CHINA AUTOMOTIVE SYSTEMS INC
Form 10-K
April 02, 2007

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

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the fiscal year ended December 31, 2006

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from ____________ to ____________.

Commission File Number 000-33123

CHINA AUTOMOTIVE SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

Delaware	**33-0885775**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
No. 1 Henglong Road, Yu Qiao Development Zone Shashi District, Jing Zhou City Hubei Province, China	**434000**
(Address of Principal Executive Offices)	*(Zip Code)*

(86) 716-8329196

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $ 0.0001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chaper) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The Company's revenues for its most recent fiscal year were $95,766,439

Aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2006, based upon the closing price of the common stock as reported on the NASDAQ Stock Market under the symbol "CAAS" on such date, was approximately $22,855,706.

23,959,702 shares of Common Stock outstanding as of February 27, 2007.

CHINA AUTOMOTIVE SYSTEMS, INC.

FORM 10-K

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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," " "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 Holding 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. Genesis owns all of the capital stock of Ji Long Enterprises Investment Corp. Ltd., a Hong Kong Company, "Ji Long". Ji Long in turn owns interests in seven 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.

Effective July 17, 2006, Hanlin Chen, Qizhou Wu, Andy Yiu Wong Tse, Robert Tung, Haimian Cai, William E. Thomson and Guangxun Xu began serving their terms as members of the Company's Board of Directors. The newly elected directors appointed Hanlin Chen as the Chief Executive Officer and Chairman of the Board of Directors, Qizhou Wu as the Chief Operating Officer and Daming Hu 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 seven Sino-foreign joint ventures in China. Set forth below is an organizational chart as at December 31, 2006.

China Automotive Systems, Inc.

|

(100%)
Great Genesis Holdings Limited

|

(100%)
Ji Long Enterprise Investment Limited

|

44.5%	81%	70%	51%	60%	(77.33%)	(85%)
Jingzhou Henglong Automotive Parts Co., Ltd.	Shashi Jiulong Power Steering Co., Ltd.	Shenyang Jinbei Henglong Automotive Steering System Co., Ltd.	Zhejiang Henglong & VIE Pump Co., Ltd.	Universal Sensor Application., Inc.	Wuhu Henglong Automotive Steering System Co., Ltd.	Wuhan Jielong Electric Power Steering Co., Ltd.
("Henglong)	("Jiulong")	("Shenyang")	("Zhejiang")	(“USAI”)	(“Wuhu”)	(“Jielong”)

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

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

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

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

On April 12, 2005, Great Genesis, entered into a joint-venture agreement with Shanghai Hongxi Investment Inc., “Hongxi”, a company controlled by Mr. Hanlin Chen, the Company’s Chairman, and Sensor System Solution Inc., “Sensor”, to establish a joint venture, Universal Sensor Application Inc., “USAI”, in the Wuhan East Lake Development Zone. The registered capital of the Joint-venture is $10 million. Great Genesis and Hongxi will invest $6 million and $1 million, respectively, including cash and land and building, which will account for 60% and 10% of the total registered capital, respectively. Sensor will invest $3 million in technology, accounting for 30% of the total registered capital. As of December 31, 2006, Great Genesis has contributed $900,337, the equivalent of RMB7,200,000 and Hongxi has contributed $436,954 in cash, the equivalent of RMB3,500,000. Even though the Company had not yet contributed 60% of the total capital, all parties had agreed that the Company was a 60% owner during 2006 and on December 31, 2006. USAI reported a net loss in 2006. Pursuant to the above joint venture agreement, Sensor has failed to contribute it's sensor-related technologies and thereby failed to fulfill it's capital contribution commitment as of March 20, 2007. As a result Sensor has withdrawn from USAI and another technology supplier is being sought.

On April 14, 2006, Great Genesis, entered into a joint-venture agreement with Hong Kong Tongda, “Tongda”, to establish a joint venture, Wuhan Jielong Electric Power Steering Co., Ltd., “Jielong”, in the Wuhan East Lake Development Zone. Jielong is mainly engaged in the production and sales of electric power steering, “EPS”. The registered capital of the joint-venture is $6 million, the equivalent of RMB48,000,000. Great Genesis and Tongda will invest $5,100,000 and $900,000, respectively, amounting to 85% and 15% of the total registered capital, respectively. As of December 31, 2006, Great Genesis and Tongda have contributed $765,000 and $135,034 in cash, the equivalent of RMB6,136,830 and RMB1,081,620 respectively.

On March 31, 2006, as amended on May 2, 2006, Great Genesis, entered into a joint-venture agreement with Wuhu Chery Technology Co., Ltd., "Chery Technology", to establish a Joint-venture, Wuhu Henglong Automotive Steering System Co., Ltd in the Wuhu Technological Development Zone. Wuhu is mainly engaged in the production and sales of automobile steering system. The registered capital of the Joint-venture is $3,750,387, the equivalent of RMB30,000,000. Great Genesis and Chery Technology will invest $2,900,300, the equivalent of RMB23,200,000 and $848,938, the equivalent of RMB6,800,000 respectively, which will account for 77.33% and 22.67% of the total registered capital, respectively. As of December 31, 2006, the capital of $3,750,387, the equivalent of RMB30,000,000, has been totally contributed in Wuhu.

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 van manufacturers 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 2005 and 2006, the Company has supplied the power steering pumps for SAIC GM Wuling Co., one of the Sino-Foreign joint ventures established by General Motors (GM).

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 is expected to offer 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 TUVRheindland 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.

