



CHINA AUTOMOTIVE SYSTEMS, INC.

2008 ANNUAL REPORT

To Our Shareholders,

At the beginning of 2008, the outlook was for continuing strong growth in China. However, as 2008 unfolded, the economies in North America, Europe and other markets declined to depths not seen in many years. Automotive sales plunged in many markets resulting in the bankruptcy of Chrysler and General Motors in 2009. Economic conditions were better in China, but the global recession reduced GDP's growth in 2008 to 9%, which was the slowest rate since 2001. For 2008, the Chinese automotive market grew 6.7% to 9.34 million units, but this was the slowest growth in a decade. With record revenues and 22.1% growth in 2008 compared with 2007 results, we once again outpaced the overall Chinese automotive industry performance. As China's automotive market continued to expand, it became the world's largest market starting in January 2009.

The Chinese government made a strategic change in 2009 to entice consumers to spend more. A number of stimuli, subsidies and incentives were implemented to re-ignite the Chinese economy. A RMB 4 trillion (US\$590 billion) spending program was established, the sales tax was reduced to 5% from 10% to encourage sales of more affordable and environmentally friendly cars with small engines, and a RMB 5 billion (US\$732 million) subsidy was granted to help farmers replace 3-wheel vehicles and outdated trucks. The healthcare system is being reformed to provide wider coverage of the population with higher healthcare subsidies.

We remain very optimistic about the prospects for the Chinese automotive industry and we see opportunities in the global market. As China's largest independent power steering manufacturer, we focused on expanding our market share. During 2008, we did not lose any key customers as we added new ones. We secured another Sino-joint venture as we shipped units to Dongfeng Peugeot Citroen Automobile Company Ltd. We further penetrated the domestic OEM automotive market by adding ChangAn Auto. And we captured our first global automotive OEM headquartered in North America.

Our new customers highlight our manufacturing excellence, improved quality controls and our R & D capabilities to meet the strictest performance and reliability requirements for our safety-related steering products. Automotive technologies and vehicle models change, and we continue to invest in new products. Within a three-year period, our R & D center's new products generated cumulative sales in excess of RMB 847 million through 2008. Newly developed products were approximately 9.8% of 2008 sales. We continue developing innovative products such as electric power steering (EPS), to maintain our leadership and to have products for future vehicles. It is expected that fuel efficiency and environmental concerns will lead to the future purchase of more alternative energy and electric cars. BYD surprised the global auto market by rolling out the world's first commercial electric car. As BYD is among our top 5 customers, we are well positioned to provide advanced steering

systems. The high-quality standards of OEMs for key safety-related products, the rising technology content in our power steering products and our close relationships with over 50 customers, especially large Chinese national brands, combine to create significant barriers to entry for our competitors.

In 2008, we achieved record sales of 1.3 million systems and components representing revenues of \$163.2 million, a 22.1% increase compared to 2007 sales of \$133.6 million. Net income was \$12.4 million, or \$0.46 per weighted average diluted share, for the 2008 year compared with \$8.9 million, or \$0.37 per weighted average diluted share last year. The 2008 global recession affected our operations, especially in the second half of 2008, as we conserved our financial resources and controlled our costs.

We believe the worst is over and we look forward to the rest of 2009 as the Chinese Association of Automobile Manufacturers (CAAM) increased its vehicle sales projection from 5% to 8.7% for this year. Key customers such as Chery Auto Ltd., Zhejiang Geely Automobile, ChangAn Auto Co. Ltd., and BYD have experienced accelerated demand for their small, fuel efficient vehicles in early 2009. Given this growth, we expect revenue growth to be over 20% in 2009.

We will maintain our market leadership by continuing to penetrate the Chinese automotive OEMs, developing new products, optimizing our operating efficiencies, and seeking potential acquisitions. We are now better positioned for growth, especially in the global market, than any time in our history. We continue to be excited about our future and we wish to acknowledge the dedication of our employees and thank our shareholders for their loyalty as we build shareholder value.

Sincerely,
Qizhou Wu
CEO & Director
China Automotive Systems, Inc.
November 1, 2009



INDEX

CAUTIONARY STATEMENT	5
PART I	5
ITEM 1. DESCRIPTION OF BUSINESS	5
ITEM 2. DESCRIPTION OF PROPERTY	13
ITEM 3. LEGAL PROCEEDINGS	14
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	14
PART II	14
ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.....	14
ITEM 6. SELECTED FINANCIAL DATA	15
ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.....	15
ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.....	32
ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	32
PART III.....	33
ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS, CORPORATE GOVERNANCE AND BOARD INDEPENDENCE.....	33
ITEM 11. EXECUTIVE COMPENSATION	36
ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.....	39
ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.....	39
ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES	39
PART IV.....	40
ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.....	40
LIST OF FINANCIAL STATEMENT / SCHEDULES.....	40
NOTES TO CONSOLIDATED FINANCIAL STATEMENT	46

CAUTIONARY STATEMENT

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or the Company's future financial performance. The Company has attempted to identify forward-looking statements by terminology including "anticipates," "believes," "expects," "can," "continue," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predict," "should" or "will" or the negative of these terms or other comparable terminology. Such statements are subject to certain risks and uncertainties, including the matters set forth in this 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. Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements. Undue reliance should not be placed on these forward-looking statements which speak only as of the date hereof. The Company's expectations are as of the date this Form 10-K is filed, and the Company does not intend to update any of the forward-looking statements after the date this Annual Report on Form 10-K is filed to confirm these statements to actual results, unless required by law.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

COMPANY HISTORY

China Automotive Systems, Inc., "China Automotive" or the "Company", was incorporated in the State of Delaware on June 29, 1999 under the name Visions-In-Glass, Inc.

On or around March 5, 2003, the Company acquired all of the issued and outstanding equity interests of Great Genesis Holdings Limited, "Genesis", a corporation organized under the laws of the Hong Kong Special Administrative Region, China, by issuance of 20,914,250 shares of common stock to certain sellers. After the acquisition, the Company continued the operations of Genesis. Presently, Genesis owns interests in eight Sino-joint ventures, which manufacture power steering systems and/or related products for different segments of the automobile industry in China.

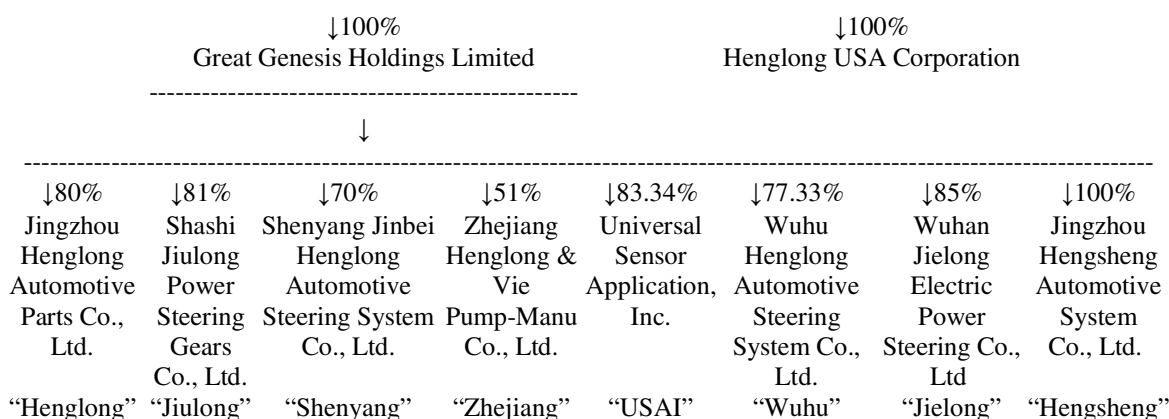
On May 19, 2003, the Company changed its name from Visions-In-Glass, Inc. to China Automotive Systems, Inc.

Since September 5, 2007, Hanlin Chen, Qizhou Wu, Robert Tung, Haimian Cai, and William E. Thomson began serving their terms as members of the Company's Board of Directors. The directors appointed Hanlin Chen as the chairman of the Board, Qizhou Wu as the Chief Executive Officer of the Board of Directors, and Jie Li as Chief Financial Officer.

BUSINESS OVERVIEW

Unless the context indicates otherwise, the Company uses the terms "the Company", "we", "our" and "us" to refer to Genesis and China Automotive collectively on a consolidated basis. The Company is a holding company and has no significant business operations or assets other than its interest in Genesis. Through Genesis, the Company manufactures power steering systems and other component parts for automobiles. All operations are conducted through eight Sino-foreign joint ventures in China and a wholly-owned subsidiary in the U.S. set forth below is an organizational chart as at December 31, 2008.

China Automotive Systems, Inc. [NASDAQ:CAAS]



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

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

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

Under the terms of the Henglong Agreement, Genesis is deemed to be the owner of Jingzhou Henglong commencing from January 1, 2008. The Henglong acquisition is considered as a business combination of companies under common control and is being accounted for in a manner of pooling of interests.

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

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

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

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

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

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

On March 7, 2007, Genesis established a wholly-owned subsidiary, Jingzhou Hengsheng Automotive System Co., Ltd, “Hengsheng”, to engage in production and sales of automotive steering systems. The registered capital of Hengsheng is \$10,000,000.

The Company has business relations with more than sixty vehicle manufacturers, including FAW Group and Dongfeng Auto Group, two of the five largest automobile manufacturers in China; Shenyang Brilliance Jinbei Co., Ltd., the largest minivan manufacturer in China; Cherry Automobile Co., Ltd, the largest state owned car manufacturer in China, and Zhejiang Geely Automobile Co., Ltd., the largest private owned car manufacturer. In 2007 and 2008, the Company has supplied power steering pumps and power steering gears for the Sino-Foreign joint ventures established by General Motors (GM) and Volkswagen.

The Company currently owns two trademarks covering automobile parts and twelve Chinese patents covering power steering technology. The Company is in the process of integrating new advanced technologies such as electronic chips in power steering systems into its current production line and is pursuing aggressive strategies in technology to maintain a competitive edge within the automobile industry. In 2001, the Company signed a Ten-Year Licensing Agreement with Bishop Steering Technology Limited, a leader in automotive steering gear technology innovation which offers advanced technology for steering valves within the contract period. In 2003, the Company signed a Technology Transfer Agreement with Nanyang Ind. Co. Ltd., a leading steering column maker, for the technology necessary for electronic power steering (EPS) systems. In addition, the Company established with Tsinghua University a steering systems research institute designed to develop Electronic Power Steering (EPS) and Electronic Hydraulic Steering Systems (EHPS).

STRATEGIC PLAN

The Company's short to medium term strategic plan is to focus on both domestic and international market expansion. To achieve this goal and higher profitability, the Company focuses on brand recognition, quality control, decreasing costs, research and development and strategic acquisitions. Set forth below are the Company's programs:

- Brand Recognition. Under the Henglong and Jiulong brands, the Company offers four separate series of power steering sets and 310 models of power steering sets, steering columns, steering oil pumps and steering hoses.

- Quality Control. The Henglong and Jiulong manufacturing facilities passed the ISO/TS 16949 System Certification in January 2004, a well-recognized quality control system in the auto industry developed by TUV Rheinland of Germany.

- Decrease Cost. By improving the Company's production ability and enhancing equipment management, optimizing the process and products structure, perfecting the supplier system and cutting production cost, the Company's goal is to achieve a more competitive profit margin.

- Research and Development. By partnering with Bishop Steering Technology Limited, Nanyang Ind. Co. Ltd. and Tsinghua University for the development of advanced steering systems, the Company's objective is to gain increased market share in China.

- International Expansion. The Company has entered into agreements with several international vehicle manufacturers and auto parts modules suppliers and carried on preliminary negotiations regarding future development projects.

- Acquisitions. The Company is exploring opportunities to create long-term growth through new ventures or acquisitions of other auto component manufacturers. The Company will seek acquisition targets that fulfill the following criteria:

- companies that can be easily integrated into product manufacturing and corporate management;
- companies that have strong joint venture partners that would become major customers; and
- companies involved with power steering systems, oil pump or engine-cooling systems.

CUSTOMERS

The Company's ten largest customers represent 78.6% of the Company's total sales for the year ended December 31, 2008. The following table sets forth information regarding the Company's ten largest customers.

Name of Major Customers	Percentage of Total Revenue in 2008
Chery Automobile Co., Ltd	15.1%
Brilliance China Automotive Holdings Limited	12.0%
Xi'an BYD Electric Car Co., Ltd	11.4%
Beiqi Foton Motor Co., Ltd.	10.7%
Zhejiang Geely Holding Co., Ltd	9.7%
China FAW Group Corporation	6.5%
Dongfeng Auto Group Co., Ltd	5.6%
Shanxi Heavy Auto Co., Ltd	2.9%
Great Wall Motor Company Limited	2.5%
Huainan Haonaite Machinery Co., Ltd.	2.2%
Total	78.6 %

The Company primarily sells its products to the above-mentioned customers; it also has excellent relationships with them, including as their first-ranking supplier and developer for new product development for new models. While the Company intends to continue to focus on retaining and winning this business, it cannot ensure that it will succeed in doing so. It is difficult to keep these contracts as a result of severe price competition and customers' diversification of their supply base. The Company's business would be materially and adversely affected if it loses one or more of these major customers.

SALES AND MARKETING

The Company's sales and marketing team has 102 sales persons, which are divided into an original equipment manufacturing, "OEM", team, a sales service team and a working group dedicated to international business. These sales and marketing teams provide a constant interface with the Company's key customers. They are located in all major vehicle producing regions to more effectively represent the Company's customers' interests within the Company's organization, to promote their programs and to coordinate their strategies with the goal of enhancing overall service and satisfaction. The Company's ability to support its customers is further enhanced by its broad presence in terms of sales offices, manufacturing facilities, engineering technology centers and joint ventures.

The Company's sales and marketing organization and activities are designed to create overall awareness and consideration of, and therefore to increase sales of, the Company's modular systems and components. To achieve that objective, the Company organized delegations to visit the United States, Korea, India and Japan and met with potential customers. Through these activities, the Company has generated potential business interests as a strong base for future development.

DISTRIBUTION

The Company's distribution system covers all of China. The Company has established sales and service offices with certain significant customers to deal with matters related to such customers in a timely fashion. The Company also established distribution warehouses close to major customers to ensure timely deliveries. The Company maintains strict control over inventories. Each of these sales and service offices sends back to the Company through e-mail or fax information related to the inventory and customers' needs. The Company guarantees product delivery in 8 hours for those customers who are located within 200 km from the Company's distribution warehouses, and 24 hours for customers who are located outside of 200 km from the Company's distribution warehouses. Delivery time is a very important competitive factor in terms of customer decision making, together with quality, pricing and long-term relationships.

EMPLOYEES AND FACILITIES

As of December 31, 2008, the Company employed approximately 2,487 persons, including approximately 1,631 by Henglong and Jiulong, approximately 261 by Shenyang, approximately 283 by Zhejiang, approximately 43 by USAI, approximately 130 by Wuhu, and approximately 139 for Hengsheng.

As of December 31, 2008, each of Henglong and Jiulong, Shenyang, Zhejiang, Wuhu and Hengsheng has a manufacturing and administration area of 278,092 square meters, 35,354 square meters, 100,000 square meters, 83,700 square meters and 170,520 square meters, respectively.

Hubei Province, which is home to Dongfeng, one of the largest automakers in China, provides an ample supply of inexpensive but skilled labor to automotive-related industries. The annual production of the Company's main product, power steering gears, was approximately 1,290,000 units and 1,070,000 units in 2008 and 2007 respectively. Although the production process continues to rely heavily on manual labor, the Company has invested substantially in high-level production machinery to improve capacity and production quality. Approximately \$33.6 million was spent over the last three years on professional-grade equipment and workshops - approximately 81% of which has used in the production process as of December 31, 2008.

RAW MATERIALS

The Company purchases various manufactured components and raw materials for use in its manufacturing processes. The principal components and raw materials the Company purchases include castings, electronic parts, molded plastic parts, finished sub-components, fabricated metal, aluminum and steel. The most important raw material is steel. The Company enters into purchase agreements with local suppliers. The annual purchase plans are determined at the beginning of the calendar year but are subject to revision every three months as a result of customers' orders. A purchase order is made according to monthly production plans. This protects the Company from building up inventory when the orders from customers change.

The Company's purchases from its ten largest suppliers represent in the aggregate 26.8% of all components and raw materials it purchased for the year ended December 31, 2008, and none of them providing more than 10% of total purchases.

All components and raw materials are available from numerous sources. The Company has not, in recent years, experienced any significant shortages of manufactured components or raw materials and normally does not carry inventories of these items in excess of what is reasonably required to meet its production and shipping schedules.

RESEARCH AND DEVELOPMENT

The Company has a ten-year consulting and licensing agreement with Bishop Steering Technology Ltd, one of the leading design firms in power steering systems. Bishop's technology in power steering systems is currently used by carmakers such as BMW and Mercedes Benz. Pursuant to the agreement, the Company has implemented the Bishop steering valve technology into the Henglong brand R&P power steering gear.

The Company owns a Hubei Provincial-Level Technical Center, which is approved by the Hubei Economic Commission. The center has a staff of 140, including 12 senior engineers, 2 foreign experts and 85 engineers, primarily focused on steering system R&D, tests, production process improvement and new material and production methodology application.

In addition, the Company has partnered with Tsinghua University to establish a steering system research center, called Tsinghua Henglong Automobile Steering Research Institute, for the purposes of R&D and experimentation for Electronic Power Steering, “EPS”.

The Company believes that its engineering and technical expertise, together with its emphasis on continuing research and development, allow it to use the latest technologies, materials and processes to solve problems for its customers and to bring new, innovative products to market. The Company believes that continued research and development activities, including engineering, are critical to maintaining its pipeline of technologically advanced products. The Company has aggressively managed costs in other portions of its business in order to maintain its total expenditures for research and development activities, including engineering, at approximately \$2,260,000, \$1,700,000, and \$1,100,000 for the years ended December 31, 2008, 2007 and 2006, respectively. In 2008, the sales of newly developed products accounted for about 9.8% of total sales.

COMPETITION

The automotive components industry is extremely competitive. 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 power steering system market is fragmented in China, and the Company has seven major competitors. Of these competitors, two are Sino-foreign joint ventures while the other five are state-owned. Like many competitive industries, there is downward pressure on selling prices.

