles decreased by 4.2% as compared to the same period of 2005. Although the Company has improved its sales by adopting technical innovation and expanding market share actively, it did not recover to the best historical level as it was heavily and adversely affected by state macro-controls.

GROSS PROFIT

For the six months ended June 30, 2006, gross profit was \$16,216,342, as compared to \$10,997,092 for the six months ended June 30, 2005, an increase of \$5,219,250 or 47.5%. The increase in unit sales contributed to an increase of \$5,244,979 in gross profit, a decrease in unit cost resulted in an increase of \$2,242,584 in gross profit, which was partially offset by a decrease in selling prices resulting in a decrease of \$2,268,313 in gross profit.

Gross margin was 35.5% for the six months ended June 30, 2006, a decrease of 0.3% from 35.8% for the same period of 2005. The decrease reflects a decrease in selling prices which was partially offset by a cost decrease for the six months ended June 30, 2006.

SELLING EXPENSES

Selling expenses were \$2,608,970 for the six months ended June 30, 2006, as compared to \$2,390,373 for the same period of 2005, an increase of \$218,597 or 9.1%. The increased selling expenses for the six months ended June 30, 2006 were mainly due to the following factors:

(1) Increased transportation expenses. The Company recorded \$817,837 of transportation expenses for the six months ended June 30, 2006, as compared to \$482,359 for the same period of 2005, an increase of \$335,478 or 69.6%, resulting from increased sales.

(2) Increased traveling allowance. The Company recorded \$364,157 of traveling allowance for the six months ended June 30, 2006, as compared to \$209,337 for the same period of 2005, an increase of \$154,820 or 74.0%, mainly as a result of increased sales.

(3) Decreased after-sales expenses. The Company recorded \$933,792 of after-sales expenses for the six months ended June 30, 2006, as compared to \$1,033,036 for the same period of 2005, a decrease of \$99,244 or 9.6%, this was mainly as a result of the Company having introduced certain policies to control the cost of after-sales, including recycling used parts.

(4) Decreased provision for market development: At the beginning of 2005, the Company began to strengthen its market development and instituted a policy for the establishment of a fund for market development expenditures. The Company recorded a provision of \$202,311 for market development expenses during the six months ended June 30, 2006 based on its historical experience, as compared to \$397,590 for the same period of 2005, a decrease of \$195,279 or 49.1%.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses were \$5,660,110 for the six months ended June 30, 2006, as compared to \$3,372,325 for the same period of 2005, an increase of \$2,287,785 or 67.8%.

Significant expense items that had increased on a comparable basis were salaries and wages, listing expenses, provision for doubtful accounts and warranty. Significant expense items that had decreased on a comparable basis were supplies and labor insurance. They are explained as follows:

(1) Salaries and wages were \$1,484,845 for the six months ended June 30, 2006, as compared to \$617,672 for the same period of 2005, an increase of \$867,173 or 140.4%, this was mainly due to increased production in 2006 which led to increased workload for management.

(2) Listing expenses were \$364,421 for the six months ended June 30, 2006, as compared to \$203,799 for the same period of 2005, an increase of \$160,622 or 78.8%, this was primarily due to increased share trading and professional services fees.

(3) Provision for doubtful accounts was \$1,260,022 for the six months ended June 30, 2006, as compared to \$47,949 for the same period of 2005, an increase of \$1,212,073. The Company's accounts receivable increased during the six months ended June 30, 2006 as a result of increased sales volume. Management believes that the Company should record a higher provision for doubtful accounts to cover estimated credit losses.

(4) Warranty provision was \$1,270,420 for the six months ended June 30, 2006, as compared to \$276,658 for the same period of 2005, an increase of \$993,762 or 359.2%. Management believes that the Company should record a higher reserve for warranty expenses to provide for the risks of product claims as increased market share.

(5) Supplies expense was \$299,298 for the six months ended June 30, 2006, as compared to \$601,158 for the same period of 2005, a decrease of \$301,860 or 50.2%. The decrease is due to the Company having executed a more economical and effective materials consumption standard for its administrative department during early 2006. These measures have been very effective.

(6) Labor insurance was \$84,873 for the six months ended June 30, 2006, as compared to \$755,051 for the same period of 2005, a decrease of \$670,178 or 88.8%. The decrease in labor insurance expenses was due to each of the Company's subsidiaries changing their respective calculation base for endowment insurance expenses set by the local government policy, which was 20% of the minimum salary ratified by the authority in 2006. The endowment insurance expenses were recorded as 20% of the salary actually paid in 2005.