The Company’s major competitors, including Shanghai ZF and FKS, are component suppliers to specific automobile manufacturers. Shanghai ZF is the joint venture of SAIC and ZF Germany, which is an exclusive supplier to SAIC-Volkswagen and SAIC-GM. First Auto FKS is a joint venture between First Auto Group and Japan’s Koyo Company and its main customer is FAW-Volkswagen Company.

While the Chinese Government limits foreign ownership of auto assemblers to 50%, there is no analogous limitation in the automotive components industry. Thus, opportunities exist for foreign component suppliers to set up factories in China. These overseas competitors employ technology that may be more advanced and may have existing relationships with global automobile assemblers, but they are generally not as competitive as the Company in China in terms of production cost and flexibility in meeting client requirements.

CHINESE AUTOMOBILE INDUSTRY

The Company is a supplier of automotive parts and all of its operations are located in China. An increase or decrease in the output and sales of Chinese vehicles could result in an increase or decrease of the Company’s results of operations. According to the latest statistics from the China Association of Automobile Manufacturers, “CAAM”, in 2008, the output and sales volume of passenger vehicles have reached 9,345,000 and 9,381,000 units respectively, with only a single-digit growth rate of 5.2% and 6.7% for the first time in at least 10 years as consumer confidence waned in a slowing economy. The output and sales volume of passenger vehicles have reached 6,738,000 and 6,756,000 units respectively with an increase of 5.6% and 7.3% compared with the year 2007. The output and sales volume of commercial vehicles have reached 2,607,000 and 2,625,000 units respectively with an increase of 4.2% and 5.3% over last year. Accordingly, the Company’s sales of steering gears and steering pumps for passenger vehicles in 2008 increased by 27.8% and 9.2% compared with the year 2007. The sales of steering gears for commercial vehicles in 2008 increased 13.1% compared with the year 2007.

To bolster auto demand in China, the government implemented a series of stimulus measures in the early 2009, including halving the purchase taxes on smaller cars, scrapping some road fees and granting subsidies for farmers who trade in their polluting vehicles for more fuel-efficient ones.

Based on the effects of these measures, management believes that the auto industry in China will grow faster and the Company's net sales in 2009 will increase by 10% to 15% compared with 2008.

CHINESE ECONOMY

Management believes that the most important factor in understanding the Chinese automobile industry is the country's rapid economic growth. During 2008, Chinese economic growth still maintained a relatively high level, although it suffered from the global financial crisis since the third quarter of 2008. According to data from the State Statistical Bureau, Chinese economic growth reached 9.0% in 2008. With the pulling function of great government investment, the investment by Chinese enterprises and consumption by Chinese residents will continue to increase relatively rapid in 2009.

Management believes that the continued investment and consumption growth will have a favorable effect on the sales of commercial vehicles and passenger vehicles.

HIGHWAY DEVELOPMENT

Management believes that the continuing development of the highway system will have a significant positive impact on the manufacture and sale of private automobiles. Statistics from the Ministry of Communications show that 100,000 kilometers of highway and 6,433 kilometers of expressway were developed in 2008. Total highways and expressways now amount to 3,673,000 kilometers and 60,300 kilometers, respectively.

DOING BUSINESS IN CHINA

CHINESE LEGAL SYSTEM

The practical effect of the Chinese legal system on the Company's business operations in China can be viewed from two separate but intertwined considerations. First, as a matter of substantive law, the Foreign Invested Enterprise Laws provide significant protection from government interference. In addition, these laws guarantee the full enjoyment of the benefits of corporate articles and contracts to Foreign Invested Enterprise participants. These laws, however, do impose standards concerning corporate formation and governance, which are not qualitatively different from the general corporation laws of other countries. Similarly, the Chinese accounting laws mandate accounting practices, which are not consistent with US Generally Accepted Accounting Principles. The Chinese accounting laws require that an annual "statutory audit" be performed in accordance with Chinese accounting standards and that the books of account of Foreign Invested Enterprises are maintained in accordance with Chinese accounting laws. Article 14 of the People's Republic of China Wholly Foreign-Owned Enterprise Law requires a Wholly Foreign-Owned Enterprise to submit certain periodic fiscal reports and statements to designated financial and tax authorities. Otherwise, there is risk that its business license will be revoked.

Second, while the enforcement of substantive rights may appear less clear than those in the United States, the Foreign Invested Enterprises and Wholly Foreign-Owned Enterprises are Chinese registered companies which enjoy the same status as other Chinese registered companies in business dispute resolution. Because the terms of the Company's various Articles of Association provide that all business disputes pertaining to Foreign Invested Enterprises will be resolved by the Arbitration Institute of the Stockholm Chamber of Commerce in Stockholm, Sweden applying Chinese substantive law, the Chinese minority partner in the Company's joint venture companies will not assume any advantageous position regarding such disputes. Any award rendered by this arbitration tribunal is, by the express terms of the various Articles of Association, enforceable in accordance with the "United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958)." Therefore, as a practical matter, although no assurances can be given, the Chinese legal infrastructure, while different from its United

States counterpart, should not present any significant impediment to the operation of Foreign Invested Enterprises.

ECONOMIC REFORM ISSUES

Although the Chinese Government owns the majority of productive assets in China, in the past several years the Government has implemented economic reform measures that emphasize decentralization and encourage private economic activity. Because these economic reform measures may be inconsistent or ineffectual, there is no assurance that:

- The Company will be able to capitalize on economic reforms;
- The Chinese Government will continue its pursuit of economic reform policies;
- The economic policies, even if pursued, will be successful;
- Economic policies will not be significantly altered from time to time; and
- Business operations in China will not become subject to the risk of nationalization.

Negative impact resulting from economic reform policies or nationalization could result in a total investment loss in the Company's common stock.

Since 1979, the Chinese Government has reformed its economic system. Because many reforms are unprecedented or experimental, they are expected to be refined and readjusted. Other political, economic and social factors, such as political changes, changes in the rates of economic growth, unemployment or inflation, or disparities in per capita wealth between regions within China, could lead to further readjustment of the reform measures. This refining and readjustment process may negatively affect the Company's operations.

Over the last few years, China's economy has registered a high growth rate. Recently, there have been indications that the rate of inflation has increased. In response, the Chinese Government recently has taken measures to curb the excessively expansive economy. These measures included implementation of a unitary and well-managed floating exchange rate system based on market supply and demand for the exchange rates of Renminbi, restrictions on the availability of domestic credit, reduction of the purchasing capability of its citizens, and centralization of the approval process for purchases of certain limited foreign products. These austerity measures alone may not succeed in slowing down the economy's excessive expansion or control inflation, and may result in severe dislocations in the Chinese economy. The Chinese Government may adopt additional measures to further combat inflation, including the establishment of freezes or restraints on certain projects or markets.

To date reforms to China's economic system have not adversely affected the Company's operations and are not expected to adversely affect the Company's operations in the foreseeable future; however, there can be no assurance that reforms to China's economic system will continue or that the Company will not be adversely affected by changes in China's political, economic, and social conditions and by changes in policies of the Chinese Government, such as changes in laws and regulations, measures which may be introduced to control inflation, changes in the rate or method of taxation, imposition of additional restrictions on currency conversion and remittance abroad, reduction in tariff protection and other import restrictions.

ENVIRONMENTAL COMPLIANCE

The Company is subject to the requirements of U.S. federal, state, local and non-U.S. environmental and occupational safety and health laws and regulations. These include laws regulating air emissions, water discharge and waste management. The Company has an environmental management structure designed to facilitate and support its compliance with these requirements globally. Although it is the Company's intent to comply with all such requirements and regulations, it cannot provide assurance that it is at all times in compliance. The Company has made and will continue to make capital and other expenditures to comply with environmental requirements, although such expenditures were not material

during the past two years. Environmental requirements are complex, change frequently and have tended to become more stringent over time. Accordingly, the Company cannot assure that environmental requirements will not change or become more stringent over time or that its eventual environmental cleanup costs and liabilities will not be material.

During 2008, the Company did not make any material capital expenditures relating to environmental compliance.

WEB SITE ACCESS TO SEC FILINGS

The Company files electronically with the SEC its annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K pursuant to Section 13(a) of the Securities Exchange Act of 1934. The SEC maintains an Internet site that contains reports, proxy information and information statements, and other information regarding issuers that file electronically with the SEC. The address of that website is <http://www.sec.gov>. The materials are also available at the SEC's Public Reference Room, located at 100 F Street, Washington, D.C. 20549. The public may obtain information through the public reference room by calling the SEC at 1-800-SEC-0330.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's headquarters are located at No. 1 Henglong Road, Yu Qiao Development Zone Shashi District, Jing Zhou City Hubei Province, PRC. Set forth below are the manufacturing facilities operated by each joint venture. The Company has forty to fifty years long-term rights to use the lands and buildings.

Name of Entity	Product	Total Area (M ²)	Building Area (M ²)	Original Cost of Equipment	Site
Henglong	Automotive Parts	225,221	20,226	\$ 28,637,306	Jingzhou City, Hubei Province
		13,393	13,707		Wuhan City, Hubei Province
Jiulong	Power Steering Gears	39,478	23,728	17,618,189	Jingzhou City, Hubei Province
Shenyang	Automotive Steering Gears	35,354	5,625	3,817,590	henyang City, Liaoning Province
Zhejiang	Steering Pumps	100,000	32,000	6,408,334	Zhuji City, Zhejiang Province
USAI	Sensor Modular	—	—	706,307	Wuhan City, Hubei Province
Wuhu	Automotive Steering Gears	83,700	12,600	1,745,373	Wuhu City, Anhue Province
Jielong	Electric Power Steering	—	—	301,823	Wuhan City, Hubei Province
Hengsheng	Automotive Steering Gears	170,520	26,000	1,706,416	Jingzhou City, Hubei Province
Total		667,666	133,886	\$ 60,941,338	

The Company is not involved in investments in (i) real estate or interests in real estate, (ii) real estate mortgages, and (iii) securities of or interests in persons primarily engaged in real estate activities, as all of its land rights are used for production purposes.

ITEM 3. LEGAL PROCEEDINGS

The Company is not a party to any pending or to the best of the Company's knowledge, any threatened legal proceedings. No director, officer or affiliate of the Company, or owner of record of more than five percent, 5%, of the securities of the Company, or any associate of any such director, officer or security holder is a party adverse to the Company or has a material interest adverse to the Company in reference to pending litigation.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On June 25 2008, the Company held a shareholder meeting at which the shareholders elected 5 directors and approved the engagement of Schwartz Levitsky Feldman LLP as independent auditor.

PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) MARKET PRICES OF COMMON STOCK

The Company's common stock has been traded on the NASDAQ Capital Market under the symbol "CAAS". The high and low bid intra-day prices of the common stock in 2008 and 2007 were reported on NASDAQ for the time periods indicated on the table below. Accordingly, the table below contains the high and low bid closing prices of the common stock as reported on the NASDAQ for the time periods indicated.

	Price Range			
	2008		2007	
	High	Low	High	Low
First Quarter	\$ 7.98	\$ 4.40	\$ 11.97	\$ 7.83
Second Quarter	7.45	4.85	8.90	7.00
Third Quarter	6.69	3.88	8.76	6.19
Fourth Quarter	\$ 4.20	\$ 2.01	\$ 9.39	\$ 6.40

(b) STOCKHOLDERS

The Company's common shares are issued in registered form. Securities Transfer Corporation in Frisco, Texas is the registrar and transfer agent for the Company's common stock. As of February 27, 2009, there were 26,983,244 shares of the Company's common stock outstanding and the Company had approximately 76 stockholders of record.

(c) DIVIDENDS

The Company has never declared or paid any cash dividends on its common stock and it does not anticipate paying any cash dividends in the foreseeable future. The Company currently intends to retain future earnings, if any, to finance operations and the expansion of its business. Any future determination to pay cash dividends will be at the discretion of the Board of Directors and will be based upon the Company's financial condition, operating results, capital requirements, plans for expansion, restrictions imposed by any financing arrangements and any other factors that the Board of Directors deems relevant.

(d) SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The securities authorized for issuance under equity compensation plans at December 31, 2008 are as follows:

Plan category	Number of securities to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuance
Equity compensation plans approved by security holders	2,200,000	\$ 3.84	1,788,650

The stock option plan was approved in the 2004 Annual Meeting of Stockholders, and the maximum common shares for issuance under this plan are 2,200,000 with a term of 10 years.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following is management's discussion and analysis of certain significant factors which have affected the Company's financial position and operating results during the periods included in the accompanying consolidated financial statements, as well as information relating to the plans of its current management. This report includes forward-looking statements. These statements relate to future events or the Company's future financial performance. The Company has attempted to identify forward-looking statements by terminology including "anticipates," "believes," "expects," "can," "continue," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predict," "should" or "will" or the negative of these terms or other comparable terminology. Such statements are subject to certain risks and uncertainties, including the matters set forth in this 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. Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements. 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. The Company's expectations are as of the date this Form 10-K is filed, and the Company does not intend to update any of the forward-looking statements after the date this Annual Report on Form 10-K is filed to confirm these statements to actual results, unless required by law. The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and the related notes thereto and other financial information contained elsewhere in this Form 10-K.

GENERAL OVERVIEW

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

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

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

The Company owns the following aggregate net interests in eight Sino-foreign joint ventures organized in the PRC as of December 31, 2008 and 2007.

Name of Entity	Percentage Interest	
	2008	2007
Jingzhou Henglong Automotive Parts Co., Ltd., “Henglong”	80.00%	44.50%
Shashi Jiulong Power Steering Gears Co., Ltd., “Jiulong”	81.00%	81.00%
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., “Shenyang”	70.00%	70.00%
Zhejiang Henglong & Vie Pump-Manu Co., Ltd., “Zhejiang”	51.00%	51.00%
Universal Sensor Application Inc., “USAI”	83.34%	75.90%
Wuhan Jielong Electric Power Steering Co., Ltd., “Jielong”	85.00%	85.00%
Wuhu HengLong Auto Steering System Co., Ltd., “Wuhu”	77.33%	77.33%
Jingzhou Hengsheng Automotive System Co., Ltd, “Hengsheng”	100.00%	100.00%

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

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

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

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

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

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

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

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

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

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

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

RESULTS OF OPERATIONS

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

	Percentage on net sales		Change in percentage
	Year Ended December 31		Year Ended December 31
	2008	2007	2008 vs. 2007
Net sales	100.00%	100.00%	22.1%
Cost of sales	71.0	66.1	31.3
Gross profit	29.0	33.9	4.3
Gain on other sales	0.4	0.4	32.5
Less: operating expenses			
Selling expenses	6.7	7.2	12.4
General and administrative expenses	7.4	6.8	34.0
R & D expenses	1.4	1.2	35.4
Depreciation and amortization	3.6	3.2	37.8
Total operating expenses	19.1	18.4	26.2
Operating income	10.3	15.9	(20.4)
Other income	0.7	0.0	-
Financial expenses	(0.8)	(0.4)	128.6
Gain (loss) on change in fair value of derivative	0.6	-	-
Income before income tax	10.8	15.5	(14.7)
Income tax	0.1	1.7	(91.7)
Income before minority interests	10.7	13.8	(5.4)
Minority interests	3.1	7.2	(47.4)
Net income	7.6%	6.6%	40.4%

RESULTS OF OPERATIONS: 2008 VERSUS 2007

NET SALES

The increase in net product sales of the Company is summarized as follows:

	Years Ended December 31			
	2008	2007	Increase (Decrease)	Percentage
Steering gear for commercial vehicles	\$ 40,457,552	\$ 35,774,012	\$ 4,683,540	13.1%
Steering gear for passenger vehicles	107,219,598	83,895,652	23,323,946	27.8
Steering pumps	15,094,357	13,828,252	1,266,105	9.2
Sensor modular	407,779	99,087	308,692	311.5
Total	\$163,179,286	\$133,597,003	\$ 29,582,283	22.1%

For the year ended December 31, 2008, net product sales were \$163,179,286, as compared to \$133,597,003 for the year ended December 31, 2007, an increase of \$29,582,283, or 22.1%. The increase in net sales in 2008 as compared to 2007 was a result of several factors.

- (1) Increases in the income of Chinese residents and the growth of consumption led to an increase in the sales of passenger vehicles, which led to the increase in the Company's sales of steering gears and pumps. During 2008, the output and sales volume of passenger vehicles in China have reached 6,737,700 and 6,755,600 units respectively, with an increase of 5.6% and 7.3% compared with last year. As a result, sales of steering gear and pumps for domestic passenger vehicles for the year ended December 31, 2008 increased 27.8% and 9.2% over 2007, respectively.

(2) Increased national economic investments in China led to an increase in sales of commercial vehicles, which led to the increase in the Company's sales of steering gears for commercial vehicles. The output and sales volume of commercial vehicles have reached 2,607,400 and 2,624,900 units respectively with an increase of 4.2% and 5.3% over last year. For the year ended December 31, 2008, sales of steering gears and accessories for commercial vehicles increased by 13.1% as compared to 2007.

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

GAIN ON OTHER SALES

Gain on other sales consisted of net amount retained from sales of materials and other assets. For the year ended December 31, 2008, gain on other sales were \$734,063, as compared to \$554,150 for the year ended December 31, 2007, an increase of \$179,913, or 32.5%, due to increased sales of materials.

GROSS PROFIT FROM PRODUCT SALES

For the year ended December 31, 2008, the gross profit was \$47,258,701, as compared to \$45,323,048 for the year ended December 31, 2007, an increase of \$1,935,653, or 4.3%, as a result of following factors:

The increased income of sales contributed to an increase of \$16,908,063 in gross profit, while the increase in unit cost resulted in a decrease of \$14,972,410 in gross profit.

Gross margin was 29.0% for the year ended December 31, 2008, a decrease of 4.9% from 33.9% for the same period of 2007, primarily due to an increase in materials price and unit cost. The Company took the following measures in 2008 to increase gross profit levels.

1. Reduce manufacturing costs by optimizing product design and production techniques. During 2008, the Company's technical personnel improved product design and production techniques to reduce wastage in the production process and improve manufacturing efficiency, thus reducing costs.

2. Raise the selling price of commercial vehicles steering gear. During the twelve months ended December 31, 2008, the unit cost of commercial vehicles steering gear increased, due to the sharp rise of the price of steel, its main raw material. In order to meet the gross margin target, the Company has raised the selling price of commercial vehicles steering gear after negotiation with the OEMs.

SELLING EXPENSES

For the years ended December 31, 2008 and 2007, selling expenses are summarized as follows:

	Years Ended December 31			
	2008	2007	Increase (Decrease)	Percentage
Salaries and wages	\$ 1,413,708	\$1,516,436	\$ (102,728)	(6.8%)
Supplies expense	138,489	76,448	62,041	81.2
Travel expense	489,872	328,095	161,777	49.3
Transportation expense	2,158,793	1,868,245	290,548	15.6
After sales service expense	5,861,783	5,251,382	610,401	11.6
Rent expense	384,167	265,908	118,259	44.5
Office expense	152,179	114,105	38,074	33.4
Advertising expense	10,009	14,168	(4,159)	(29.4)
Business entertainment expense	219,787	222,200	(2,413)	(1.1)
Insurance expense	16,917	15,431	1,486	9.6

Other expense	23,957	2,058	21,899	1,063.6
Total	<u>\$10,869,661</u>	<u>\$9,674,476</u>	<u>\$ 1,195,185</u>	<u>12.4%</u>

Selling expenses were \$10,869,661 for the year ended December 31, 2008, as compared to \$9,674,476 for 2007, an increase of \$1,195,185, or 12.4%. Major items that increased by more than \$100,000 in 2008 as compared to 2007 were travel expenses, transportation expense, after sales service expense, and rent expenses.

The increase in travel expense was due to increased sales and marketing activities, which led to increases in business travel.

The increase in transportation expense was due to increased sales and a rise in the price of oil, which led to increases in domestic transportation prices.

After sales service expense for the year ended December 31, 2008 increased by \$610,401, or 11.6%, as compared with the last year, mainly due to the increased product sales.

The increase in rent expense was due to increased marketing areas, which led to increases in product warehouses and offices.

GENERAL AND ADMINISTRATIVE EXPENSES

For the years ended December 31, 2008 and 2007, general and administrative expenses are summarized as follows:

	Years Ended December 31			
	2008	2007	Increase (Decrease)	Percentage
Salaries and wages	\$ 3,929,989	\$3,921,572	\$ 8,417	0.2%
Travel expenses	487,690	491,422	(3,732)	(0.8)
Office expenses	551,760	473,796	77,964	16.5
Supplies expenses	611,169	609,895	1,274	0.2
Repairs expenses	656,886	564,284	92,602	16.4
Business entertainment expenses	363,791	206,677	157,114	76.0
Labor insurance expenses	1,667,287	1,017,072	650,215	63.9
Labor union dues expenses	108,704	65,200	43,504	66.7
Board of directors expense	66,920	63,677	3,243	5.1
Taxes	690,918	476,765	214,153	44.9
Provision for bad debts	989,584	(649,512)	1,639,096	-
Training expenses	194,954	128,032	66,922	52.3
Listing expenses	1,624,161	1,203,104	421,057	35.0
Others expenses	153,687	454,733	(301,046)	(66.2)
Total	<u>\$12,097,500</u>	<u>\$9,026,717</u>	<u>\$ 3,070,783</u>	<u>34.0%</u>

General and administrative expenses were \$12,097,500 for the year ended December 31, 2008, as compared to \$9,026,717 for the year ended December 31, 2007, an increase of \$3,070,783, or 34.0%.

The expense items that increased more than \$100,000 in 2008 as compared to 2007 were business entertainment expenses, labor insurance expenses, taxes expenses, provision for bad debts expenses and listing expenses. Listing expenses consisted of the costs associated with legal, accounting and auditing fees for operating a public company.

The increase in business entertainment expense was due to reception of Government staff to inspect and direct the Company's management in 2008.

The increase in labor insurance expenses was mainly due to an increase of housing fund expenses at Henglong and Jiulong for 2008.

The increase in tax expense was due to the increased assets of the Company, which led to increased property taxes.

The increase in provision for bad debts was mainly due to certain accounts receivable and advance payment for equipment which had remained outstanding after the credit period. The Company believes that an additional provision for bad debts is required.

The increase in listing expenses was due to increased costs associated with auditing, legal, consulting and accounting fees for issuance of convertible notes, and acquisition of 35.5% equity of Henglong, one of the Company's Joint-venture.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were \$2,255,892 for the year ended December 31, 2008, as compared to \$1,666,274 for the year ended December 31, 2007, an increase of \$589,618, or 35.4%.

The global automotive parts industry is highly competitive; winning and maintaining new businesses require suppliers to rapidly produce new and innovative products on a cost-competitive basis. In order to maintain the Company's competitiveness, the Company needs to invest more R & D expenses. In 2008, the Company not only developed new products for foreign OEMs, but also increased R & D expenses of power steering gears for domestic OEMs.

DEPRECIATION AND AMORTIZATION EXPENSE

For the year ended December 31, 2008, depreciation and amortization expenses excluded from that recorded under cost of sales were \$5,846,290, as compared to \$4,243,930 for the year ended December 31, 2007, an increase of \$1,602,360, or 37.8%, as a result of the Company's increasing its fixed assets.

INCOME FROM OPERATIONS

Income from operations was \$16,923,421 for the year ended December 31, 2008, as compared to \$21,265,801 for the year ended December 31, 2007, a decrease of \$4,342,380, or 20.4%, mainly consisting of an increase of \$1,935,653, or 4.3% from gross profit; an increase of \$179,913, or 32.5% from net sales from materials and others, and a decrease of operating income of \$6,457,946, or 26.2%, as a result of increased operating expenses.

OTHER INCOME

Other income was \$1,067,309 for the year ended December 31, 2008, as compared to \$38,462 for the year ended December 31, 2007, an increase of \$1,028,847, primarily as a result of increased government subsidies.

Government subsidies including interest subsidies are the refunds by the Chinese Government of interest charged by banks to companies which are entitled to such subsidies, and subsidies for encouraging foreign investors to set up technologically advanced enterprises in China.

Interest subsidies apply only to loan interest related to production facilities expansion. During 2005 and 2006, the Company had used this special loan to improve technologically its production line in order

to enlarge capability and enhance quality. The expansion project was completed and new facilities were put into use at the end of 2006 and 2007, respectively.

During 2007 and 2008, the experts sent by the Chinese Government reviewed and assessed the actual usage of technologically improved production facilities on site in order to confirm whether the improvement has achieved its expected goal of production expansion and quality enhancement. Whether or not a company can receive interest subsidies from the Chinese Government depends on the company's achieving the two goals set forth above after the technological improvement.

Chinese government also provided incentives to foreign investors for setting up technologically advanced enterprises in China. During 2008, Genesis, as a foreign investor, has received \$802,331 for re-investment in Jiulong and Henglong with their profit distribution, and those entities were technologically advanced enterprises and entitled to such subsidies.

Since such government subsidy is similar to an investment income, the Company has recorded it as other income.

FINANCIAL EXPENSES

Financial expenses were \$1,296,218 for the year ended December 31, 2008, as compared to financial expenses of \$566,986 for the year of 2007, an increase of \$729,232, or 128.6%, primarily as a result of an increase in interest expense of \$678,992, an increase in convertible notes discount amortization of \$424,665 and an increase in bank service fee of \$36,210, as well as an increase of foreign currency exchange gain of \$210,081 and an increase in notes discount gain of \$200,554.

GAIN ON CHANGE IN FAIR VALUE OF DERIVATIVE

Gain on change in fair value of the derivatives embedded in the convertible notes was \$998,014 for the year ended December 31, 2008.

INCOME BEFORE INCOME TAXES

Income before income taxes was \$17,692,526 for the year ended December 31, 2008, as compared to \$20,737,277 for the year ended December 31, 2007, a decrease of \$3,044,751, or 14.7%, consisting of decreased income from operations of \$4,342,380, increased other income of \$1,028,847, increased finance expenses of \$729,232, and increased gain on change in fair value of derivative of \$998,014.

INCOME TAXES

Income tax expense was \$185,877 for the year ended December 31, 2008, as compared to \$2,231,032 for the year ended December 31, 2007, a decrease of \$2,045,155, or 91.7%, mainly because of:

1. Decreased income from taxable income resulted in decreased income tax of \$325,105.
2. The Company has received an income tax refund of \$2,762,823 for domestic equipment purchased during the year ended December 31, 2008, as compared to \$2,085,180 for the year of 2007, leading to a decrease of income tax of \$677,643.
3. The income tax rate for Jiulong, one of the Company's Sino-foreign joint ventures in 2008, decreased to 25% from previous year's 30%. This decrease in income tax rate led to a decreased income tax expenses of \$68,023.

4. An increase in deferred income taxes assets led to a decreased income tax expenses of \$974,383.

INCOME BEFORE MINORITY INTEREST

Income before minority shareholders' was \$17,506,649 for the year ended December 31, 2008, as compared to \$18,506,245 for the year ended December 31, 2007, a decrease of \$999,596, or 5.4%, consisting of decreased income before income taxes of \$3,044,751, or 14.7%, and an increase of \$2,045,155, or 91.7% due to decreased income tax expenses.

MINORITY INTEREST

The Company recorded minority shareholders' share in the earnings of the Sino-foreign joint ventures aggregating \$5,071,408 for the year ended December 31, 2008, and compared to \$9,646,339 for the year ended December 31, 2007, a decrease of \$4,574,931, or 47.4%.

The Company owns different equity interest in eight Sino-foreign joint ventures, through which it conducts its operations. All the operating results of these eight Sino-foreign joint ventures were consolidated in the Company's financial statements as of December 31, 2008 and 2007. The Company records the minority shareholders' share in the earnings of the respective Sino-foreign joint ventures for each period.

In 2008, minority interest decreased significantly as compared to 2007, primarily because the minority shareholders' equity interest in Henglong decreased by 35.5%. In early 2008, the Company acquired such equity interest.

NET INCOME

Net income was \$12,435,241 for the year ended December 31, 2008, as compared to \$8,859,906 for the year ended December 31, 2007, an increase of \$3,575,335, or 40.4%, consisting of decreased income before minority interest of \$999,596, or 5.4%, and a decreased minority interest of \$4,574,931, or 47.4%, which increased net income.

LIQUIDITY AND CAPITAL RESOURCES

Capital resources and use of cash

The Company has historically financed its liquidity requirements from a variety of sources, including short-term borrowings under bank credit agreements, bankers' acceptance, issuances of capital stock and internally generated cash. As of December 31, 2008, the Company had cash and cash equivalents of \$37,113,375, as compared to \$19,487,159 as of December 31, 2007, an increase of \$17,626,216, or 90.5%.

The Company had working capital of \$42,032,901 as of December 31, 2008, as compared to \$35,022,355 as of December 31, 2007, an increase of \$7,010,546, or 20.0%.

Financing activities

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

The Company had bank loans maturing in less than one year of \$7,315,717 and bankers' acceptances of \$20,650,596 as of December 31, 2008.

The Company currently expects to be able to obtain similar bank loans and bankers' acceptance bills in the future if it can provide adequate mortgage security following the termination of the above mentioned agreements (See the table in section (a) Bank loan). If the Company is not able to do so, it will have to refinance such debt as it becomes due or repay that debt to the extent it has cash available from operations or from the proceeds of additional issuances of capital stock. Owing to depreciation, the value of the mortgages securing the above-mentioned bank loans and banker's acceptance bills will be devalued by approximately \$7,449,616. If the Company wishes to obtain the same amount of bank loans and banker's acceptance bills, it will have to provide \$7,449,616 additional mortgages as of the mature date of such agreements (See the table in section (a) Bank loan). The Company still can obtain a reduced line of credit with a reduction of \$2,205,537, which is 30% (the mortgage rates) of \$7,449,616, if it cannot provide additional mortgages. The Company expects that the reduction of bank loans will not have a material adverse effect on its liquidity.

On February 15, 2008, the Company issued \$35,000,000 of convertible notes to Lehman Brothers Commercial Corporation Asia Limited, and YA Global Investments, L.P., maturing in 5 years. According to the terms of the Senior Convertible Notes (as described in Note 13), convertible notes may be required to be repaid in cash on or prior to their maturity. For example, Convertible Note holders are entitled to require the Company redeem all or any portion of the Convertible Notes in cash, if the Weighted Average Price (WAP) for twenty (20) consecutive trading days is less than \$3.187 at any time following February 15, 2009, the "WAP Default", by delivering written redemption notice to the Company within five (5) business days after the receipt of the Company's notice of the WAP Default. As a result of the recent worldwide financial turmoil, the Company's stock's WAP for twenty (20) consecutive trading days ended on March 16, 2009 was below \$3.187. On March 17, 2009, the Company delivered the WAP Default notice to the Convertible Note holders. Since the Company has not received any notice from YA Global Investments, L.P. as of March 24, 2009, its redemption rights under such WAP Default has lapsed. On March 23, 2009, the Company received a letter from the joint and several provisional liquidators acting on behalf of Lehman Brothers Commercial Corporation Asia Limited, "LBCCA Liquidator", requesting that it be granted an extension of time until April 24, 2009 to obtain legal advice and to consider its rights under the Convertible Notes. The Company has granted an extension to April 15, 2009. Although the LBCCA Liquidator has not given the Company any notice of redemption yet, it may exercise its discretionary right of early redemption on any date that is no earlier than ninety (90) days after it delivers the written redemption notice to the Company, so long as it delivers such notice on or before April 15, 2009.

The Company's ability to redeem the Convertible Notes and meet the Company's payment obligations depends on the Company's cash position and the Company's ability to refinance or generate significant cash flow, which is subject to general economic, financial and competition factors and other factors beyond the Company's control. The Company cannot assure you that it has sufficient funds available or will be able to obtain sufficient funds to meet its payment obligations under the Convertible Notes, and the Company's failure to redeem would result in a material adverse effect on its liquidity and capital resources, business, results of operations or financial condition.

(a) Bank loans

As of December 31, 2008, the principal outstanding under the Company's credit facilities and lines of credit was as follows:

	Bank	Due Date	Amount available	Amount borrowed
Comprehensive credit facilities	Bank of China	Dec-09	\$ 8,924,809	\$ 7,070,641
Comprehensive credit facilities	China Construction Bank	Oct-09	8,984,988	3,613,379
Comprehensive credit facilities	CITIC Industrial Bank	Jul-09	6,804,559	4,096,802
	Shanghai Pudong Development Bank			
Comprehensive credit facilities	Bank	Oct-09	7,350,740	2,936,383
Comprehensive credit facilities	Jingzhou Commercial Bank	Oct-09	9,972,786	1,155,883
	Industrial and Commercial Bank of China			
Comprehensive credit facilities	Bank of China	Sep-09	2,926,287	1,593,363
	Bank of Communications Co., Ltd			
Comprehensive credit facilities	Ltd	Sep-09	3,335,967	1,360,723
Comprehensive credit facilities	China Merchants Bank Co. Ltd	Sep-09	2,194,715	2,194,715
Total			<u>\$50,494,851</u>	<u>\$24,021,889</u>

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

The Company refinanced its short-term debt during early 2008 at annual interest rates of 5.31% to 6.83%, and for terms of six to twelve months. Pursuant to the refinancing arrangement, the Company pledged \$30,567,846 of equipment, \$5,334,489 of land use rights and \$3,177,816 of buildings as security for its comprehensive credit facility with the Bank of China; pledged \$2,105,054 of land use rights and \$11,392,532 of buildings as security for its comprehensive credit facility with Shanghai Pudong Development Bank; pledged \$5,863,884 of land use rights and \$7,455,433 of equipment as security for its revolving comprehensive credit facility with Jingzhou Commercial Bank; pledged \$1,575,707 of land use rights and \$1,064,522 of buildings as security for its comprehensive credit facility with Industrial and Commercial Bank of China; pledged \$1,463,143 of accounts receivable, \$7,034,062 of land use rights and \$3,660,990 of buildings as security for its comprehensive credit facility with China Construction Bank; pledged \$2,985,764 of land use rights and \$4,252,217 of buildings as security for its comprehensive credit facility with China CITIC Bank; pledged \$3,465,792 of land use rights and \$1,920,101 of buildings as security for its comprehensive credit facility with China Merchants Bank; pledged \$4,151,801 of land use rights and \$2,341,907 of buildings as security for its comprehensive credit facility with Bank of Communications Co., Ltd.

(b) Financing from investors

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

According to the terms of the Senior Convertible Notes (as described in Note 13), convertible notes may be required to be repaid in cash on or prior to their maturity. For example, Convertible Note holders are entitled to require the Company redeem all or any portion of the Convertible Notes in cash, if the Weighted Average Price (WAP) for twenty (20) consecutive trading days is less than \$3.187 at any time following February 15, 2009, the "WAP Default", by delivering written redemption notice to the Company within five (5) business days after the receipt of the Company's notice of the WAP Default. As a result of the recent worldwide financial turmoil, the Company's stock's WAP for twenty (20) consecutive trading days ended on March 16, 2009 was below \$3.187. On March 17, 2009, the Company delivered the WAP Default notice to the Convertible Note holders. Since the Company has not received any notice

from YA Global Investments, L.P. as of March 24, 2009, its redemption rights under such WAP Default has lapsed. On March 23, 2009, the Company received a letter from the joint and several provisional liquidators acting on behalf of Lehman Brothers Commercial Corporation Asia Limited, "LBCCA Liquidator", requesting that it be granted an extension of time until April 24, 2009 to obtain legal advice and to consider its rights under the Convertible Notes. The Company has granted an extension to April 15, 2009. Although the LBCCA Liquidator has not given the Company any notice of redemption yet, it may exercise its discretionary right of early redemption on any date that is no earlier than ninety (90) days after it delivers the written redemption notice to the Company, so long as it delivers such notice on or before April 15, 2009.

The Company's ability to redeem the Convertible Notes and meet its payment obligations depends on its cash position and its ability to refinance or generate significant cash flow, which is subject to general economic, financial and competition factors and other factors beyond the Company's control. If the aforementioned convertible notes must be repaid in cash at or before scheduled maturity, and if at that time the Company cannot issue new notes or stock to refinance, or acquire enough bank loans, or cannot extend the maturity dates of such notes, the Company's liquidity and capital resources will be adversely affected.