DEPRECIATION AND AMORTIZATION EXPENSES

For the six months ended June 30, 2006, the depreciation and amortization expenses excluding those recorded in cost of sales were \$1,942,094, as compared to \$1,384,771 for the six months ended June 30, 2005, an increase of \$557,323 or 40.2%, as a result of USAI, one of the Joint-ventures of the Company, amortizing intangible assets for the six months ended June 30, 2006, while there were no such expenses for the same period of 2005.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were \$441,141 for the six months ended June 30, 2006, as compared to \$495,948 for the six months ended June 30, 2005, a decrease of \$54,807 or 11.1%, as a result of the Company's R&D department focusing on applications of technology previously purchased rather than new research initiatives for the six months ended June 30, 2006.

STOCK-BASED COMPENSATION

As of June 28, 2005, the Company issued common stock options to three independent directors to purchase 22,500 shares of common stock at \$6.83 per share over a period of five years. The aggregated fair value of these options, calculated pursuant to the Black-Scholes option-pricing model, was estimated to be \$68,850, which was charged to operations during the three months ended June 30, 2005.

INCOME FROM OPERATIONS

Income from operations was \$5,564,027 for the six months ended June 30, 2006, as compared to \$3,284,825 for the six months ended June 30, 2005, an increase of \$2,279,202 or 69.4%, as a result of an increase of \$5,219,250 or 47.5% in gross profit and an increase of \$2,940,048 or 38.1% in operating expenses.

OTHER NON-OPERATING INCOME

Other non-operating income was \$201,227 for the six months ended June 30, 2006, as compared to \$57,021 for the six months ended June 30, 2005, an increase of \$144,206 or 252.9%, as a result of increased sales of materials during the six months ended June 30, 2006.

FINANCIAL EXPENSES

Financial expenses were \$511,863 for the six months ended June 30, 2006, as compared to \$607,601 for the six months ended June 30, 2005, a decrease of \$95,738 or 15.8%, primarily due to decreased interest expenses resulting from decreased average balances of bank loans and decreased discount expenses resulting from the decreased volume of bills discounted.

INCOME BEFORE INCOME TAXES

Income before income taxes was \$5,253,391 for the six months ended June 30, 2006, as compared to \$2,734,245 for the six months ended June 30, 2005, an increase of \$2,519,146 or 92.1%, as a result of an increase in income from operations of \$2,279,202 or 69.4%, an increase in other non-operating income of \$144,206 or 252.9%, and a decrease in financial expenses of \$95,738 or 15.8%.

INCOME TAXES

Income taxes expense was \$1,051,450 for the six months ended June 30, 2006, as compared to \$553,323 for the six months ended June 30, 2005, an increase of \$498,127 or 90.0%. The increase was primarily due to an increase in income before income taxes. Furthermore, Zhejiang, one of the Company's Sino-foreign Joint-ventures, has ended its two-year tax holiday as of December 2005 and has begun to pay income tax in 2006.

INCOME BEFORE MINORITY INTERESTS

Income before minority interests was \$4,201,941 for the six months ended June 30, 2006, as compared to \$2,180,922 for the six months ended June 30, 2005, an increase of \$2,021,019 or 92.7%, as a result of an increase in income before income taxes of \$2,519,146 or 92.1%, and an increase in income taxes of \$498,127 or 90.0%.

MINORITY INTERESTS

Minority interests in the earnings of the Sino-foreign Joint-ventures amount to \$2,355,907 for the six months ended June 30, 2006, as compared to \$812,685 for the six months ended June 30, 2005, an increase of \$1,543,222 or 189.9%. The increase was primarily due to an increase in net income for Henglong and Zhejian, two of the Company's Sino-foreign Joint-ventures. The minority shareholders own 55.5% of Henglong's equity and 49% of Zhejiang's equity during the six months ended June 30, 2006, respectively.

NET INCOME

Net income was \$1,846,034 for the six months ended June 30, 2006, as compared to a net income of \$1,368,237 for the six months ended June 30, 2005, an increase of \$477,797 or 34.9%, as a result of an increase in income before minority interests of \$2,021,019 or 92.7%, and an increase in minority interests of 1,543,222 or 189.9%.

LIQUIDITY AND CAPITAL RESOURCES

The Company has relied primarily on cash flow from operations, bank loans and investment for its capital requirements for the three months and six months ended June 30, 2006.

OPERATIONS

THREE MONTHS ENDED JUNE 30, 2006

The Company's operations used cash of \$6,735,941 for the three months ended June 30, 2006, as compared with providing cash of \$4,014,184 for the three months ended June 30, 2005, a decrease of \$10,750,125, which is primarily the result of the following:

(1) Net cash from continued operations increased during the period as a result of increased cash flow provided by product sales and service: For the three months ended June 30, 2006, cash flow provided by product sales and service was \$4,574,587, as compared to \$2,483,148 for the same period of 2005, an increase of \$2,091,439 as a result of increased sales in 2006.

(2) Net cash provided by operating activities decreased during the period as a result of increased net cash used in operating assets: For the three months ended June 30, 2006, net cash used in operating assets was \$7,133,235, as compared to \$1,239,141 for the same period of 2005, a decrease of \$5,894,094, mainly due to increased operating assets along with the increased sales.

(3) Net cash from continued operations decreased during the period as a result of decreased net cash provided by operating liabilities: Net cash provided by operating liabilities decreased by \$4,177,293 for the three months ended June 30, 2006, as compared to an increase of \$2,770,177 for the same period of 2005, a decrease in net cash of \$6,947,470, mainly due to a decrease in bills payable of \$7,430,551 for the three months ended June 30, 2006, while it increased by \$146,898 for the three months ended June 30, 2005.

SIX MONTHS ENDED JUNE 30, 2006

The Company's operations provided cash of \$1,203,829 for the six months ended June 30, 2006, as compared with providing cash of \$4,912,823 for the six months ended June 30, 2005, a decrease of \$3,708,994, which is primarily the result of the following:

(1) Net cash from continued operations increased during the period as a result of increased cash flow provided by product sales and service: For the six months ended June 30, 2006, cash flow provided by product sales and service was \$8,799,805, as compared to \$4,739,532 for the same period of 2005, an increase of \$4,060,273 as a result of increased sales in 2006.

(2) Net cash provided by operating activities decreased during the period as a result of increased net cash used in operating assets: For the six months ended June 30, 2006, net cash used in operating assets was increased by \$15,914,302, as compared to \$1,686,360 for the same period of 2005, a decrease of \$14,227,942, mainly due to increased operating assets along with the increased sales.

(3) Net cash from continued operations increased during the period as a result of increased net cash provided by operating liabilities: The net cash provided by operating liabilities was increased by \$8,318,326 for the six months ended June 30, 2006, as compared to an increase of \$1,859,651 for the same period of 2005, an increase in net cash of \$6,458,675, mainly due to increased account payable and provision for warranties by \$5,377,861 and \$1,270,420 for the six months ended June 30, 2006, respectively, while the account payable and provision for warranties increased by \$697,484 and \$276,658 for the same period of the prior year.

As of June 30, 2006, cash and cash equivalents were \$19,792,500, and working capital was \$24,134,914. As of December 31, 2005, cash and cash equivalents were \$12,374,944 and working capital were \$9,102,809, reflecting a current ratio of 1.35:1 and 1.15:1 at June 30, 2006 and December 31, 2005, respectively.

The Company intends to finance its operating costs and expenses for the remaining period of 2006 and next year in the following ways:

(1) The Company has working capital of \$24,134,914 as of June 30, 2006 and cash flow provided from continued operations activities in the remaining months of 2006.

(2) Equity line of credit financing: On March 20, 2006, the Company entered into a Standby Equity Distribution Agreement with Cornell Capital Partners, LP entitling it to, from time to time, sell common stock at a slight discount to the market price for an amount of up to \$15 million. The Company has raised \$300,000 in the three months ended June 30, 2006. Under the agreement, Cornell Capital Partners, LP has committed to provide funding to be drawn down over a 24-month period at the Company's discretion, following a registration which was declared effective on April 28, 2006.

(3) Loans by banks: The Company's Sino-foreign joint-ventures have good credit records with Chinese banks. Throughout 2006, the Company had a 364-day revolving credit line with the following banks, including \$12,484,395, the equivalent of RMB100,000,000, from Bank of China, \$8,739,076, the equivalent of RMB70,000,000, from China Construction Bank, \$2,496,879, the equivalent of RMB20,000,000, from CITIC Industrial Bank, \$3,745,318, the equivalent of RMB30,000,000, from Shanghai Pudong Development Bank and \$6,242,197, the equivalent of RMB50,000,000, from Jingzhou Commercial Bank, respectively.

INVESTING

THREE MONTHS ENDED JUNE 30, 2006

During the three months ended June 30, 2006, the Company expended net cash of \$1,429,013 in investment activities, as compared to providing cash of \$2,916,280 for the same period of 2005, an increase of \$4,345,293 as a result of following factors:

(1) Net cash provided by investment activities increased during the period as a result of decreased net cash used in other receivables: For the three months ended June 30, 2006, net cash used in other receivables was decreased by \$1,726,035, as compared to an increase of \$1,123,711 for the same period of 2005, an increase of \$2,849,746. The decreased net cash used in other receivables principally reflects Henglong, one of the subsidiary companies, receiving the investment proceeds from the Wuhu project, and Shenyang, one of the subsidiary companies, obtaining the warranty proceeds from purchasing property and equipment.

(2) Net cash used in investment activities decreased during the period as a result of decreased net disbursements in purchasing property and equipment: The Company expended net cash of \$299,718 for purchasing property and equipment for the three months ended June 30, 2006, as compared to \$1,674,042 for the three months ended June 30, 2005, a decrease of \$1,374,324.