Cash Requirements

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

	Payment Due Dates				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Short-term bank loan	\$ 7,315,717	\$ 7,315,717	\$ —	\$ —	\$ —
Notes payable	20,650,596	20,650,596	—	—	—
Convertible notes payable	35,000,000	35,000,000	—	—	—
Other contractual purchase commitments, including information technology	7,103,327	5,971,113	1,132,214	—	—
Total	\$70,069,640	\$68,937,426	\$1,132,214	\$ —	\$ —

Short-term bank loans

The following table summarizes the contract information of short-term borrowings between the banks and the Company as of December 31, 2008

Bank	Purpose	Borrowing Date	Borrowing Term (Year)	Annual Percentage Rate	Date of Interest Payment	Date of payment	Amount Payable on Due Date
Bank of China	Working Capital	31-Oct-08	1	6.66%	Pay monthly	31-Oct-09	2,194,715
China Construction Bank	Working Capital	29-Dec-08	1	5.31%	Pay monthly	29-Dec-09	2,926,287
China Construction Bank	Working Capital	28-Sep-08	0.5	6.83%	Pay monthly	19-Mar-09	2,194,715
Total							7,315,717

The Company must use the loans for the purpose described in the table. If the Company fails, it will be charged a penalty interest at 100% of the specified loan rate. The Company has to pay interest at the interest rate described in the table on the 20th of each month. If the Company fails, it will be charged a compounded interest at the specified rate. The Company has to repay the principal outstanding on the specified date in the table. If it fails, it will be charged a penalty interest at 50% of the specified loan rate.

Management believes that the Company had complied with such financial covenants as of December 31, 2008, and will continue to comply with them.

The following table summarizes the contract information of issuing notes payable between the banks and the Company as of December 31, 2008:

Purpose	Term (Month)	Due Date	Amount Payable on Due Date
Working Capital	3-6	Jan-09	\$ 2,500,975
Working Capital	3-6	Feb-09	4,150,806
Working Capital	3-6	Mar-09	4,042,958
Working Capital	3-6	Apr-09	4,892,752
Working Capital	3-6	May-09	594,329
Working Capital	3-6	Jun-09	4,468,777
Total			<u>\$ 20,650,597</u>

The Company must use the loan for the purpose described in the table. If it fails, the banks will no longer issue the notes payable, and it may have an adverse effect on the Company's liquidity and capital resources. The Company has to deposit sufficient cash in the designated account of the bank on the due date of notes payable for payment to the suppliers. If the bank has advanced payment for the Company, it will be charged a penalty interest at 150% of the specified loan rate. Management believes that the Company had complied with such financial covenants as of December 31, 2008, and will continue to comply with them.

The Company had approximately \$7,103,327 of capital commitment as of December 31, 2008, arising from equipment purchases for expanding production capacity. The Company intends to pay \$5,971,113 in 2009 using its working capital. Management believes that it will not have a material adverse effect on the Company's liquidity.

Cash flows

(a) Operating activities

Net cash generated from operations during the year ended December 31, 2008 was \$16,373,966, compared with \$11,324,473 for the year of 2007, an increase of \$5,049,493, primarily due to increased net income.

During the year ended December 31, 2008, the most important factor of cash outflow of operation activities is increased accounts receivables, notes receivables, and inventories, the same as the year ended December 31, 2007.

First, cash outflow caused by the increased accounts receivables was about \$12,080,000, mainly due to increased sales in 2008 than in 2007. The credit terms on sale of goods between customers and the Company generally range from 3 - 4 months, which resulted in increased accounts receivable as sales increased. This is a normal capital circulation and the Company believes that it will not have a material adverse effect on future cash flows. Second, cash outflow caused by increased notes receivable was about \$2,160,000, mainly due to the Company having sufficient working capital, thus having less notes receivable discounted during this period. Since the notes receivable were based on bank credit standing, they may turn into cash any time the Company elects. Therefore, the increase of notes receivable will not have a material adverse effect on the Company's future operating activities. Third, increased inventories led to cash outflow of \$4,960,000, mainly due to the Company's intention to produce sufficient inventories to meet huge demands in the first quarter of 2009.

(b) Investing activities

The Company expended net cash of \$22,356,060 in investment activities during the year ended December 31, 2008, as compared to \$13,159,277 during the year of 2007, an increase of \$9,196,783.

There were two major investment activities in 2008:

First, as in 2007, the Company invested cash for equipment purchases and building facility to expand production to meet market needs. Cash used for equipment purchases and building facility in 2008 and 2007 were \$12,245,383 and \$13,982,490, respectively.

Second, the Company acquired 35.5% equity interest in Henglong, one of the Company's Joint-Ventures.

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

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

(c) Financing activities

During the year ended December 31, 2008, the Company obtained net cash of \$21,981,953 in financing activities, as compared to expending net cash of \$7,429,025 through financing activities for the same period of 2007, an increase of \$29,410,978 as a result of the following factors:

During the year ended December 31, 2008, the Company sold \$30,000,000 and \$5,000,000 of convertible notes to Lehman Brothers Commercial Corporation Asia Limited, and YA Global Investments, L.P., respectively. During the same period in 2007, the Company issued 108,121 shares of common stock and raised \$1,145,500.

The Company also repaid bank loans of \$7,567,697 during the year ended December 31, 2008, to decrease bank loan interest.

OFF-BALANCE SHEET ARRANGEMENTS

At December 31, 2008 and 2007, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

COMMITMENTS AND CONTINGENCIES

The following table summarizes the Company's contractual payment obligations and commitments as of December 31, 2008:

	Payment Obligations by Period					Total
	2009	2010	2011	2012	Thereafter	
Obligations for service agreements	\$ 110,000	\$ 110,000	\$ 110,000	\$ —	\$ —	\$ 330,000
Obligations for purchasing agreements	5,861,113	912,214	—	—	—	6,773,327
Total	<u>\$5,971,113</u>	<u>\$1,022,214</u>	<u>\$ 110,000</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$7,103,327</u>

SUBSEQUENT EVENTS

Since the Company's stock Weighted Average Price for twenty (20) consecutive trading days ended on March 16, 2009 was below \$3.187, which is less than 45% of the Conversion Price in effect of the Issuance Date, as adjusted, the "WAP Default", the Convertible Debt holder shall have the right, at its sole discretion, to require that the Company redeem all or any portion of the Convertible Debt by delivering written redemption notice to the Company within five (5) business days after the receipt of the Company's notice of the WAP Default. On March 17, 2009, the Company delivered the WAP Default notice to the Convertible Debt holders. Since the Company has not received any notice from YA Global Investments, L.P. as of March 24, 2009, its redemption rights under such WAP Default has lapsed. On March 23, 2009, the Company received a letter from the joint and several provisional liquidators acting on behalf of Lehman Brothers Commercial Corporation Asia Limited, "LBCCA Liquidator", requesting that it be granted an extension of time until April 24, 2009 to obtain legal advice and to consider its rights under the Convertible Debt. The Company has granted an extension to April 15, 2009. Although the LBCCA Liquidator has not given the Company any notice of redemption yet, it may exercise its discretionary right of early redemption on any date that is no earlier than ninety (90) days after it delivers the written redemption notice to the Company, so long as it delivers such notice on or before April 15, 2009.

INFLATION AND CURRENCY MATTERS

In the most recent decade, the Chinese economy has experienced periods of rapid economic growth as well as relatively high rates of inflation, which in turn has resulted in the periodic adoption by the Chinese Government of various corrective measures designed to regulate growth and contain inflation.

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

In July 2005, the Chinese Government adjusted its exchange rate policy from "Fixed Rate" to "Floating Rate". During July 2005 to July 2008, the exchange rate between RMB and US dollars experienced a big fluctuation, for RMB 1.00 to US\$0.1205 and RMB 1.00 to US\$0.1462, respectively. Since August 2008, the exchange rate has maintained stable, and was approximately at RMB 1.00 to US\$0.1462. There can be no assurance that the exchange rate 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.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair values. SFAS 159 is effective for fiscal years after November 15, 2007. The Company has adopted the provisions of this statement since January 1, 2008.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), Business Combinations. SFAS 141(R) retains the fundamental requirements of the original pronouncement requiring that the purchase method be used for all business combinations. SFAS 141(R) defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquirer achieves control and requires the acquirer to recognize the assets acquired, liabilities

assumed and any noncontrolling interest at their fair values as of the acquisition date. In addition, SFAS 141(R) requires expensing of acquisition-related and restructure-related costs, remeasurement of earn out provisions at fair value, measurement of equity securities issued for purchase at the date of close of the transaction and non-expensing of in-process research and development related intangibles. 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 141R beginning in the first quarter of 2009. The Company is currently evaluating the impact of the implementation of SFAS No. 141(R) on its consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51." The objective of SFAS No. 160 is to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing additional accounting and reporting standards. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. Early adoption of this statement is prohibited. By adopting SFAS No. 160, the noncontrolling interests will be reported as equity while the noncontrolling interests are reported in the mezzanine section between liabilities and equity currently. The Company is currently assessing the impact of adopting SFAS No. 160 on its consolidated financial statements.

In March 2008, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities. The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is currently evaluating the impact of adopting SFAS No. 161 on its consolidated financial statements.

In May 2008, the FASB issued Financial Accounting Standard No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"). The statement is intended to improve financial reporting by identifying a consistent hierarchy for selecting accounting principles to be used in preparing financial statements that are prepared in conformance with GAAP. Unlike SAS No. 69, "The Meaning of Present in Conformity With GAAP," SFAS No. 162 is directed to the entity rather than the auditor. The statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with GAAP." The Company is currently assessing the impact of this statement, but believes it will not have a material impact on its financial position, results of operations, or cash flows upon adoption.

In May 2008, the FASB issued SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts-an interpretation of FASB Statement No. 60." Diversity exists in practice in accounting for financial guarantee insurance contracts by insurance enterprises under FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises. This results in inconsistencies in the recognition and measurement of claim liabilities. This Statement requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement requires expanded disclosures about financial guarantee insurance contracts. The accounting and disclosure requirements of the Statement will improve the quality of information provided to users of financial statements. The adoption of FASB 163 is not expected to have a material impact on the Company's financial position.

In May 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") APB 14-1, Accounting for Convertible Debt Instruments That May be Settled in Cash upon Conversion (Including Partial Cash Settlement). FSP APB14-1 clarifies that convertible debt instruments that may be settled in cash upon either mandatory or optional conversion (including Partial Cash Settlement) are not addressed by paragraph 12 of APB Opinion No.14, Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants. Additionally, FSP APB14-1 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect

the entity's non-convertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company has adopted FSP APB14-1 beginning January 1, 2009, and this standard must be applied on a retrospective basis. The Company is evaluating the impact the adoption of FSP APB14-1 will have on its consolidated financial position and results of operations.

In June 2008, the FASB ratified the consensus reached on EITF Issue No. 07-05; Determining Whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock. EITF Issue No. 07-05 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which would qualify as a scope exception under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. EITF Issue No. 07-05 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. The Company is currently evaluating the impact of adopting EITF Issue No. 07-05 on its consolidated financial statements.

On June 16, 2008, the FASB issued final Staff Position (FSP) No. EITF03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transaction Are Participating Securities," to address the question of whether instrument granted in share-based payment transaction are participating securities prior to vesting. The FSP determines that unvested share-based payment awards that contain rights to dividend payments should be included in earnings per share calculations. The guidance will be effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the requirement of (FSP) No. EITF03-6-1 as well as the impact of the adoption on its consolidated financial statements.

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities" ("FSP FAS 140-4 and FIN 46 (R)-8"). FSP FAS140-4 and FIN 46(R)-8 amends FAS140 and FIN 46(R) to require additional disclosures regarding transfers of financial assets and interest in variable interest entities. FSP FAS 140-4 and FIN 46 (R)-8 is effective for interim or annual reporting periods ending after December 15, 2008. The Company is currently evaluating the impact of the adoption of FSP FAS140-4 and FIN 46(R)-8 will have on its consolidated financial position and results of operations.

SIGNIFICANT ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

The Company prepares its 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 consolidated financial statements.

The Company considers an accounting estimate to be critical if:

- It requires the Company to make assumptions about matters that were uncertain at the time it was making the estimate, and
- Changes in the estimate or different estimates that the Company could have selected would have had a material impact on the Company's financial condition or results of operations.

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

Balance Sheet Caption	Critical Estimate Item	Nature of Estimates Required	Assumptions/Approaches Used	Key Factors
Accrued liabilities and other long-term liabilities	Warranty obligations	Estimating warranty requires the Company to forecast the resolution of existing claims and expected future claims on products sold. VMs are increasingly seeking to hold suppliers responsible for product warranties, which may impact the Company's exposure to these costs.	The Company bases its estimate on historical trends of units sold and payment amounts, combined with its current understanding of the status of existing claims and discussions with its customers.	<ul style="list-style-type: none"> • VM (Vehicle Manufacturer) sourcing • VM policy decisions regarding warranty claims • VMs
Property, plant and equipment, intangible assets and other long-term assets	Valuation of long-lived assets and investments	The Company is required from time-to-time to review the recoverability of certain of its assets based on projections of anticipated future cash flows, including future profitability assessments of various product lines.	The Company estimates cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments.	<ul style="list-style-type: none"> • Future Production estimates • Customer preferences and decisions
Accounts and notes receivables	Provision for doubtful accounts and notes receivable	Estimating the provision for doubtful accounts and notes receivable require the Company to analyze and monitor each customer's credit standing and financial condition regularly. The Company grants credit to its customers, generally on an open account basis. It will have material adverse effect on the Company's cost disclosure if such assessment were improper.	The Company grants credit to its customers for three to four months based on each customer's current credit standing and financial data. The Company assesses allowance on an individual customer basis, under normal circumstances ; the Company does not record any provision for doubtful accounts for those accounts receivable amounts which were in credit terms. For those receivables out of credit terms, certain proportional provision, namely 25% to 100%, will be recorded based on respective overdue terms.	<ul style="list-style-type: none"> • Customers' credit standing and financial condition
Deferred income taxes	Recoverability of deferred tax assets	The Company is required to estimate whether recoverability of its deferred tax assets is more likely than not based on forecasts of taxable earnings in the related tax jurisdiction	The Company uses historical and projected future operating results, based upon approved business plans, including a review of the eligible carry forward period, tax planning opportunities and other relevant considerations.	<ul style="list-style-type: none"> • Tax law changes • Variances in future projected profitability, including by taxing entity

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

(a) FINANCIAL STATEMENTS

The following financial statements are set forth at the end hereof.

1. Report of Independent Auditors
2. Consolidated Balance Sheets as of December 31, 2008 and 2007
3. Consolidated Statements of Earnings for the years ended December 31, 2008 and 2007
4. Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2008 and 2007
5. Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2008 and 2007
6. Consolidated Statements of Cash Flows for the years ended December 31, 2008 and 2007
7. Notes to Consolidated Financial Statements

(b) SELECTED QUARTERLY FINANCIAL DATA FOR THE PAST TWO YEARS APPEARS IN THE FOLLOWING TABLE

	Quarterly Results of Operations							
	First		Second		Third		Fourth	
	2008	2007	2008	2007	2008	2007	2008	2007
Net Sales	\$41,467,043	\$28,383,392	\$46,508,340	\$36,312,338	\$36,936,755	\$31,202,731	\$38,267,148	\$37,698,542
Gross Profit	12,212,370	9,191,906	14,463,004	12,093,806	9,878,223	11,362,751	10,705,104	12,674,585
Operating Income	6,784,664	5,188,611	5,477,887	5,944,365	3,697,416	6,630,432	963,454	3,502,393
Net Income	4,430,174	1,643,101	4,744,355	2,455,154	2,758,779	2,574,418	501,933	2,187,233
Earnings Per Share \$	0.18 \$	0.07 \$	0.19 \$	0.10 \$	0.10 \$	0.11 \$	0.01 \$	0.09

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

CONTROLS AND PROCEDURES

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

As of December 31, 2008, an evaluation was performed under the supervision and with the participation of the Company's management, including its Chief Executive officer and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures. Based on

that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2008.

Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of the Company's management, including its principal executive officer and its principal financial officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting, based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, the Company's management concluded that its internal control over financial reporting was effective as of December 31, 2008.

Changes in Internal Control over Financial Reporting

Management identified material weaknesses in the Company's internal control over financial reporting for the twelve months ended December 31, 2006 in its 10K for 2006, including inadequate reclassification adjustments and inadequate presentation of other income and warranties.

Commencing October 1, 2006, the Company has taken remediation measures to improve its internal control and performed testing of those remediation measures to ensure improvement of its internal control. For example, the Company has provided its in-house accountants training of accounting policy to follow the provision of GAAP in order to ensure the financial reports are prepared under the provision of GAAP and has employed experienced accountants.

Management believes, based on testing performed, that the material weakness in the Company's internal control over financial reporting had been remediated.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS, CORPORATE GOVERNANCE AND BOARD INDEPENDENCE

The following table and text set forth the names and ages of all directors and executive officers of the Company as of December 31, 2008. The Board of Directors is comprised of only one class. All of the directors will serve until the next annual meeting of stockholders and until their successors are elected and qualified, or until their earlier death, retirement, resignation or removal. Also provided herein are brief descriptions of the business experience of each director and executive officer during the past five years and an indication of directorships held by each director in other companies subject to the reporting requirements under the federal securities laws.

Name	Age	Position(s)
Hanlin Chen	51	Chairman of the Board
Qizhou Wu	44	Chief Executive Officer and Director
Jie Li	39	Chief Financial Officer
Tse, Yiu Wong Andy	38	Sr. VP
Shengbin Yu	55	Sr. VP
Shaobo Wang	46	Sr. VP
Daming Hu	50	Chief Accounting Officer
Robert Tung	52	Director
Dr. Haimian Cai	45	Director
William E. Thomson	67	Director

(a) BIOGRAPHIES OF DIRECTORS AND EXECUTIVE OFFICERS

Hanlin Chen has served as Chairman of the board and CEO since September 2007. Mr. Chen is a standing board member of the Political Consulting Committee of Jingzhou city and vice president of Foreign Investors Association of Hubei Province. He was the general manager of Jiulong from 1993 to 1997. Since 1997, he has been the Chairman of the Board of Henglong.

Qizhou Wu has served as the Chief Executive Officer since September 2007. Prior to that position he served as the Chief Operating Officer since March 2003. He was the Executive Vice General Manager of Jiulong from 1993 to 1999 and GM of Henglong from 1999 to 2002. Mr. Wu graduated from Tsinghua University in Beijing with a Masters degree in Automobile Engineering.

Jie Li has served as the Chief Financial Officer since September 2007. Prior to that position he served as the Corporate Secretary from December 2004. Prior to joining the Company in September 2003, Mr. Li was the Assistant President of Jingzhou Jiulong Industrial Inc from 1999 to 2003 and the general manager of Jingzhou Tianxin Investment Management Co. Ltd. from 2002 to 2003. Mr. Li has a Bachelor's degree from the University of Science and Technology of China. He also completed his graduate studies in economics and business management at the Hubei Administration Institute.