(3) Net cash used in investment activities decreased during the period as a result of decreased net disbursements in purchasing intangible assets: The Company expended net cash of \$1,224 for purchasing intangible assets for the three months ended June 30, 2006, as compared to \$118,527 for the three months ended June 30, 2005, a decrease of \$117,303.

(4) Net cash provided by investment activities increased during the period as a result of increased net cash provided by other investment activities: For the three months ended June 30, 2006, the Company has achieved a translation gain of \$3,920 in the foreign currency investment in Wuhu.

SIX MONTHS ENDED JUNE 30, 2006

During the six months ended June 30, 2006, the Company expended net cash of \$993,661 in investment activities, as compared to using \$3,687,041 for the same period of 2005, a decrease of \$2,693,380 as a result of following factors:

(1) Net cash provided by investment activities increased during the period as a result of decreased net cash used in other receivables: For the six months ended June 30, 2006, net cash used in other receivables was decreased by \$94,383, as compared to an increase of \$1,265,964 for the same period of 2005, an increase of \$1,360,347. The decrease net cash used in other receivables principally reflects Henglong, one of the subsidiary companies, receiving the investment proceeds from the Wuhu project, and Shenyang, one of the subsidiary companies, obtaining the warranty proceeds from purchasing property and equipment.

(2) Net cash used in investment activities decreased during the period as a result of decreased net disbursements in purchasing property and equipment: The Company expended net cash of \$952,502 for purchasing property and equipment for the six months ended June 30, 2006, as compared to \$2,226,932 for the six months ended June 30, 2005, a decrease of \$1,274,430.

(3) Net cash used in investment activities decreased during the period as a result of decreased net disbursements in purchasing intangible assets: The Company expended net cash of \$139,462 for purchasing intangible assets for the six months ended June 30, 2006, as compared to \$194,145 for the six months ended June 30, 2005, a decrease of \$54,683.

(4) Net cash provided by investment activities increased during the period as a result of increased net cash provided by other investment activities: For the six months ended June 30, 2006, the Company has achieved a translation gain of \$3,920 in the foreign currency investment in Wuhu.

FINANCING

THREE MONTHS ENDED JUNE 30, 2006

During the three months ended June 30, 2006, the Company obtained net cash of \$2,958,832 in financing activities, as compared to using \$3,015,108 for the three months ended June 30, 2005, an increase of \$5,973,940 as a result of following factors:

(1) Net cash provided in financing activities increased during the period as a result of increased net proceeds from bank loans: The Company has increased the net proceeds from bank loans of \$2,496,879 for the three months ended June 30, 2006, as compared to a decrease of \$3,012,048 for the same period of 2005, an increase of \$5,508,927, mainly due to net cash provided by operating activities having decreased, which led to increased demand on bank loans.

(2) Net cash provided in financing activities decreased during the period as a result of increased dividends paid to the minority interest holders of Joint-ventures: The Company expended \$614,742 of dividends to the minority interest holders of Joint-ventures for the three months ended June 30, 2006, while there was no such item for the same period of 2005.

(3) Net cash provided in financing activities decreased during the period as a result of decreased amounts due to shareholders/directors: The Company repaid \$365,120 of advances from shareholders/directors for the three months ended June 30, 2006, as compared to \$3,060 of advances from shareholders/directors for the same period of 2005, an increase of \$362,060.

(4) Net cash provided in financing activities increased during the period as a result of issuing common stock: For the three months ended June 30, 2006, the Company raised \$333,750 of cash through financing, less the relevant professional service fees of \$314,010. The Company raised \$19,740 of net cash actually during three months ended June 30, 2006.

(5) Net cash provided in financing activities increased during the period as a result of an increase in capital investment by minority shareholders of joint ventures: The minority shareholders of joint ventures have contributed \$1,422,075 during the three months ended June 30, 2006, including Shanghai Hongxi Investment Inc., the minority shareholder of USAI investing \$436,954; HongKong Tongda, the minority shareholder or Jielong investing \$135,034; Wuhu Chery Technology Co., Ltd., the minority shareholder of Wuhu investing \$850,087.

SIX MONTHS ENDED JUNE 30, 2006

During the six months ended June 30, 2006, the Company obtained net cash of \$6,605,989 through financing activities, as compared to \$1,335,186 for the six months ended June 30, 2005, an increase of \$7,941,175 as a result of following factors:

(1) Net cash provided in financing activities increased during the period as a result of increased net proceeds from bank loans: The Company has increased the net proceeds from bank loans of \$1,414,898 for the six months ended June 30, 2006, as compared to a decrease of \$602,410 for the same period of 2005, an increase of \$2,017,308, mainly due to net cash provided by operating activities having decreased, which led to increased demand on bank loans.

(2) Net cash provided in financing activities increased during the period as a result of decreased dividends paid to the minority interest holders of Joint-ventures: The Company expended \$739,586 of dividends to the minority interest holders of Joint-ventures for the six months ended June 30, 2006, as compared to \$787,321 for the same period of prior year, a decrease of \$47,735.

(3) Net cash provided in financing activities decreased during the period as a result of decreased amounts due to shareholders/directors: The Company repaid \$451,138 of advances from shareholders/directors for the six months ended June 30, 2006, as compared to \$54,545 of advances from shareholders/directors for the same period of 2005, a decrease of \$505,683.

(4) Net cash provided in financing activities increased during the period as a result of issuing common stock and financing: For the six months ended June 30, 2006, the Company raised \$5,333,750 of cash through financing, less the relevant professional service fees of \$374,010. The Company raised \$4,959,740 of net cash actually during three months ended June 30, 2006.

(5) Net cash provided in financing activities increased during the period as a result of an increase in capital investment by minority shareholders of joint ventures: The minority shareholders of joint ventures have contributed \$1,422,075 during the six months ended June 30, 2006, including Shanghai Hongxi Investment Inc., the minority shareholder of USAI investing \$436,954; HongKong Tongda, the minority shareholder or Jielong investing \$135,034; Wuhu Chery Technology Co., Ltd., the minority shareholder of Wuhu investing \$850,087.

OFF-BALANCE SHEET ARRANGEMENTS

At June 30, 2006 and 2005, 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:

| Date | Parties Involved | Description of Commitments and Contingencies |
|-------------------------|---|--|
| October 30, 2001 | Henglong & Bishop Steering Technology Limited, "Bishop", an Australian company | Ten year license agreement for the design of power steering systems. Henglong is obligated to pay Bishop a technical assistance fee of approximately \$200,000 per year during the first two years and \$110,000 per year during the remaining eight years of the agreement. |
| July 21, 2003 | Henglong & Namyang Industrial Co. Ltd., "Namyang", a Korean manufacturer of steering assemblies for automobiles | Five year license and technical assistance 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, which includes the licensed columns and universal joint technology. |
| March to December, 2004 | Henglong & some equipment manufacturers | Have entered into equipment contracts with total value approximately \$4,719,967. Henglong paid \$1,743,201 and \$2,606,332 during 2004 and 2005. The Company paid \$130,542 in the six months ended June 30, 2006 and \$239,892 remains outstanding. The Company will pay \$146,265 and \$93,627 in the six months ended December 31, 2006 and in 2007, respectively. |
| March to December, 2004 | Jiulong & some equipment manufacturers | Have entered into equipment contracts with total value of approximately \$2,752,479. Jiulong paid \$1,021,021 and \$1,117,318 during 2004 and 2005. The Company paid \$92,658 in the six months ended June 30, 2006 and \$521,482 remains outstanding. The Company will pay \$279,940 and \$241,542 in the six months ended December 31, 2006 and in 2007, respectively. |

| | | |
|----------------------------|--|---|
| April to December, 2005 | Henglong & some equipment manufacturers | Have entered into equipment contracts with total value approximately \$1,163,650. Henglong paid \$1,039,442 in 2005 and \$7,388 in the six months ended June 30, 2006, respectively, and \$116,820 remains outstanding. The Company will pay \$110,916 and \$5,904 in the six months ended December 31, 2006 and in 2007, respectively. |
| April to December, 2005 | Jiulong & some equipment manufacturers | Have entered into equipment contracts with total value approximately \$637,108. Jiulong paid \$350,542 in 2005 and \$30,723 in the six months ended June 30, 2006, respectively, and \$255,843 remains outstanding. The Company will pay \$232,157 and \$23,686 in the six months ended December 31, 2006 and in 2007, respectively. |
| April to December, 2005 | USAI & some equipment manufacturers | Have entered into equipment contracts with total value approximately \$238,577 in 2005. USAI paid \$141,346 in 2005 and \$45,277 in the six months ended June 30, 2006, respectively, and will pay off the remaining \$51,954 during the six months ended December 31, 2006. |

SUBSEQUENT EVENTS

None

Item 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

CREDIT RISK: The Company's financial instruments that are exposed to concentration of credit risk consist primarily of cash and cash equivalents, accounts receivable from customers and other receivable due from related parties, which were controlled by Mr. Hanlin Chen, the Company's Chairman.

Cash and cash equivalents are maintained with major state-owned banks in the PRC. The Management has not evaluated the credit risk from banks based on its notion that state-owned banks command considerable funds with good reputation.