Tse, Yiu Wong Andy has served as Sr. VP of the Company since March 2003. He has also served as the general manager of the Henglong and Jiulong joint ventures and the chairman of the board of Shenyang since 2003. He was the vice GM of Jiulong from 1993 to 1997 and the vice GM of Henglong. Mr. Tse has over 10 years of experience in automotive parts sales and strategic development. Mr. Tse has an MBA from the China People University.

Shengbin Yu has served as Sr. VP of the Company and had overall charge of the production since March 2003. Mr. Yu was the Vice-G.M. of Jiulong from 1993 to 1996 and Executive Vice-G.M. of Henglong from 1997 to 2003.

Shaobo Wang has served as Sr. VP of the Company and had overall charge of the technology since March 2003. He was the Vice-G.M. of Jiulong from 1993 to 2003. Mr. Wang graduated from Tsinghua University in Beijing with a bachelor degree in Automobile Engineering.

Daming Hu has served as the Chief Accounting Officer since September 2007 and had overall charge of the financial report. During March 2003 to August 2007, he served as Chief Financial Officer of the Company. Mr. Hu was the Finance Manager of Jiulong from 1996 to 1999 and Finance Manager of Henglong from 1999 to 2002. Mr. Hu graduated from Zhongnan University of Economics and Law as an accountant bachelor.

Robert Tung has been a Director of the Company since September 2003 and a member of the Company's Audit, Compensation and Nominating Committees. Mr. Tung is currently the President of Multi-Media Communications, Inc., and Vice President of Herbal Blends International, LLC. Mr. Tung holds a M.S. in Chemical Engineering from the University of Virginia and B.S. degrees in Computer Science and Chemical Engineering from the University of Maryland and National Taiwan University, respectively. Since 2003, Mr. Tung has been actively developing the business in China. Currently, Mr. Tung is the China Operation General Manager of Ulamatic Inc., a leading North American automated equipment design house and manufacturer. In addition, Mr. Tung holds grand China sales representative position of TRI Products, Inc., a well known North American iron ores and scrap metals supplier.

Haimian Cai has been a Director since September 2003 and a member of the Company's Audit, Compensation and Nominating Committees. Dr. Cai is a technical specialist in the automotive industry. Prior to that, Dr. Cai was a staff engineer in ITT Automotive Inc. Dr. Cai has written more than fifteen technical papers and co-authored a technical book regarding the Powder Metallurgy industry for automotive application. Dr. Cai has more than ten patents including pending patents. Dr. Cai holds a B.S. Degree in Automotive Engineering from Tsinghua University and a M.S. and Ph. D. in manufacturing engineering from Worcester Polytechnic Institute.

William E. Thomson, CA, has been a Director of the Company since September 2003 and is a member of the Company's Audit, Compensation and Nominating Committees. Mr. Thomson has been the president of Thomson Associates, Inc., a leading merchant banking and crisis management company, since 1978. Mr. Thomson's current additional directorships include: Nasdaq-Maxus Technology Inc. (eWaste Management Solutions); Asia Bio Chem (Agriculture); TSX-Score Media Inc. (Media); Electrical Contacts Ltd. (Industrial), Open EC Technologies Inc.(IT Financing), Wright Environmental Management Inc. (Waste Management Solutions), YTW Growth Capital Management Corporation (CPC facilitation), Redpearl Funding Corp. (Financial), Han Wind Energy (BVI) (Sustainable Energy), Summit Energy Management (Oil and Gas), Paradox Financial Solutions Inc. (Supply Chain Financing), and Pure Med Laser (Healthcare).

BOARD COMPOSITION AND COMMITTEES

(b) AUDIT COMMITTEE AND INDEPENDENT DIRECTORS

The Company has a standing Audit Committee of the Board of Directors established in accordance with Section 3(a)(58)(A) of the Exchange Act, as amended. The Audit Committee consists of the following individuals, all of whom the Company considers to be independent, as defined under the SEC's rules and regulations and the Nasdaq's definition of independence: Robert Tung, Haimian Cai, and William Thomson. Mr. William Thomson is the Chairman of the Audit Committee. The Board has determined that Mr. William Thomson is the Audit Committee financial expert, as defined in Item 407(d)(5) of Regulation S-K, serving on the Company's audit committee.

(c) COMPENSATION COMMITTEE

The Company has a standing Compensation Committee of the Board of Directors. The Compensation Committee is responsible for determining compensation for the Company's executive officers. Three of the Company's independent directors, as defined under the SEC's rules and regulations and the Nasdaq's definition of independence, Robert Tung, Haimian Cai and William Thomson, serve on the Compensation Committee. Dr. Haimian Cai is the Chairman of the Compensation Committee.

The Company's Compensation Committee is empowered to review and approve the annual compensation and compensation procedures for the executive officers of the Company. The primary goals of the Compensation Committee of the Company's Board of Directors with respect to executive compensation are to attract and retain the most talented and dedicated executives possible and to align executives' incentives with stockholder value creation. The Compensation Committee evaluates individual executive performance with a goal of setting compensation at levels the committee believes are comparable with executives in other companies of similar size and stage of development operating in similar industry while taking into account the Company's relative performance and its strategic goals.

The Company has not retained a compensation consultant to review its policies and procedures with respect to executive compensation. The Company conducts an annual review of the aggregate level of its executive compensation, as well as the mix of elements used to compensate its executive officers. The Company compares compensation levels with amounts currently being paid to executives in its industry and most importantly with local practices in China. The Company is satisfied that its compensation levels are competitive with local conditions.

(d) NOMINATING COMMITTEE

The Company has a standing Nominating Committee of the Board of Directors. Director candidates are nominated by the Nominating Committee. The Nominating Committee will consider candidates based upon their business and financial experience, personal characteristics, and expertise that are complementary to the background and experience of other Board members, willingness to devote the required amount of time to carry out the duties and responsibilities of Board membership, willingness to

objectively appraise management performance, and any such other qualifications the Nominating Committee deems necessary to ascertain the candidates' ability to serve on the Board. The Nominating Committee will not consider nominee recommendations from security holders, other than the recommendations received from a security holder or group of security holders that beneficially owned more than five (5) percent of the Company's outstanding common stock for at least one year as of the date the recommendation is made. Three of the Company's independent directors, as defined under the SEC's rules and regulations and the Nasdaq's definition of independence, Robert Tung, William Thomson and Haimian Cai, serve on the Nominating Committee. Mr. Robert Tung is the Chairman of the Nominating Committee.

(e) STOCKHOLDER COMMUNICATIONS

Stockholders interested in communicating directly with the Board of Directors, or individual directors, may email the Company's independent director William Thomson at Bill.Thomson@chl.com.cn. Mr. Thomson will review all such correspondence and will regularly forward to the Board copies of all such correspondence that deals with the functions of the Board or committees thereof or that he otherwise determines requires their attention. Directors may at any time review all of the correspondence received that is addressed to members of the Board of Directors and request copies of such correspondence. Concerns relating to accounting, internal controls or auditing matters will immediately be brought to the attention of the Audit Committee and handled in accordance with procedures established by the Audit Committee with respect to such matters.

(f) FAMILY RELATIONSHIPS

Mr. Hanlin Chen and Mr. Tse, Yiu Wong Andy are brothers-in-law.

(g) CODE OF ETHICS AND CONDUCT

The Board of Directors has adopted a Code of Ethics and Conduct which is applicable to all officers, directors and employees. The Code of Ethics and Conduct is filed as an exhibit to this Form 10-K, which incorporates it by reference from the Form 10-KSB for year ended December 31, 2003.

(h) SECTION 16(a) BENEFICIAL OWNERSHIP COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's executive officers and directors and persons who own more than 10% of a registered class of the Company's equity securities to file with the Securities and Exchange Commission initial statements of beneficial ownership, reports of changes in ownership and annual reports concerning their ownership of common stock and other of the Company's equity securities, on Forms 3, 4 and 5 respectively. Executive officers, directors and greater than 10% stockholders are required by Commission regulations to furnish the Company with copies of all Section 16(a) reports they file. To the best of the Company's knowledge, based solely upon a review of the Form 3, 4 and 5 filed, no officer, director or 10% beneficial shareholder failed to file on a timely basis any reports required by Section 16(a) of the Securities Exchange Act of 1934, as amended.

ITEM 11. EXECUTIVE COMPENSATION

Compensation Committee

The Company has a standing Compensation Committee of the Board of Directors as described under Item 10(c) above. The Compensation Committee is responsible for determining compensation for the Company's executive officers. Three of the Company's independent directors, as defined under the SEC's rules and regulations and the Nasdaq's definition of independence, Robert Tung, Haimian Cai and William Thomson, serve on the Compensation Committee. Dr. Haimian Cai is the Chairman of the Compensation Committee.

Executive compensation consists of salary, stock option awards, and performance bonus in cash.

Salary

The Company's Board of Directors and Compensation Committee have approved the current salaries for executives: \$150,000 for the Chairman, \$100,000 for the CEO, and \$60,000 for other officers in 2008.

Stock Option Awards

The stock options plan proposed by management, which aims to incentivize and retain core employees, to meet employees' benefits, the Company's long term operating goals and shareholder benefits, was approved at the 2004 Annual Meeting of Stockholders, and the maximum common shares for issuance under this plan is 2,200,000 with a period of 10 years.

The stock option granted for management in 2008 was as follows, which was approved by the Board of Directors and Compensation Committee.

- a. Total Number of Options Granted: 298,850
- b. Exercise Price Per Option: \$2.93, the closing price of the common shares of the Company on December 09, 2008
- c. Date of Grant: December 10, 2008
- d. Expiration Date: on or before December 9, 2011
- e. Vesting Schedule
 - (i) On December 10, 2008, 1/3 of the granted stock option shall be vested and become exercisable
 - (ii) On December 10, 2009, another 1/3 of the granted stock option shall be vested and become exercisable
 - (iii) On December 10, 2010, remaining 1/3 of the granted stock option shall be vested and become exercisable

In accordance with SFAS No. 123R, the cost of the above mentioned stock options issued to directors was measured on the grant date based on their fair value. The fair value is determined using the Black-Scholes option pricing model and certain assumptions. Please see Note 21.

The compensation that executive officers received for their services for fiscal year 2008 and 2007 were as follows:

Name and principal position	Year	Salary	Bonus	Stock awards	Option awards	Non-equity incentive plan compensation	Change in pension value and non-qualified deferred compensation earnings	All other compensation	Total
Hanlin									
Chen	2008	\$150,000	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$150,000
(Chairman)	2007	\$116,667	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$116,667
Qizhou									
Wu	2008	\$100,000	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$100,000
(CEO)	2007	\$ 86,667	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 86,667
Jie Li	2008	\$ 60,000	\$ —	\$ —	\$ 38,654	\$ —	\$ —	\$ —	\$ 98,654
(CFO)	2007	\$ 35,000	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 35,000

Performance bonus

- a. Grantees: Hanlin Chen, Qizhou Wu, Shengbin Yu, Shaobo Wang, Andy Tse, Jie Li, and Daming Hu;
- b. Conditions: (i) based on the Company's consolidated financial statements, the year over year growth rates of net sales and net profits for 2008 must exceed 10%; and (ii) the average growth rate of the foregoing indicators must exceed that of the whole industry in 2008;
- c. Bonus: 50% of each officer's annual salary in 2008.

Awards for performance bonus of \$265,000 were accrued in 2008 and have not been paid by the end of 2008.

Outstanding Equity Awards at Fiscal Year-End:

Not Applicable.

Compensation for Directors

Based on the number of the board of directors' service years, workload and performance, the Company decides on their pay. The management believes that the pay for the members of the Board of Directors was appropriate as of December 31, 2008.

The compensation that directors received for serving on the Board of Directors for fiscal year 2008 was as follows:

Name	Fees earned or paid in cash	Stock awards	Option awards*	Non-equity incentive plan compensation	Change in pension value and nonqualified deferred compensation earnings	All other compensation**	Total
Haimian Cai	\$ 40,000	\$ -	\$ 31,800	\$ -	\$ -	\$ 101,200	\$173,000
William E. Thomson	\$ 45,500	\$ -	\$ 31,800	\$ -	\$ -	\$ 15,600	\$ 92,900
Robert Tung	\$ 40,000	\$ -	\$ 31,800	\$ -	\$ -	\$ 9,200	\$ 81,000

* Other than the cash payment based on the number of a director's service years, workload and performance, the Company grants 7,500 option awards to each director every year.

In accordance with SFAS No. 123R, the cost of the above mentioned stock options issued to directors was measured on the grant date based on their fair value. The fair value is determined using the Black-Scholes option pricing model and certain assumptions. Please see Note 21.

**The cost of the above mentioned compensation paid to directors was measured based on investment, operating, technology, and consulting services they provided.

During the year 2008, Mr. Haimian Cai provided additional investment and technology consulting services. Mr. Thomson and Robert Tung provided additional investment consulting services.

All other directors did not receive compensation for their service on the Board of Directors.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

As used in this section, the term beneficial ownership with respect to a security is defined by Rule 13d-3 under the Securities Exchange Act of 1934, as amended, as consisting of sole or shared voting power, including the power to vote or direct the vote, and/or sole or shared investment power, including the power to dispose of or direct the disposition of, with respect to the security through any contract, arrangement, understanding, relationship or otherwise, subject to community property laws where applicable. The percentage ownership is based on 26,983,244 shares of common stock outstanding at February 27, 2009.

Name/Title	Total Number of Shares	Percentage Ownership
Hanlin Chen, Chairman ⁽¹⁾	15,659,826	58.03%
Qizhou Wu, CEO, President and Director	2,157,296	7.99%
Jie Li, CFO	11,247	0.04%
Li Ping Xie ⁽²⁾	15,659,826	58.03%
Tse, Yiu Wong Andy, Sr. VP, Director	899,426	3.33%
Shaobo Wang, Sr. VP	425,104	1.58%
Shengbin Yu, Sr. VP	476,429	1.77%
Daming Hu, CAO	9,000	0.03%
Robert Tung, Director	7,500	0.02%
Dr. Haimian Cai, Director	7,500	0.02%
William E. Thomson, Director	—	—
Wiselink Holdings Limited ⁽³⁾	3,023,542	11.21%
All Directors and Executive Officers (10 persons) ⁽⁴⁾	22,374,516	82.92%

⁽¹⁾ Includes 2,011,425 shares of common stock beneficially owned by Mr. Chen's wife, Ms. Xie and 302,354 shares indirectly held in Wiselink Holdings Limited.

⁽²⁾ Includes 13,648,401 shares of common stock beneficially owned by Ms. Xie's husband, Mr. Chen.

⁽³⁾ Wiselink Holdings Limited is a company controlled by Mr. Chen and other executive officers.

⁽⁴⁾ Excludes 302,354 shares indirectly held by Mr. Chen in Wiselink Holdings Limited

In July 2004, the Company adopted a stock option plan subject to shareholders approval, which was approved at the Company's annual general meeting on June 28, 2005. The stock option plan provides for the issuance to the Company's officers, directors, management and employees of options to purchase shares of the Company's common stock.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

For the information required by Item 13 please refer to Consolidated Financial Statements notes 3 and 23 "Certain Relationships And Related Transactions" and "Related Party Transactions" in the Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees for professional audit services rendered by Schwartz Levitsky Feldman LLP for the audit of the Company's annual financial statements, and fees billed for other services for the fiscal years 2008 and 2007. The Audit Committee has approved all of the following fees.

	Fiscal Year Ended	
	2008	2007
Audit Fees	\$ 285,000	\$ 280,000
Audit-Related Fees ⁽¹⁾	24,100	-
Tax Fees ⁽²⁾	8,400	8,000
Total Fees Paid	<u>\$ 317,500</u>	<u>\$ 288,000</u>

⁽¹⁾ Includes accounting and reporting consultations related to financing and internal control procedures.

⁽²⁾ Includes fees for service related to tax compliance services, preparation and filing of tax returns and tax consulting services.

Audit Committee's Pre-Approval Policy

During fiscal years ended December 31, 2008 and 2007, the Audit Committee of the Board of Directors adopted policies and procedures for the pre-approval of all audit and non-audit services to be provided by the Company's independent auditor and for the prohibition of certain services from being provided by the independent auditor. The Company may not engage the Company's independent auditor to render any audit or non-audit service unless the service is approved in advance by the Audit Committee or the engagement to render the service is entered into pursuant to the Audit Committee's pre-approval policies and procedures. On an annual basis, the Audit Committee may pre-approve services that are expected to be provided to the Company by the independent auditor during the fiscal year. At the time such pre-approval is granted, the Audit Committee specifies the pre-approved services and establishes a monetary limit with respect to each particular pre-approved service, which limit may not be exceeded without obtaining further pre-approval under the policy. For any pre-approval, the Audit Committee considers whether such services are consistent with the rules of the Securities and Exchange Commission on auditor independence.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

LIST OF FINANCIAL STATEMENT / SCHEDULES

1. Report of Independent Auditors
2. Consolidated Balance Sheets as of December 31, 2008 and 2007
3. Consolidated Statements of Earnings for the years ended December 31, 2008 and 2007
4. Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2008 and 2007
5. Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2008 and 2007
6. Consolidated Statements of Cash Flows for the years ended December 31, 2008 and 2007
7. Notes to Consolidated Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of China Automotive Systems, Inc. and Subsidiaries:

We have audited the accompanying consolidated balance sheets of China Automotive Systems, Inc. and Subsidiaries as at December 31, 2008 and 2007 and the related consolidated statements of earnings, and comprehensive income, cash flows and changes in stockholders' equity for the years ended December 31, 2008 and 2007. These consolidated financial statements are the responsibility of the management of China Automotive Systems, Inc. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The company is not required to have nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audits procedures that we appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal controls over financing reporting. Accordingly, we express no such opinion.

In our opinion, these consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Automotive Systems, Inc. and Subsidiaries as of December 31, 2008 and 2007 and the results of its earnings and its cash flows for the years ended December 31, 2008 and 2007 in conformity with generally accepted accounting principles in the United States of America.