The Company's business activity is primarily 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. Because of the increase of activities and business, and the increase of customers' accounts receivable, there is no assurance that foresaid measures will be completely effective. The Company has approximately \$38,000,000 of accounts receivable as of June 30, 2006, the Company's revenues and/or operating cash flow would be materially and adversely affected if there is a 3% allowance for doubtful accounts which is a reduction of approximately \$1,100,000 for the Company.

The other receivable due from related parties, which were controlled by Mr. Hanlin Chen, the Company's Chairman, was \$4,488,910 as of June 30, 2006. These amounts will be due on demand on or before December 31, 2006.

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CURRENCY EXCHANGE RATE RISK: The Company's currency exchange rate risks consist primarily of currency from financing. The Company's financing activities were settled in US dollars and deposited in its bank account in US dollars, while the Company conducts virtually all of its business and investment activity in China and the value of its business is effectively denominated in Renminbi. The Company will convert US dollars into RMB to conduct its investment activities and business. The Company does not hedge its RMB - US dollar exchange rate exposure. The Company has dollar holdings of approximately \$3,900,000 as for June 30, 2006, if the exchange rate between US dollars and RMB were to increase by 10%, the Company would potentially suffer loss by approximately \$390,000. Therefore, the Company will choose to reduce its exposures through financial instruments (hedges) that provide offsets or limits to its exposures when considered appropriate.

MARKET INTEREST RATE RISK: The Company has \$30,000,000 of short-term revolving credit line with annual interest expenses of \$1,770,000 based on based on full utilization. Bank loan rates in China have a history of volatility and have been rising recently, and if market interest rates increase by 10%, such increases could result in increased loan interest for the company.

RISK OF INVENTORY PRICES: The risk to inventory prices of the Company comes from the upward movement in prices of raw materials and the downward movement of selling price. Management believes the latter is more material. In recent years, price fluctuation on raw materials was not excessive, but prices for steering gears have fluctuated significantly. During the years 2003-2005, prices for steering gear have decreased approximately 10% each year on average. In 2005, the output and sales of domestic commercial vehicles has decreased greatly as compared to 2004, as a result of state macro-controls. One of the Joint-ventures of the Company, Jiulong, also suffered similarly as a supplier of commercial vehicles. There is no sign that the market will recover. As of June 30, 2006, Jiulong's inventory amount was approximately \$6,000,000. If selling prices of steering decreases by 10%, then the income of the Company will decrease by \$600,000. In 2006, the Company will take the following two measures to reduce inventories to a reasonable level thus decreasing the risk from inventory prices:

- (1) Further develop the market in order to utilize finished goods inventory through increased sales.
 - (2) Improve internal information flows, balance inventories in various warehouses, and avoid unnecessary production.
- But there is no assurance that the aforesaid measures will be effective.

ITEM 4. CONTROLS AND PROCEDURES

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company's 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, the "SEC". The Company's disclosure controls and procedures are also designed to ensure that information required to be disclosed in the reports filed under the Exchange Act of 1934, the "Exchange Act", 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 provide reasonable assurance that information the Company is required to disclose in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to its management, including its chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) CHANGES IN INTERNAL CONTROLS

There was no change in the Company's internal control over financial reporting that occurred during its last fiscal quarter that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

ITEM 1A. Risk Factors

Risks Factors that May Affect Our Results

The Company's businesses, financial conditions and results of operations could be materially and adversely affected by many risk factors. Because of these risk factors, actual results might differ significantly from those projected in the forward-looking statements. Factors that might cause such differences include, among others, the following:

Risks Related to the Company's Business and Industry

Because the Company is a holding company with substantially all of its operations conducted through its subsidiaries, its performance will be affected by the performance of its subsidiaries.

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

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

With the automobile parts markets being highly competitive and many of the Company's competitors having greater resources than it does, the Company may not be able to compete successfully.

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

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

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

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

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

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

Increasing costs for manufactured components and raw materials may adversely affect the Company's profitability.

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

Pricing pressure by automobile manufacturers on their suppliers may adversely affect the Company's business and results of operations.

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

The Company's business, revenues and profitability would be materially and adversely affected if it loses any of its large customers.

For the six months ended June 30, 2006, approximately 14.1% of the Company's sales were to Brilliance China Automotive Holdings Limited, approximately 12.3% were to Beiqi Foton Motor Co., Ltd., approximately 16.2% were to Chery Automobile Co., Ltd. and approximately 11.1% were to Zhejiang Geely Holding Co., Ltd., the Company's four largest customers. The loss of, or significant reduction in purchases by, one or more of these major customers could adversely affect the Company's business.

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

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

The Company is subject to environmental and safety regulations, which may increase the Company's compliance costs and may adversely affect the Company's results of operation.

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

Non-performance by the Company's suppliers may adversely affect its operations by delaying delivery or causing delivery failures, which may negatively affect demand, sales and profitability.