Toronto, Ontario, Canada
March 16, 2009

/s/ Schwartz Levitsky Feldman LLP
Schwartz Levitsky Feldman LLP
Chartered Accountants
Licensed Public Accountant

China Automotive Systems, Inc. and Subsidiaries Consolidated Balance Sheets December 31, 2008 and 2007

	December 31,	
	2008	2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 37,113,375	\$ 19,487,159
Pledged cash deposits (note 4)	6,739,980	4,645,644
Accounts and notes receivable, net, including \$1,285,110 and \$1,869,480 from related parties at December 31, 2008 and 2007, net of an allowance for doubtful accounts of \$4,910,478 and \$3,827,838 at December 31, 2008 and 2007 (note 5)	96,424,856	82,022,643
Advance payments and others, including \$9,374 and \$55,323 to related parties at December 31, 2008 and 2007	1,442,614	922,578
Inventories (note 7)	26,571,755	20,193,286

Total current assets	\$ 168,292,580	\$ 127,271,310
Long-term Assets:		
Property, plant and equipment, net (note 8)	\$ 51,978,905	\$ 46,585,041
Intangible assets, net (note 9)	504,339	589,713
Other receivables, net, including \$903,674 and \$638,826 from related parties at December 31, 2008 and 2007, net of an allowance for doubtful accounts of \$659,837 and \$652,484 at December 31, 2008 and 2007 (note 6)	1,349,527	888,697
Advance payment for property, plant and equipment, including \$2,473,320 and \$1,560,378 to related parties at December 31, 2008 and 2007	6,459,510	6,260,443
Long-term investments	79,010	73,973
Deferred income tax assets (note 10)	2,383,065	1,315,510
Total assets	<u>\$231,046,936</u>	<u>\$182,984,687</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank loans (note 11)	\$ 7,315,717	\$ 13,972,603
Accounts and notes payable, including \$1,097,641 and \$1,134,817 to related parties at December 31, 2008 and 2007 (note 12)	59,246,043	47,530,383
Convertible notes payable, net, including \$2,077,923 for discount of convertible note payable at December 31, 2008. (note 13)	32,922,077	-
Derivative liabilities (note 14)	1,502,597	-
Customer deposits	236,018	135,627
Accrued payroll and related costs	2,715,116	2,664,464
Accrued expenses and other payables (note 15)	12,460,784	14,938,055
Accrued pension costs (note 16)	3,806,519	3,622,729
Taxes payable (note 17)	5,717,438	9,080,493
Amounts due to shareholders/directors (note 18)	337,370	304,601
Total current liabilities	<u>\$ 126,259,679</u>	<u>\$ 92,248,955</u>
Long-term liabilities:		
Advances payable (note 19)	234,041	334,600
Total liabilities	<u>\$ 126,493,720</u>	<u>\$ 92,583,555</u>
Minority interests (note 20)	<u>\$23,222,566</u>	<u>\$ 23,166,270</u>
Related Party Transactions (note 30)		
Commitments and contingencies (note 31)		
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 – 26,983,244 shares and 23,959,702 shares at December 31, 2008 and 2007, respectively (note 21)	2,698	2,396
Additional paid-in capital (note 21)	27,148,206	30,125,951
Retained earnings- (note 22)		
Appropriated	7,525,777	7,525,777
Unappropriated	36,026,516	23,591,275
Deferred stock compensation (note 23)	(500,052)	-
Accumulated other comprehensive income	11,127,505	5,989,463
Total stockholders' equity	<u>\$81,330,650</u>	<u>\$ 67,234,862</u>
Total liabilities and stockholders' equity	<u>\$231,046,936</u>	<u>\$182,984,687</u>

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

China Automotive Systems, Inc. and Subsidiaries
Consolidated Statements of Earnings
Years Ended December 31, 2008 and 2007

	Years Ended December 31	
	2008	2007
Net product sales, including \$4,675,410 and \$5,472,509 to related parties for Years Ended December 31, 2008 and 2007	\$163,179,286	\$133,597,003
Cost of product sold, including \$7,901,944 and \$5,472,595 purchased from related parties at Years Ended December 31, 2008 and 2007	115,920,585	88,273,955
Gross profit	\$47,258,701	\$ 45,323,048
Add: Gain on other sales	734,063	554,150
Less: Operating expenses		
Selling expenses	10,869,661	9,674,476
General and administrative expenses	12,097,500	9,026,717
R&D expenses	2,255,892	1,666,274
Depreciation and amortization	5,846,290	4,243,930
Total Operating expenses	31,069,343	24,611,397
Income from operations	\$16,923,421	\$ 21,265,801
Add: Other income, net (note 24)	1,067,309	38,462
Financial income (expenses) (note 25)	(1,296,218)	(566,986)
Gain (loss) on change in fair value of derivative (note 26)	998,014	-
Income before income taxes	17,692,526	20,737,277
Less: Income taxes (note 27)	185,877	2,231,032
Income before minority interests	17,506,649	18,506,245
Less: Minority interests	5,071,408	9,646,339
Net income	\$12,435,241	\$ 8,859,906
Net income per common share—		
Basic	\$ 0.48	\$ 0.37
Diluted (note 28)	\$ 0.46	\$ 0.37
Weighted average number of common shares outstanding –		
Basic	25,706,364	23,954,370
Diluted	29,668,726	23,958,705

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

China Automotive Systems, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2008 and 2007

	Years Ended December 31	
	2008	2007
Net income	\$12,435,241	\$ 8,859,906
Other comprehensive income:		
Foreign currency translation gain	5,138,042	3,520,663
Comprehensive income	\$17,573,283	\$12,380,569

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

China Automotive Systems, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2008 and 2007

	Common Stock		Additional Paid-in Capital	Retained Earnings		Deferred stock compensation	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Par value		Appropriated	Unappropriated			
Balance at January 1, 2007	23,851,581	\$ 2,385	\$ 28,651,959	\$ 6,209,909	\$ 16,047,237	\$ -	\$ 2,468,800	\$ 53,380,290
Foreign currency translation gain	-	-	-	-	-	-	3,520,663	3,520,663
Sale of common stock	108,121	11	1,199,989	-	-	-	-	1,200,000
Cash paid for retaining fee, commissions and placement agent fee in connection with offering	-	-	(54,500)	-	-	-	-	(54,500)
Increase in connection with minority shareholders' abandonment of all its right and interest in Joint-venture	-	-	174,828	-	-	-	-	174,828
Issuance of stock options to independent directors	-	-	153,675	-	-	-	-	153,675
Net income for the year ended December 31, 2007	-	-	-	-	8,859,906	-	-	8,859,906
Appropriation of retained earnings	-	-	-	1,315,868	(1,315,868)	-	-	-
Balance at December 31, 2007	23,959,702	\$ 2,396	\$ 30,125,951	\$ 7,525,777	\$ 23,591,275	\$ -	\$ 5,989,463	\$ 67,234,862
Foreign currency translation gain	-	-	-	-	-	-	5,138,042	5,138,042
Difference between the book value of and Consideration paid for the 35.5% equity interest of Henglong	-	-	(25,912,921)	-	-	-	-	(25,912,921)
Issuance of common stock	3,023,542	302	22,089,698	-	-	-	-	22,090,000
Issuance of stock options to independent directors and management	-	-	845,478	-	-	-	-	845,478
Net income for the year ended December 31, 2008	-	-	-	-	12,435,241	-	-	12,435,241
Issuance of stock options to management	-	-	-	-	-	(500,052)	-	(500,052)
Balance at December 31, 2008	26,983,244	\$ 2,698	\$ 27,148,206	\$ 7,525,777	\$ 36,026,516	\$ (500,052)	\$ 11,127,505	\$ 81,330,650

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

China Automotive Systems, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2008 and 2007

	Years Ended December 31	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 12,435,241	\$ 8,859,906
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Minority interests	5,071,408	9,646,339

Stock-based compensation	345,426	153,675
Depreciation and amortization	9,924,992	7,349,546
Deferred income taxes	(974,383)	(1,315,510)
Allowance for doubtful accounts (Recovered)	1,030,738	(881,423)
Amortization for discount of convertible note payable	424,665	-
(Gain) loss on change in fair value of derivative	(998,014)	-
Other operating adjustments	2,533	92,401
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Pledged cash deposits	(1,776,424)	(981,519)
Accounts and notes receivable	(9,335,776)	(19,748,023)
Advance payments and other	(417,973)	41,648
Inventories	(4,955,085)	(3,454,479)
Increase (decrease) in:		
Accounts and notes payable	8,319,472	7,120,821
Customer deposits	89,046	(20,924)
Accrued payroll and related costs	(128,344)	1,032,723
Accrued expenses and other payables	1,487,900	627,192
Accrued pension costs	(69,998)	128,136
Taxes payable	(3,974,905)	2,673,964
Advances payable	(126,553)	-
Net cash provided by operating activities	<u>\$ 16,373,966</u>	<u>\$ 11,324,473</u>
Cash flows from investing activities:		
(Increase) decrease in other receivables	(353,834)	481,042
Cash received from equipment sales	368,707	629,918
Cash paid to acquire property, plant and equipment	(12,245,383)	(13,982,490)
Cash paid to acquire intangible assets	(125,550)	(287,747)
Cash paid for the acquisition of 35.5% of Henglong equity	(10,000,000)	-
Net cash (used in) investing activities	<u>\$(22,356,060)</u>	<u>\$(13,159,277)</u>
Cash flows from financing activities:		
Repayment of bank loans	\$ (7,567,697)	\$ (2,182,860)
Dividends paid to the minority interest holders of Joint-venture companies	(6,198,489)	(6,307,189)
Increase (decrease) in amounts due to shareholders/directors	2,416	(84,476)
Proceeds from issuance of common stock	-	1,145,500
Capital Contribution from the minority interest holders of Joint-venture companies	745,723	-
Proceeds from issuance of convertible note payable	35,000,000	-
Net cash provided by (used in) financing activities	<u>\$ 21,981,953</u>	<u>\$ (7,429,025)</u>
Cash and cash equivalents effected by foreign currency	<u>\$ 1,626,357</u>	<u>\$ 1,332,488</u>
Net change in cash and cash equivalents		
Net increase (decrease) in cash and cash equivalents	\$ 17,626,216	\$ (7,931,341)
Cash and cash equivalents, at the beginning of year	19,487,159	27,418,500
Cash and cash equivalents, at the end of year	<u>\$ 37,113,375</u>	<u>\$ 19,487,159</u>

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

China Automotive Systems, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (continued)
Years Ended December 31, 2008 and 2007

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

	Years Ended December 31	
	2008	2007
Cash paid for interest	\$ 1,266,204	\$ 895,491
Cash paid for income taxes	\$ 4,126,048	\$ 1,970,544

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

	Years Ended December 31	
	2008	2007
Acquisition of 35.5% of Henglong equity from the minority shareholder on a cashless basis	\$(22,090,000)	\$ -
Liability result from issuance of common stock to acquire 35.5% of Henglong's equity	22,090,000	-
Decrease in minority interests as a result of minority shareholder's withdrawal from Joint-venture	-	(2,830,545)
Withdrawal of invested intangible assets by minority shareholder of Joint-venture	-	2,600,204
Increase in equity in connection with minority shareholder's withdrawal from Joint-venture	\$ -	\$ 230,341

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENT

China Automotive Systems, Inc. and Subsidiaries
Years Ended December 31, 2008 and 2007

1. Organization and Business

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

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

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

The Company owns the following aggregate net interests in eight Sino-foreign joint ventures organized in the PRC as of December 31, 2008 and 2007.

Name of Entity	Percentage Interest	
	2008	2007
Jingzhou Henglong Automotive Parts Co., Ltd., "Henglong"	80.00%	44.50%
Shashi Jiulong Power Steering Gears Co., Ltd., "Jiulong"	81.00%	81.00%
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., "Shenyang"	70.00%	70.00%
Zhejiang Henglong & Vie Pump-Manu Co., Ltd., "Zhejiang"	51.00%	51.00%
Universal Sensor Application Inc., "USAI"	83.34%	75.90%
Wuhan Jielong Electric Power Steering Co., Ltd., "Jielong"	85.00%	85.00%
Wuhu HengLong Auto Steering System Co., Ltd., "Wuhu"	77.33%	77.33%
Jingzhou Hengsheng Automotive System Co., Ltd., "Hengsheng"	100.00%	100.00%

2. Basis of Presentation

For the year ended December 31, 2008 and 2007, the accompanying consolidated financial statements include the accounts of the Company and its two subsidiaries and eight joint ventures, which are described 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.

During early 2003, the Directors of the Company and the other joint venture partners in the Company's Sino-foreign joint ventures executed "Act in Concert" agreements, resulting in the Company having voting control in such Sino-foreign joint ventures. Consequently, effective January 1, 2003, the Company changed from equity accounting to consolidation accounting for its investments in Sino-foreign joint ventures for the year ended December 31, 2003. Prior to January 1, 2003, the Company used the equity method pursuant to Emerging Issues Task Force Issue No. 96-16, as described as follows.

Henglong was formed in 1997, the Company increased its shareholdings from 44.5% to 80% in 2008 and the remaining 20% owned by Jingzhou Jiulong Machinery and Electronic Manufacturing Co., Ltd., "JLME". The highest authority of the joint venture is the Board of Directors, which is comprised of five directors, four of which, 80%, are appointed by the Company, and one of which, 20%, is appointed by JLME. Because of the Company's control over the operation and assets of Henglong, the minority shareholders of Henglong have no right to select, terminate and set the compensation of management responsible for implementing the enterprise's policies and procedures, nor do they have any right to establish operating and capital decisions of Henglong.

Jiulong was formed in 1993, with 81% owned by the Company, 10% owned by Jingzhou Jiulong Machinery and Electronic Manufacturing Co., Ltd., "JLME", and 9% owned by Jingzhou Tianxin Investment Consulting Co., Ltd., "Tianxin". The highest authority of the joint venture is the Board of Directors, which is comprised of five directors, four of which, 80%, are appointed by the Company, and one of whom, 20%, are appointed by JLME. As for day-to-day operating matters, approval by more than two-thirds of the members of the Board of Directors, 67%, is required. The Chairman of the Board of Directors is appointed by JLME. The general manager is appointed by the Company.

Shenyang was formed in 2002, with 70% owned by the Company, 30% owned by Shenyang Automotive Industry Investment Corporation, "JB Investment". The highest authority of the joint venture is the Board of Directors, which is comprised of seven directors, four of whom, 57%, are appointed by the Company, and three of whom, 43%, are appointed by JB Investment. As for day-to-day operating matters, approval by more than two-thirds of the members of the Board of Directors, 67%, is required. The Chairman of the Board of Directors is appointed by the Company. The general manager is appointed by the Company.

Zhejiang was formed in 2002, with 51% owned by Genesis and 49% owned by Zhejiang Vie Group, "ZVG". The highest authority of the joint venture is the Board of Directors, which is comprised of seven directors, four of whom, 57%, are appointed by the Company and three of whom, 43%, are appointed by ZVG. As for day-to-day operating matters, approval by more than two-thirds of the members of the Board of Directors, 67%, is required. The Chairman of the Board of Directors is appointed by ZVG. The general manager is appointed by the Company.

USAI was formed in 2005. As at December 31, 2008, 83.34% was owned by the Company. The highest authority of the joint venture is the Board of Directors, which is comprised of three directors, two of whom, 67%, are appointed by the Company, one of whom, 33%, is appointed by Hongxi. As for day-to-day operating matters, approval by more than two-thirds of the members of the Board of Directors, 67%, is required. The Chairman of the Board of Directors is appointed by the Company. The general manager is appointed by the Company.

Jielong was formed in April 2006, with 85% owned by the Company, 15% owned by Hong Kong Tongda, "Tongda". The highest authority of the joint venture is the Board of Directors, which is comprised of three directors, two of whom, 67%, are appointed by the Company, one of whom, 33%, is appointed by Tongda. As for day-to-day operating matters, approval by more than two-thirds of the members of the Board of Directors, 67%, is required. The Chairman of the Board of Directors is appointed by the Company. The general manager is appointed by the Company.

Wuhu was formed in May 2006, with 77.33% owned by the Company, 22.67% owned by Wuhu Chery Technology Co., Ltd., "Chery Technology". The highest authority of the joint venture is the Board of Directors, which is comprised of five directors, three of whom, 60%, are appointed by the Company, two of whom, 40%, are appointed by Chery Technology. As for day-to-day operating matters, approval by more than two-thirds of the members of the Board of Directors, 67%, is required. The directors of the Company and the other joint venture partner of Wuhu executed "Act in Concert" agreement, resulting in the Company having voting control in the joint venture. The Chairman of the Board of Directors is appointed by the Company. The general manager is appointed by the Company.

The minority partners of each of the joint ventures are all private companies not controlled, directly or indirectly, by any PRC municipal government or other similar government entity.

Certain Relationships and Related Transactions

The following related parties are related through common ownership with the major shareholders of the Company:

- Jingzhou Henglong Fulida Textile Co., Ltd. ("Jingzhou")
- Xiamen Joylon Co., Ltd. ("Xiamen Joylon")
- Shanghai Tianxiang Automotive Parts Co., Ltd. ("Shanghai Tianxiang")
- Shanghai Fenglong Materials Co., Ltd. ("Shanghai Fenglong")
- Changchun Hualong Automotive Technology Co., Ltd. ("Changchun Hualong")
- Jiangling Tongchuang Machining Co., Ltd. ("Jiangling Tongchuang")
- Beijing Hualong Century Digital S&T Development Co., Ltd. ("Beijing Hualong")
- Jingzhou Jiulong Material Co., Ltd. ("Jiulong Material")
- Shanghai Hongxi Investment Inc. ("Hongxi")
- Hubei Wiselink Equipment Manufacturing Co., Ltd. ("Hubei Wiselink")
- Jingzhou Tongyi Special Parts Co., Ltd. ("Jingzhou Tongyi")
- Jingzhou Derun Agricultural S&T Development Co., Ltd. ("Jingzhou Derun")
- Jingzhou Tongying Alloys Materials Co., Ltd. ("Jingzhou Tongying")
- WuHan Dida Information S&T Development Co., Ltd. ("WuHan Dida")
- Hubei Wanlong Investment Co., Ltd. ("Hubei Wanlong")
- Jiangling Yude Machining Co., Ltd. ("Jiangling Yude")
- Wiselink Holdings Limited. ("Wiselink")

Principal policies of the Company in connection with transaction with related parties is as follows:

Products sold to related parties - The Company sold products to related parties at fair market prices, and also granted them credit of three to four months on an open account basis. These transactions were consummated under similar terms as the Company's other customers.

Materials purchases from related parties - The Company purchased materials from related parties at fair market prices, and also received them credit of three to four months on an open account basis. These transactions were consummated under similar terms as the Company's other suppliers.

Equipment and production technology purchased from related parties - The Company purchased equipment and production technology from related parties at fair market prices, and was required to pay in advance based on the purchase agreement between the two parties, because such equipment manufacturing and technology development was required for a long period. These transactions were consummated under similar terms as the Company's other suppliers.