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

The Company's business and growth may suffer if it fails to attract and retain key personnel.

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

The Company's management controls approximately 87.2% of its outstanding common stock and may have conflicts of interest with its minority stockholders.

Members of the Company's management beneficially own approximately 87.2% of the outstanding shares of the Company's common stock. As a result, these majority stockholders have control over decisions to enter into any corporate transaction and have the ability to prevent any transaction that requires the approval of stockholders, which could result in the approval of transactions that might not maximize stockholders' value. Additionally, these stockholders control the election of members of the Company's board, have the ability to appoint new members to the Company's management team and control the outcome of matters submitted to a vote of the holders of the Company's common stock. The interests of these majority stockholders may at times conflict with the interests of the Company's other stockholders.

There is a limited public float of the Company's common stock, which can result in its stock price being volatile and prevent the realization of a profit on resale of the Company's common stock.

There is a limited public float of the Company's common stock. Of the Company's outstanding common stock, approximately 13% is considered part of the public float. The term "public float" refers to shares freely and actively tradable on the NASDAQ SmallCap Market and not owned by officers, directors or affiliates, as such term is defined under the Securities Act. Due to the Company's relatively small public float and the limited trading volume of its common stock, purchases and sales of relatively small amounts of the Company's common stock can have a disproportionate effect on the market price for the Company's common stock. As a result, the market price of the Company's common stock can be volatile. This stock price volatility could prevent a stockholder seeking to sell Company common stock from being able to sell it at or above the price at which the stock was bought.

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

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

Risks Related to Doing Business in China and other International Countries

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

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

The Company's international expansion plans subject it to risks inherent in doing business internationally.

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

The Company faces risks associated with currency exchange rate fluctuations, any adverse fluctuation may adversely affect the Company's operating margins.

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

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

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

The Chinese Government could change its policies toward private enterprises, which could adversely affect the Company's business.

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

The economic, political and social conditions in China could affect the Company's business.

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

The significant but uneven growth in the economy of China in the past 20 years could have negative effect on the Company's business and results of operations.

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

Government control of currency conversion and future movements in exchange rates may adversely affect the Company's operations and financial results.

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

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

Because the Chinese legal system is not fully developed, the Company's legal protections may be limited.

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

It may be difficult to serve the Company with legal process or enforce judgments against the Company's management or the Company.

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

Risks Related to the Standby Equity Distribution Agreement (“SEDA”)

Future sales by the Company’s stockholders may adversely affect its stock price and its ability to raise funds in new stock offerings.

Sales of the Company’s common stock in the public market following the SEDA could lower the market price of its common stock. Sales may also make it more difficult for the Company to sell equity securities or equity-related securities in the future at a time and price that management deems acceptable, or at all. Of the 23,274,495 shares of common stock outstanding as of June 30, 2006, all such shares are, or will be, freely tradable without restriction, unless held by our “affiliates.” Some of these shares may be resold under Rule 144.

Existing stockholders could experience significant dilution from the Company’s sale of shares under the SEDA.

The Company’s financial needs will be partially provided from the SEDA. The issuance of shares of the Company’s common stock under the SEDA, at below-market prices, will have a dilutive impact on its other stockholders and the issuance or even potential issuance of such shares could have a negative effect on the market price of its common stock. As a result, the Company’s net income per share could decrease in future periods, and the market price of the Company’s common stock could decline. In addition, the lower the Company’s stock price, the more shares of common stock it will have to issue under the SEDA to draw down the full amount. If the Company’s stock price is lower, then its existing stockholders would experience greater dilution.

Under the SEDA, Cornell Capital Partners will pay less than the then-prevailing market price of the Company’s common stock.

The common stock to be issued under the SEDA will be issued at a 1.5% discount to the lowest daily VWAP of the Company’s common stock during the five consecutive trading day period immediately following the date the Company notifies Cornell Capital Partners that it desires to access the SEDA; provided, that the price per share paid by Cornell Capital Partners will in no event be less than a minimum of 90% of the closing bid price for the Company’s common stock on the trading day immediately preceding the date that it delivers an advance request. Further, Cornell Capital Partners will retain 4.5% of each advance under the SEDA. Based on this discount, Cornell Capital Partners will have an incentive to sell immediately to realize the gain on the 1.5% discount. These sales could cause the price of the Company’s common stock to decline, based on increased selling of its common stock.

The sale of the Company’s stock under the SEDA could encourage short sales by third parties, which could contribute to the future decline of the Company’s stock price.