3. Recent Accounting Pronouncements

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair values. SFAS 159 is effective for fiscal years after November 15, 2007. The Company has adopted the provisions of this statement since January 1, 2008.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), Business Combinations. SFAS 141(R) retains the fundamental requirements of the original pronouncement requiring that the purchase method be used for all business combinations. SFAS 141(R) defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquirer achieves control and requires the acquirer to recognize the assets acquired, liabilities assumed and any noncontrolling interest at their fair values as of the acquisition date. In addition, SFAS 141(R) requires expensing of acquisition-related and restructure-related costs, remeasurement of earn out provisions at fair value, measurement of equity securities issued for purchase at the date of close of the transaction and non-expensing of in-process research and development related intangibles. 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is required to and plans to adopt the provisions of SFAS 141R beginning in the first quarter of 2009. The Company is currently evaluating the impact of the implementation of SFAS No. 141(R) on its consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51." The objective of SFAS No. 160 is to improve the relevance, comparability and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing additional accounting and reporting standards. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. Early adoption of this statement is prohibited. By adopting SFAS No. 160, the noncontrolling interests will be reported as equity while the noncontrolling interests are reported in the mezzanine section between liabilities and equity currently. The Company is currently assessing the impact of adopting SFAS No. 160 on its consolidated financial statements.

In March 2008, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is currently evaluating the impact of adopting SFAS No. 161 on its consolidated financial statements.

In May 2008, the FASB issued Financial Accounting Standard No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"). The statement is intended to improve financial reporting by identifying a consistent hierarchy for selecting accounting principles to be used in preparing financial statements that are prepared in conformance with GAAP. Unlike SAS No. 69, "The

Meaning of Present in Conformity With GAAP," SFAS No. 162 is directed to the entity rather than the auditor. The statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with GAAP." The Company is currently assessing the impact of this statement, but believes it will not have a material impact on its financial position, results of operations, or cash flows upon adoption.

In May 2008, the FASB issued SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60." Diversity exists in practice in accounting for financial guarantee insurance contracts by insurance enterprises under FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises. This results in inconsistencies in the recognition and measurement of claim liabilities. This Statement requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement requires expanded disclosures about financial guarantee insurance contracts. The accounting and disclosure requirements of the Statement will improve the quality of information provided to users of financial statements. The adoption of FASB 163 is not expected to have a material impact on the Company's financial position.

In May 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") APB 14-1, Accounting for Convertible Debt Instruments That May be Settled in Cash upon Conversion (Including Partial Cash Settlement). FSP APB14-1 clarifies that convertible debt instruments that may be settled in cash upon either mandatory or optional conversion (including Partial Cash Settlement) are not addressed by paragraph 12 of APB Opinion No.14, Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants. Additionally, FSP APB14-1 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's non-convertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company has adopted FSP APB14-1 beginning January 1, 2009, and this standard must be applied on a retrospective basis. The Company is evaluating the impact the adoption of FSP APB14-1 will have on its consolidated financial position and results of operations.

In June 2008, the FASB ratified the consensus reached on EITF Issue No. 07-05; Determining whether an instrument (or embedded feature) is indexed to an entity's own stock. EITF Issue No. 07-05 clarifies the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which would qualify as a scope exception under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. EITF Issue No. 07-05 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption for an existing instrument is not permitted. The Company is currently evaluating the impact of adopting EITF Issue No. 07-05 on its consolidated financial statements.

On June 16, 2008, the FASB issued final Staff Position (FSP) No. EITF03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transaction Are Participating Securities," to address the question of whether instrument granted in share-based payment transaction are participating securities prior to vesting. The FSP determines that unvested share-based payment awards that contain rights to dividend payments should be included in earnings per share calculations. The guidance will be effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the requirement of (FSP) No.EITF03-6-1 as well as the impact of the adoption on its consolidated financial statements.

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities" ("FSP FAS 140-4 and FIN 46 (R)-8"). FSP FAS140-4 and FIN 46(R)-8 amends FAS140 and FIN 46(R) to require additional disclosures regarding transfers of financial assets and interest in variable interest entities. FSP FAS 140-4 and FIN 46 (R)-8 is effective for interim or annual reporting periods ending after December 15, 2008. The Company is currently evaluating the impact of the adoption of FSP FAS140-4 and FIN 46(R)-8 will have on its consolidated financial position and results of operations.

4. Pledged cash deposits

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

5. Accounts Receivable and Notes Receivable

The Company's accounts receivable at December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Accounts receivable	\$ 60,345,494	\$49,605,411
Notes receivable	40,989,840	36,245,070
	<u>101,335,334</u>	<u>85,850,481</u>
Less: allowance for doubtful accounts	(4,910,478)	(3,827,838)
Balance at end of year	<u>\$ 96,424,856</u>	<u>\$82,022,643</u>

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

The activity in the Company's allowance for doubtful accounts of accounts receivable during the year ended December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Balance at beginning of year	\$3,827,838	\$4,086,218
Amounts provided for (recovered) during the year	841,078	(532,392)
Add: foreign currency translation	241,562	274,012
Balance at end of year	<u>\$4,910,478</u>	<u>\$3,827,838</u>

6. Other Receivables

The Company's other receivables at December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Other receivables	\$2,009,364	\$1,541,181
Less: allowance for doubtful accounts	(659,837)	(652,484)
Balance at end of the year	<u>\$1,349,527</u>	<u>\$ 888,697</u>

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

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

	December 31,	
	2008	2007
Balance at beginning of the year	\$ 652,484	\$ 898,203
Add: amounts provided (recovered) during the year	(41,264)	(297,870)
Add: foreign currency translation	48,617	52,151
Balance at end of the year	<u>\$ 659,837</u>	<u>\$ 652,484</u>

7. Inventories

The Company's inventories at December 31, 2008 and 2007 consisted of the following:

	December 31,	
	2008	2007
Raw materials	\$ 8,354,397	\$ 7,904,167
Work in process	4,466,720	4,181,248
Finished goods	14,826,961	9,586,709
	27,648,078	21,672,124
Less: provision for loss	(1,076,323)	(1,478,838)
Balance at end of the year	<u>\$26,571,755</u>	<u>\$20,193,286</u>

8. Property, Plant and Equipment

The Company's property, plant and equipment at December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Land use rights and buildings	\$ 27,416,977	\$ 23,101,634
Machinery and equipment	54,405,700	42,512,900
Electronic equipment	4,356,475	3,480,008
Motor vehicles	2,461,378	2,427,375
Construction in progress	1,007,415	1,542,865
	89,647,945	73,064,782
Less: Accumulated depreciation	(37,669,040)	(26,479,741)
Balance at end of the year	<u>\$ 51,978,905</u>	<u>\$ 46,585,041</u>

Depreciation charge for the years ended December 31, 2008 and 2007 are \$9,672,948 and \$7,079,313 respectively.

9. Intangible Assets

The activity in the Company's intangible asset account during the years ended December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Balance at beginning of year	\$ 589,713	\$ 3,140,548
Patent technology	—	144,390
Management software license	125,550	143,356
Patent technology	-	(2,600,204)
Foreign currency translation	41,120	31,856
	756,383	859,946
Less: Amortization for the year	(252,044)	(270,233)
Balance at end of year	<u>\$ 504,339</u>	<u>\$ 589,713</u>

The estimated aggregated amortization expense for each of the five succeeding years is \$198,734, \$126,596, \$95,358, \$68,874, and \$23,958 respectively.

10. Deferred Income Tax Assets

Deferred income taxes are provided for temporary differences between amounts of assets and liabilities for financial reporting purposes and the basis of such assets and liabilities as measured by tax

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

The components of deferred income tax assets at December 31, 2008 and 2007 were as follows:

	December 31,	
	2008	2007
Losses carry forward (U.S.)	\$ 2,300,322	\$ 1,646,531
Losses carry forward (PRC)	287,285	275,422
Product warranties and other reserves	\$ 1,737,052	\$ 1,258,559
Property, plant and equipment	2,471,716	1,573,787
Bonus accrual	297,208	347,089
All other	154,348	161,121
	<u>7,247,931</u>	<u>5,262,509</u>
Valuation allowance *	(4,864,866)	(3,946,999)
Total deferred tax assets	<u>\$ 2,383,065</u>	<u>\$ 1,315,510</u>

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

The estimated losses available to reduce taxable income in future years will expire as follows:

Years ending December 31,	
2028	\$ 2,179,305
2027	779,388
2026	1,044,363
2025	471,623
2024	933,308
2023	2,259,753
2013	161,020
2012	1,284,938
2011	918,439
Total	<u>\$ 10,032,137</u>

11. Bank Loans

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

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

12. Accounts and notes payable

The Company's accounts and notes payable at December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Accounts payable	\$38,595,446	\$32,511,812
Notes payable	20,650,597	15,018,571
Balance at end of year	<u>\$59,246,043</u>	<u>\$47,530,383</u>

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

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

13. Convertible notes payable

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

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

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

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

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

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

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

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

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

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

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

In the event that the Company has not completed the necessary filings to list the conversion shares on its principal market by the date that is ninety (90) days after the issuance date or has not so listed the conversion shares by the date that is ninety (90) days after the issuance date or the shares of the Company’s common stock are terminated from registration under the Securities Act of 1933, the

Convertible Debt holders will have the right, in its sole discretion, to require that the Company redeem all or any portion of the Convertible Debt. The portion of the Convertible Debt subject to redemption in connection with this listing default will be redeemed by the Company in cash at a price equal to the sum of the conversion amount being redeemed and the Other Make Whole Amount as mentioned above.

At any time following February 15, 2009, if the Weighted Average Price (WAP) for twenty (20) consecutive trading days is less than 45% of the Conversion Price in effect on the Issuance Date, as adjusted, namely \$3.187, the Convertible Debt holder shall have the right, in its sole discretion, to require that the Company redeem all or any portion of the Convertible Debt. The portion of this Convertible Debt subject to redemption in connection with the share price change of the underlying common stock will be redeemed by the Company in cash at a price equal to the sum of the conversion amount being redeemed and the Other Make Whole Amount as mentioned above.

Since the Company's stock Weighted Average Price for twenty (20) consecutive trading days ended on March 16, 2009 was below \$3.187, which is less than 45% of the Conversion Price in effect of the Issuance Date, as adjusted, the "WAP Default", the Convertible Debt holder shall have the right, at its sole discretion, to require that the Company redeem all or any portion of the Convertible Debt by delivering written redemption notice to the Company within five (5) business days after the receipt of the Company's notice of the WAP Default. On March 17, 2009, the Company delivered the WAP Default notice to the Convertible Debt holders. Since the Company has not received any notice from YA Global Investments, L.P. as of March 24, 2009, its redemption rights under such WAP Default has lapsed. On March 23, 2009, the Company received a letter from the joint and several provisional liquidators acting on behalf of Lehman Brothers Commercial Corporation Asia Limited, "LBCCA Liquidator", requesting that it be granted an extension of time until April 24, 2009 to obtain legal advice and to consider its rights under the Convertible Debt. The Company has granted an extension to April 15, 2009. Although the LBCCA Liquidator has not given the Company any notice of redemption yet, it may exercise its discretionary right of early redemption on any date that is no earlier than ninety (90) days after it delivers the written redemption notice to the Company, so long as it delivers such notice on or before April 15, 2009. The Convertible Debt and related Derivative liabilities have been recorded as short-term liabilities.

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

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

When a financial instrument contains embedded derivatives that require bifurcation, such as the redemption put, and freestanding instruments that are recorded at fair value each period, such as the warrants, the accounting is to record the embedded derivative and the freestanding instruments at fair value on inception and the residual proceeds are allocated to the debt instrument. Based on this premise, upon inception of the debt instruments, the Company recorded the redemption put at fair value \$1,703,962 and the Company recorded the warrants at fair value \$798,626. The remaining proceeds were then allocated to the debt instrument.

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

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

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

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

Allocation of basis in the financing arrangement to the warrants and derivative liability has resulted in an original issue discount to the face value of the convertible notes in the amount of \$2,502,588, which amount is subject to amortization over the Convertible Debt's term using the effective method. The Company recorded amortization expense during 2008 of \$424,665. If the convertible note becomes callable, the unamortized discount on the convertible note will be written off as expense at the earliest date of June 15, 2009.

14. Derivative liabilities

The Company has evaluated the convertible notes for terms and conditions that are not clearly and closely associated with the risks of the debt-type host instrument (see Note 13). Generally, such features require separation from the host contract and treatment as derivative financial instruments. Certain features, such as the conversion option, were found to be exempt. Other features, such as puts and redemption features were found to require bifurcation and recognition as derivative liabilities. These derivative liabilities are recognized initially at fair value, using forward cash-flow valuation techniques. As of February 15, 2008, the compound derivative value amounted to \$1,703,962. This derivative will be adjusted to its estimated fair value at the completion of each reporting period until the debt arrangement is

ultimately settled, converted or paid. As of December 31, 2008, the compound derivative value amounted to \$1,502,597. The income from adjustment of fair value of compound derivative has been recorded in the income statement as gain or loss on change in fair value of derivative. (See note 13 and 26)

15. Accrued expenses and other payables

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

	December 31,	
	2008	2007
Accrued expenses	\$ 2,441,352	\$ 1,957,146
Other payables	1,690,046	1,340,442
Warranty reserves*	6,335,613	4,919,491
Dividend payable to minority interest shareholders of Joint-ventures	1,991,796	6,720,976
Liabilities in connection with warrants**	1,977	-
Balance at end of year	<u>\$12,460,784</u>	<u>\$14,938,055</u>

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

For the year ended December 31, 2008 and 2007, the warranties activities were as follows:

	December 31,	
	2008	2007
Balance at the beginning of year	\$ 4,919,491	\$ 2,954,326
Additions during the year	5,861,782	5,228,556
Settlement within the year	(4,797,457)	(3,529,875)
Foreign currency translation	351,797	266,484
Balance at end of year	<u>\$ 6,335,613</u>	<u>\$ 4,919,491</u>

The Company has recorded \$6,335,613 and \$ 4,919,491 product warranty reserves as at December 31, 2008 and 2007, which were included in the accrued expenses and other payables in the accompanying consolidated financial statements.

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

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

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

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

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

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

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

As of August 15, 2008, the Company valued the warrant using conversion price at inception and reset respectively. The fair value of the warrant is \$489,719 at the inception conversion price of \$8.8527, and \$551,131 at the reset conversion price of \$8.55, respectively. Such difference resulting from using the reset conversion price has increased warrant liabilities by \$61,412.

As of December 31, 2008, the fair value of warrants was \$1,977, which was determined using the Black-Scholes option pricing model. The income from adjustment of fair value of liabilities in connection with warrants amount of gain has been recorded in the income statement as gain or loss on change in fair value of derivative. (See note 26)

16. Accrued pension costs

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

The activities in the Company's pension account during the year ended December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Balance at beginning of the year	\$ 3,622,729	\$ 3,266,867
Amounts provided during the year	2,311,049	1,286,566
Settlement during the year	(2,381,047)	(1,154,462)
Foreign currency translation	253,788	223,758
Balance at end of year	<u>\$ 3,806,519</u>	<u>\$ 3,622,729</u>

17. Taxes payable

The Company's taxes payable at December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Value-added tax payable	\$6,279,089	\$7,052,682
Income tax payable (recoverable)*	(652,865)	1,883,185
Other tax payable	91,214	144,626
Balance at end of year	<u>\$5,717,438</u>	<u>\$9,080,493</u>

* At the end of the fiscal year of 2008, the Company paid income tax in advance, and the government will settle with the Company during 2009.

18. Amounts Due to Shareholders/Directors

The activity in the amounts due to shareholders/directors during the years ended December 31, 2008 and 2007 is summarized as follows:

	December 31,	
	2008	2007
Balance at beginning of the year	\$ 304,601	\$ 358,065
Increase (decrease) during the year	2,415	(84,476)
Foreign currency translation	30,354	31,012
Balance at end of year	<u>\$ 337,370</u>	<u>\$ 304,601</u>

At December 31, 2008 and 2007, the amounts due to shareholders/directors were unsecured, interest free and repayable on demand.

19. Advances payable

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

The balances are unsecured, interest-free and will be repayable to the Chinese government if the usage of such advance does not continue to qualify for the subsidy (see notes 24 and 31).

20. Minority Interests

The Company's activities in respect of the amounts of the minority interests' equity at December 31, 2008 and 2007 are summarized as follows:

	December 31,	
	2008	2007
Balance at beginning of the year	\$23,166,270	\$23,112,667
Add: Additions during the year-		
Minority interest's income	5,071,408	9,646,339
Capital Contribution from the minority interest holders of Joint-venture companies	745,723	55,512
Less: decrease during the year		
Dividends declared to the minority interest holders of Joint-venture companies	(1,016,733)	(8,468,572)
Transfer and assign equity interest in Henglong by minority interest holders of Joint-venture companies*	(6,177,079)	-
Decrease in minority interests as a result of minority shareholders' withdrawal from Joint-venture**	-	(2,830,545)
Foreign currency translation	1,432,977	1,650,869
Balance at end of year	<u>\$23,222,566</u>	<u>\$23,166,270</u>

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

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

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

**As of March 20, 2007, Sensor withdrew from USAI, its withdrawal of intangible assets, and abandonment of all its rights and interest in USAI, was charged to minority interests of \$2,830,545.

21. Share Capital and Additional paid-in capital

The activities in the Company's share capital and Additional paid-in capital account during the years ended December 31, 2008 and 2007 are summarized as follows:

	Share Capital		Additional paid-in capital
	Shares	Par Value	
Balance at January 1, 2007	23,851,581	2,385	28,651,959
Cash from sale of common stock	108,121	11	1,199,989
Cash paid for retaining fee, commissions and placement agent fee in connection with offering	-	-	(54,500)
Increase in connection with minority shareholders' abandonment of all its rights and interest in Joint-venture	-	-	174,828
Issuance of stock options to independent directors	-	-	153,675
Balance at December 31, 2007	23,959,702	2,396	30,125,951
Issuance of common stock*	3,023,542	302	22,089,698
Decrease in additional paid-in capital in connection with Henglong equity acquisition **	-	-	(25,912,921)
Issuance of stock options to independent directors and management***	-	-	845,478
Balance at December 31, 2008	26,983,244	2,698	27,148,206

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

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

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

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

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

***In July 2004, the Company adopted a stock incentive plan. The maximum number of common shares for issuance under this plan is 2,200,000 with a period of 10 years. The stock incentive plan provides for the issuance, to the Company's officers, directors, management and employees, of options to purchase shares of the Company's common stock. Since the adoption of the stock incentive plan, the

Company has issued 411,350 stock options under this plan, and there remain 1,788,650 stock options issuable in future. As of December 31, 2008, the Company had 388,850 stock options outstanding.