In many circumstances, the provisions of a SEDA have the potential to cause a significant downward pressure on the price of a company’s common stock. This is especially the case if the shares being placed into the market exceed the market’s ability to take up the increased stock or if the Company has not performed in such a manner to show that the equity funds raised will be used for growth. Such an event could place further downward pressure on the price of the Company’s common stock. The Company may request numerous drawdowns pursuant to the terms of the SEDA. Even if the Company uses the SEDA to invest in ways that are materially beneficial to it, the opportunity exists for short sellers and others to contribute to the future decline of the Company’s stock price. If there are significant short sales of stock, the price decline that would result from this activity in turn may cause long holders of the stock to sell their shares thereby contributing to sales of stock in the market. If there is an imbalance on the sell side of the market for the Company’s common stock, the price will decline.

It is not possible to predict those circumstances whereby short sales could materialize or the extent to which the stock price could drop. In some companies that have been subjected to short sales the stock price has dropped significantly. This could happen to the Company's stock price.

Cornell Capital Partners may sell shares of the Company's common stock after it delivers an advance notice during the pricing period, which could cause the Company's stock price to decline.

Cornell Capital Partners is deemed to beneficially own the shares of common stock corresponding to a particular advance on the date that the Company delivers an advance notice to Cornell Capital Partners, which is prior to the date the stock is delivered to Cornell Capital Partners. Cornell Capital Partners may sell such shares any time after the Company delivers an advance notice. Accordingly, Cornell Capital Partners may sell such shares during the pricing period. Such sales may cause the Company's stock price to decline and if so would result in a lower VWAP during the pricing period, which would result in the Company having to issue a larger number of shares of common stock to Cornell Capital Partners in respect of the advance.

The Company may not be able to obtain a cash advance under the SEDA if Cornell Capital Partners holds more than 9.9% of the Company's common stock.

In the event Cornell Capital Partners holds more than 9.9% of our then-outstanding common stock, the Company will be unable to obtain a cash advance under the SEDA. A possibility exists that Cornell Capital Partners may own more than 9.9% of the Company's outstanding common stock at a time when it would otherwise plan to request an advance under the SEDA. In that event, if the Company is unable to obtain additional external funding, it could fail to achieve the corporate objectives that it had hoped to use the cash to achieve.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS. None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES. None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS. None.

ITEM 5. OTHER INFORMATION. None.

ITEM 6. 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.

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SIGNATURES

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

CHINA AUTOMOTIVE SYSTEMS, INC.
(Registrant)

Date: August 10, 2006

By: /s/ HANLIN CHEN

Hanlin Chen,
President and Chief Executive Officer

Date: August 10, 2006

By: /s/ DAMING HU

Daming Hu, Chief Financial Officer

INDEX TO EXHIBITS

| Exhibit Number | Description of Document |
|-----------------------|---|
| 3(i).1 | Certificate of Incorporation* |
| 3(i).2 | Certificate of Amendment of Certificate of Incorporation** |
| 3(ii).1 | By - laws*** |
| 10.1 | Standby Equity Distribution Agreement dated March 20, 2006 between the Company and Cornell Capital Partners, LP**** |
| 10.2 | Placement Agent Agreement dated March 20, 2006 between the Company and Newbridge Securities Corporation**** |
| 10.3 | Registration Rights Agreement dated March 20, 2006 between the Company and Cornell Capital Partners, LP**** |
| 10.4 | Securities Purchase Agreement dated March 20, 2006 between the Company and Cornell Capital Partners, LP**** |
| 10.5 | Investor Registration Rights Agreement dated March 20, 2006 between the Company and Cornell Capital Partners, LP**** |
| 10.6 | Warrant to purchase 86,806 shares of common stock at \$14.40 per share, issued to Cornell Capital Partners, LP**** |
| 10.7 | Warrant to purchase 69,444 shares of common stock at \$18.00 per share, issued to Cornell Capital Partners, LP**** |
| 10.8 | Joint-venture Agreement, dated March 31, 2006, as amended on May 2, 2006, between Hongkong Great Genesis Group Co., Ltd. and Wuhu Chery Technology Co., Ltd.***** |
| 21.1 | Subsidiaries of the Company***** |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification -Hanlin Chen***** |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification -Daming Hu***** |
| 32.1 | Section 1350 Certification -Hanlin Chen***** |
| 32.2 | Section 1350 Certification - Daming Hu***** |

* Incorporated by reference to exhibit 3(i) to the Company's Form 10SB Registration Statement filed on August 27, 2001.

** Incorporated by reference to Appendix A to the Company's Schedule 14C Definitive Information Statement filed on April 21, 2003.

*** Incorporated by reference to exhibit 3(ii) to the Company's Form 10SB Registration Statement filed on August 27, 2001.

**** Incorporated by reference to the exhibit of the same number to the Company's Form S-3 Registration Statement (File No. 333 - 133331) filed on April 17, 2006.

***** Incorporated by reference to the exhibit 10.8 to the Company's Form 10Q Quarterly Report on May 10, 2006.

***** Filed herewith