The fair value of the options at the grant date was \$845,478 and \$153,674, for the years 2008 and 2007, respectively, which was calculated based on Black-Scholes option pricing model. The fair value was credited in additional paid-in capital, debited in operating expenses using straight line method over the expected beneficiary period. Difference was recorded as deferred stock compensation. For the years ended December 31, 2008 and 2007, there was \$345,426 and \$153,674 recorded in operating expenses respectively.

The weighted-average fair value of options granted during the periods 2008 and 2007 was \$3.12 and \$6.83, respectively. The fair value of each option granted was estimated on the date of grant using the Black-Scholes option valuation model and assumptions noted in the following table:

Issuance Date	Expected volatility	Risk-free rate	Expected term (years)	Dividend yield
December 10, 2008	134.39%	1.21%	3	0.00%
June 25, 2008	98.29%	3.34%	5	0.00%
October 1, 2007	118.53%	3.00%	4	0.00%

A summary of option activities under the plans for the years ended December 31, 2008 and 2007 was as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Contractual Term (years)
Outstanding - January 1, 2007	45,000	\$ 7.39	5
Granted	22,500	7.01	4
Exercised	—	—	—
Cancelled	—	—	—
Outstanding - December 31, 2007	67,500	\$ 7.26	4.7
Granted	321,350	3.12	3.1
Exercised	—	—	—
Cancelled	—	—	—
Outstanding - December 31, 2008	388,850	\$ 3.84	3.4

The following is a summary of warrants outstanding for the years ended December 31, 2008 and 2007:

	Shares	Weighted-Average Exercise Price	Weighted-Average Contractual Term (years)
Outstanding - January 1, 2007	156,250	\$ 16.00	3
Issued	—	—	—
Exercised	—	—	—
Cancelled	—	—	—
Outstanding - December 31, 2007	156,250	\$ 16.00	3
Issued	1,317,864	8.55	1
Exercised	—	—	—
Cancelled	—	—	—
Outstanding - December 31, 2008	1,474,114	\$ 9.34	1.2

The following is a summary of the range of exercise prices for stock options that are outstanding and exercisable at December 31, 2008:

Range of Exercise Prices	Outstanding Stock Options	Weighted Average Remaining Life	Weighted Average Exercise Price	Number of Stock Options Exercisable
\$2.00 - \$4.49	298,850	2.94	\$ 2.93	99,617
\$4.50 - \$10.00	90,000	2.81	\$ 6.86	90,000
	<u>388,850</u>			<u>189,617</u>

The following is a summary of the range of exercise prices for warrants that are outstanding and exercisable at December 31, 2008:

Range of Exercise Prices	Issued Warrants	Weighted Average Remaining Life	Weighted Average Exercise Price	Number of Warrants Exercisable
\$4.50 - \$9.99	1,317,864	0.13	\$ 8.55	1,317,864
\$10.01 - \$20.00	156,250	0.22	\$ 16.00	156,250
	<u>1,474,114</u>			<u>1,474,114</u>

22. Retained earnings

Pursuant to the relevant PRC laws and regulations of Sino-foreign joint venture enterprises, the profits distribution of the Company's Sino-foreign subsidiaries, which are based on their PRC statutory financial statements, are available for distribution in the form of cash dividends after these subsidiaries have paid all relevant PRC tax liabilities, provided for losses in previous years, and made appropriations to statutory surplus at 10%.

The Company did not distribute the profit for the year 2008, therefore, there was no statutory surplus recorded.

When the statutory surplus reserve reaches 50% of the registered capital of a company, additional reserve is no longer required. However, the reserve cannot be distributed to joint venture partners. Based on the business licenses of the Sino-foreign joint ventures, the registered capital of Henglong, Jiulong, Shenyang, Zhejiang, USAI, Jielong, Wuhu, and Hengsheng are \$10,000,000, \$4,283,170 (RMB35,000,000), \$8,132,530 (RMB67,500,000), \$7,000,000, \$2,600,000, \$6,000,000, \$3,750,387 (RMB30,000,000), and \$10,000,000 respectively.

Net income as reported in the US GAAP financial statements differs from that reported in the PRC statutory financial statements. In accordance with relevant laws and regulations in the PRC, profits available for distribution are based on the statutory financial statements. If the Company has foreign currency available after meeting its operational needs, the Company may make its profit distributions in foreign currency to the extent foreign currency is available. Otherwise, it is necessary to obtain approval and convert such distributions at an authorized bank.

23. Deferred stock compensation

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

24. Other Income

During 2008 and 2007, the Company recorded other income, government subsidies, of \$1,067,309 and \$38,462, respectively.

Government subsidies including interest subsidies, which mean the refunds by the Chinese Government of interest charged by banks to companies which are entitled to such subsidies (see note 31), and subsidies for encouraging foreign investors to set up technologically advanced enterprises in China .

Chinese government also provided incentives to foreign investors for setting up technologically advanced enterprises in China. During 2008, Genesis, as a foreign investor, received \$802,331 for re-investment in Jiulong and Henglong with their profit distribution, and those entities were technologically advanced enterprises and entitled to such subsidies.

Since such government subsidy is similar to an investment income, the Company has recorded it as other income.

25. Financial income (expenses)

During the year ended December 31, 2008 and 2007, the Company recorded financial income (expenses) which was summarized as follows:

	Years Ended December 31,	
	2008	2007
Interest income(expenses),net	\$ (1,238,764)	\$ (559,773)
Foreign exchange gain (loss), net	305,578	95,497
Income (loss) of note discount, net	150,654	(49,900)
Amortization for discount of convertible note payable	(424,665)	-
Handling charge	(89,021)	(52,810)
Total	<u>\$ (1,296,218)</u>	<u>\$ (566,986)</u>

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

	Years Ended December 31,	
	2008	2007
Income from adjustment of fair value of liabilities in connection with warrants	\$ 796,649	\$ -
Income from adjustment of fair value of compound derivative liabilities	201,365	-
Total	<u>\$ 998,014</u>	<u>\$ -</u>

27. Income Taxes

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

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

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

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

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

USAI, Wuhu, Jielong and Hengsheng are at their start up stage in 2008 and 2007, accordingly, there is no assessable profit for the year ended December 31, 2008 and 2007 subject to PRC enterprise income tax. They have an enterprise income tax exemption in 2008 and 2009, and are subject to enterprise income tax at a rate of 16.5% for the next three years thereafter, from 2010 to 2012, and a 25% enterprise national income tax for the years commencing from January 1, 2013.

No provision for Hong Kong tax is made as Genesis is an investment holding company, and has no assessable income in Hong Kong for the year ended December 31, 2008 and 2007. The enterprise income tax of Hong Kong is 17.5%.

No provision for US tax is made as the Company has no assessable income in the US for the year ended December 31, 2008 and 2007. The enterprise income tax of US is 30%.

The provision for income tax differs from the provision computed at statutory rates as follows:

	Years Ended December 31,	
	2008	2007
Average tax rate	14.17%	17.95%
Computed income tax provision	2,507,295	3,722,141
Permanent Differences		
Income tax refund*	(2,762,823)	(2,085,180)
Other reconciling items	441,405	594,071
Total current and deferred tax expense	185,877	2,231,032

*For the years ended December 31, 2008 and 2007, the income tax refund mainly includes the income tax benefit received by the Company's Sino-foreign joint ventures for purchase of domestically manufactured equipments.

28. Income Per Share

Basic income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated based on the treasury stock method, assuming the issuance of common shares, if dilutive, resulting from the exercise of warrants.

The calculations of diluted income per share were:

	Years Ended December 31,	
	2008	2007
Numerator:		
Net income	\$12,435,241	\$ 8,859,906
Add: interest expenses of convertible notes payable	918,750	-
Add: Amortization for discount of convertible notes payable	424,665	-
	<u>\$13,778,656</u>	<u>\$ 8,859,906</u>
Denominator:		
Weighted average shares outstanding	25,706,364	23,954,370
Effect of dilutive securities	3,962,362	4,335
	<u>29,668,726</u>	<u>23,958,705</u>
Net income per common share- diluted	<u>\$ 0.46</u>	<u>\$ 0.37</u>

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

29. 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.

In 2008, the Company's ten largest customers accounted for 78.4% of the Company's consolidated sales, with four customers accounting for in excess of 10% of consolidated sales, i.e. 15.1%, 11.9%, 11.4% and 10.6% of consolidated sales, or an aggregate of 49.1% of consolidated sales.

In 2007, the Company's ten largest customers accounted for 73.9% of the Company's consolidated sales, with four customers accounting for in excess of 10% of consolidated sales, i.e. 16.4%, 13.7%, 11.5% and 10.6% of consolidated sales, or an aggregate of 52.2% of consolidated sales.

At December 31, 2008 and 2007, approximately 34.2% and 38.1% of accounts receivable were from trade transactions with the aforementioned customers.

30. Related Party Transactions

The Company's related party transactions include product sales, material purchases and purchases of equipment and technology. These transactions were consummated under similar terms as those with the Company's customers and suppliers. On some occasions, the Company's related party transactions also include purchase/sale of capital stock of the joint ventures and sale of property, plant and equipment.

Related sales and purchases: During the years ended December 31, 2008 and 2007, the joint-ventures entered into related party transactions with companies with common directors as shown below:

Merchandise Sold to Related Parties

	Years ended December 31,	
	2008	2007
Xiamen Joylon	\$ 2,143,418	\$ 5,020,465
Shanghai Fenglong	166,885	452,044
Jiangling Yude	2,365,107	-
Total	<u>\$ 4,675,410</u>	<u>\$ 5,472,509</u>

Materials Purchased from Related Parties

	Years ended December 31,	
	2008	2007
Xiamen Joylon	\$ 9,547	\$ 2,157
Shanghai Fenglong	136,990	144,333
Jiangling Tongchuang	5,485,206	4,032,771
Jingzhou Tongyi	285,347	225,451
Jingzhou Tongying	1,984,854	953,796
Hubei Wiselink	-	114,087
Total	<u>\$ 7,901,944</u>	<u>\$ 5,472,595</u>

Technology Purchased from Related Parties

	Years ended December 31,	
	2008	2007
Changchun Hualong	\$ 321,892	\$ 479,452

Equipment Purchased from Related Parties

	Years ended December 31,	
	2008	2007
Hubei Wiselink	\$ 3,031,072	\$ 1,015,493

Purchase of 35.5% equity interest in Jinzhou Henglong (refer to note 20)

Related receivables, advance payments and account payable: As at December 31, 2008 and 2007, accounts receivables, advance payments and account payable between the Company and related parties are as shown below:

Due from Related Parties

	December 31,	
	2008	2007
Xiamen Joylon	\$ 1,077,659	\$ 1,704,571
Shanghai Fenglong	207,451	164,909
Total	\$ 1,285,110	\$ 1,869,480

Other Receivables from Related Parties

	December 31,	
	2008	2007
Jiangling Tongchuang	\$ 3,511	\$ 3,288
Jingzhou Derun	-	22,472
Wuhan Dida	141,560	93,925
Jiulong Material	534,369	519,141
Changchun Hualong	224,234	—
Total	\$ 903,674	\$ 638,826

Other receivables from related parties are primarily unsecured demand loans, with no stated interest rate or due date.

On December 31, 2008 and 2007, with the exception of the receivable from the investee of Jiulong, Jiulong Material, of \$534,309 and \$519,141, which were fully recorded in the allowance for doubtful accounts, the Company believes that all other receivables are collectible, as the related parties are in good financial condition and are paying their payables to Company pursuant to the terms of their respective contracts.

Due to Related Parties

	December 31,	
	2008	2007
Xiamen Joylon	\$ -	\$ 3,007
Shanghai Tianxiang	609,675	570,806
Shanghai Fenglong	38,063	1,007
Jiangling Tongchuang	206,039	287,292
Hubei Wiselink	159,482	146,658
Jingzhou Tongyi	17,377	33,859
Jingzhou Tongying	67,006	92,188
Total	\$ 1,097,642	\$ 1,134,817

Advanced Equipment Payment to Related Parties

	Years ended December 31,	
	2008	2007
Hubei Wiselink	\$ 2,473,320	\$ 1,560,378

Advanced Expenses and Others to Related Parties

	Years ended December 31,	
	2008	2007
Jingzhou Tongyi	\$ -	\$ 54,799
Jingzhou Tongying	9,374	524
Total	\$ 9,374	\$ 55,323

31. Commitments and Contingencies

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

The following table summarizes the Company's major contractual payment obligations and commitments as of December 31, 2008:

	Payment Obligations by year					
	2009	2010	2011	2012	Thereafter	Total
Obligations for service agreements	\$ 110,000	\$ 110,000	\$ 110,000	\$ -	\$ -	\$ 330,000
Obligations for purchasing agreements	5,861,113	912,214	-	-	-	6,773,327
Total	\$5,971,113	\$1,022,214	\$110,000	\$ -	\$ -	\$7,103,327

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

32. Off-Balance Sheet Arrangements

At December 31, 2008 and 2007, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

33. Subsequent Events

Since the Company's stock Weighted Average Price for twenty (20) consecutive trading days ended on March 16, 2009 was below \$3.187, which is less than 45% of the Conversion Price in effect of the Issuance Date, as adjusted, the "WAP Default", the Convertible Debt holder shall have the right, at its sole discretion, to require that the Company redeem all or any portion of the Convertible Debt by delivering written redemption notice to the Company within five (5) business days after the receipt of the Company's notice of the WAP Default. On March 17, 2009, the Company delivered the WAP Default notice to the Convertible Debt holders. Since the Company has not received any notice from YA Global Investments, L.P. as of March 24, 2009, its redemption rights under such WAP Default has lapsed. On March 23, 2009, the Company received a letter from the joint and several provisional liquidators acting on behalf of

Lehman Brothers Commercial Corporation Asia Limited, “LBCCA Liquidator”, requesting that it be granted an extension of time until April 24, 2009 to obtain legal advice and to consider its rights under the Convertible Debt. The Company has granted an extension to April 15, 2009. Although the LBCCA Liquidator has not given the Company any notice of redemption yet, it may exercise its discretionary right of early redemption on any date that is no earlier than ninety (90) days after it delivers the written redemption notice to the Company, so long as it delivers such notice on or before April 15, 2009.

34. Segment Reporting

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

During the year ended December 31, 2008 and 2007, the Company had nine product sectors, five of them were principal profit makers, which were reported as separate sectors which engaged in the production and sales of power steering (Henglong), power steering (Jiulong), power steering (Shenyang), power pumps (Zhejiang), and power steering (Wuhu). The other four sectors which were established in 2005, 2006 and 2007 respectively, engaged in the production and sales of sensor modular (USAI), electronic power steering (Jielong), power steering (Hengsheng), and provider of after sales and R&D services (HLUSA). Since the revenues, net income and net assets of these four sectors are less than 10% of its segment in the consolidated financial statements, the Company incorporated these four sectors into “other sectors”.

The Company’s product sectors information is as follows:

For the year ended December 31, 2008

	Henglong	Jiulong	Shenyang	Zhejiang	Wuhu	Other Sectors	Other(a)	Total
Revenue								
Net product sales – external	\$ 65,903,560	\$40,457,552	\$21,360,581	\$15,094,357	\$19,953,632	\$ 409,604	\$ -	\$163,179,286
Net product sales – internal	27,088,095	2,250,714	3,646,916	684,098	-	491,871	(34,161,694)	-
Gain on other sales and other income – external	317,477	73,819	156,743	33,930	134,472	21,217	(3,595)	734,063
Total revenue	<u>\$ 93,309,132</u>	<u>\$42,782,085</u>	<u>\$25,164,240</u>	<u>\$15,812,385</u>	<u>\$20,088,104</u>	<u>\$ 922,692</u>	<u>\$(34,165,289)</u>	<u>\$163,913,349</u>
Depreciation and amortization	4,575,115	2,569,716	701,120	1,147,517	401,379	416,957	113,188	9,924,992
Net income (loss)	11,989,130	286,376	1,464,617	1,394,015	(369,090)	(816,921)	(1,512,886)	12,435,241
Total assets	107,998,822	46,541,107	23,460,621	23,907,010	10,068,515	18,714,486	856,427	231,546,988
Capital expenditures	\$ 2,277,253	\$ 3,407,505	\$ 269,207	\$ 501,557	\$ 716,239	\$ 5,199,172	\$ 10,000,000	\$ 22,370,933

For the year ended December 31, 2007

	Henglong	Jiulong	Shenyang	Zhejiang	Wuhu	Other Sectors	Other(a)	Total
Revenue								
Net product sales								
– external	\$45,612,058	\$35,774,010	\$19,787,916	\$13,828,252	\$18,495,678	\$ 99,089	\$ -	\$133,597,003
Net product sales								
– internal	30,487,995	3,151,173	3,696,888	142,185	-	-	(37,478,241)	-
Gain on other sales and other income – external	419,814	115,472	70,879	5,973	5,595	(18,831)	(6,290)	592,612
Total revenue	<u>\$76,519,867</u>	<u>\$39,040,655</u>	<u>\$23,555,683</u>	<u>\$13,976,410</u>	<u>\$18,501,273</u>	<u>\$ 80,258</u>	<u>\$(37,484,531)</u>	<u>\$134,189,615</u>
Depreciation and amortization	3,594,199	1,897,886	531,033	848,534	176,952	197,311	103,631	7,349,546
Net income (loss)	6,154,185	3,105,196	2,121,008	1,415,060	(942,270)	(755,821)	(2,237,452)	8,859,906
Total assets	82,336,597	43,072,284	22,360,047	19,432,066	10,469,583	7,279,420	(1,965,310)	182,984,687
Capital expenditures	\$ 3,845,364	\$ 2,283,801	\$ 1,288,001	\$ 2,127,630	\$ 1,702,612	\$ 3,022,829	\$ -	\$ 14,270,237

- (a) Other includes activity at the corporate level, unrealized income between product companies (sectors), and elimination of inter-sector transactions.

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Annual Meeting

The Annual Meeting of China Automotive Systems stockholders will be held on December 17, 2009 (Thursday) at 10 a.m. local time in Wuhan, China

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