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- 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 72.6% of the Company's total sales for the year ended December 31, 2006. The following table sets forth information regarding the Company's ten largest customers.

Name of Major Customers	Percentage of Total Revenue in 2006
Chery Automobile Co., Ltd	16.4%
Brilliance China Automotive Holdings Limited	13.3%
Beiqi Foton Motor Co., Ltd.	11.1%
Zhejiang Geely Holding Co., Ltd	10.3%
Xi'an BYD Electric Car Co., Ltd	7.2%
Dongfeng Auto Group Co., Ltd	4.6%
China FAW Group Corporation	3.2%
Shanxi Heavy Auto Co., Ltd	2.5%
Shenyang Zhongshun Auto Co., Ltd	2.1%
Great Wall Motor Company Limited	1.9%
Total	72.6%

We primarily sell our products to the above-mentioned customers; we also have excellent relationships with them, including as their first-ranking supplier and developer for new product development for new models. While we intend to continue to focus on retaining and winning this business, we cannot ensure that we 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, 2006, the Company employed approximately 2,042 persons, including approximately 1,452 by Henglong and Jiulong, approximately 217 by Shengyan, approximately 264 by Zhejiang, approximately 43 by USAI and approximately 66 by Wuhu.

As of December 31, 2006, each of Henglong and Jiulong, Shenyang, Zhejiang and Wuhu has a manufacturing and administration area of 448,612 square meters, 35,354 square meters, 27,756 square meters, and 83,705 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 450,000 units, 510,000 units and 800,000 units in 2004, 2005 and 2006 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 $21.5 million was spent over the last three years on professional-grade equipment -- approximately 88% of which is already in place and in use as of December 31, 2006.

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 21.9% of all components and raw materials it purchased for the year ended December 31, 2006, with no single supplier providing more than 10% of total purchases.

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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.

Henglong owns a Hubei Provincial-Level Technical Center, which is approved by the Hubei Economic Commission. The center has a staff of 122, including 12 senior engineers, 2 foreign experts and 68 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-controlled Power Steering (EPS).

We believe that our engineering and technical expertise, together with our emphasis on continuing research and development, allow us to use the latest technologies, materials and processes to solve problems for our customers and to bring new, innovative products to market. We believe that continued research and development activities, including engineering, are critical to maintaining our pipeline of technologically advanced products. We have aggressively managed costs in other portions of our business in order to maintain our total expenditures for research and development activities, including engineering, at approximately $1,100,000, $1,000,000 and $1,500,000 for the years ended December 31, 2006, 2005 and 2004, respectively. In 2006, the sales of newly developed products accounted for about 9.6% 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. For the year ended December 31, 2006, the selling price of the Company's principal products was reduced by an average of 9.5% compared with 2005.

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 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 2006, the output and sales volume of domestic made vehicles has reached 5,233,100 and 5,176,000 units respectively, with an increase of 32.76% and 30.02% compared with the same period of last year. The sales volume of national brand vehicles had reached 982,800 units, representing 25.67% of total passenger vehicles sales, an increase of 4.13% as compared with 21.54% market share in 2005. The output and sales volume of commercial vehicles has reached 2,050,000 and 2,040,000 units respectively with an increase of 15.0% and 14.0% over last year. National brand vehicles maintained a lead in the commercial vehicle market obtaining more than 96% thereof.

In 2006, due to the increased sales volume of Chinese vehicles, the Company's sales of steering gear and steering pumps for passenger vehicles increased by 50.5% and 70.6%, respectively, as compared with the corresponding period in 2005, however, the Company's sales of steering gears for commercial vehicles increased by 43.3% as compared with the corresponding period in 2005.

The Company expects that in 2007, China's automobile market will develop steadily.

Lei Jiang, the Secretary General of the China Association of Automotive Manufacturers and Chairman of the Automobile Industry of the China Council for the promotion of International Trade, predicted that in 2007, there will be healthy development for the Chinese auto market, and the output and sales of vehicles will increase by approximately 15%. Based on this prediction, management believes that the Company's net sales would increase by 15%-20%.

CHINESE ECONOMY

Management believes that the most important factor in understanding the Chinese automobile industry is the country's rapid economic growth. Chinese economic growth maintained high levels in 2006. According to data from State Statistical Bureau, the Chinese economic growth reached 10.7% in 2006. Because of the growth of the Chinese economy and the increased income level of its residents, the investment by Chinese enterprises and consumption by Chinese residents will continue to increase rapidly.

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 94,000 kilometers of highway and 4,300 kilometers of expressway were developed in 2006. Total highways and expressways now amount to 2,014,000 kilometers and 44,000 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 provinces. 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 be 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.

ITEM 1A. RISK FACTORS.

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

Risks Related to the Company's Business and Industry

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

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

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

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

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

· Quality;

· Price/cost competitiveness;

· System and product performance;

· Reliability and timeliness of delivery;

· New product and technology development capability;

· Excellence and flexibility in operations;

· Degree of global and local presence;

· Effectiveness of customer service; and

· Overall management capability.

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

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

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

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

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

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

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

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

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

For the year ended December 31, 2006, approximately 16.4% of the Company's sales were to Chery Automobile Co., Ltd, approximately 13.3% were to Brilliance China Automotive Holdings Limited, approximately 11.1% were to Beiqi Foton Motor Co., Ltd, and approximately 10.3% were to Zhejiang Geely Holding Co., Ltd, the Company's four largest customers. The loss of, or significant reduction in purchases by, one or more of these major customers could adversely affect the Company's business.

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

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

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

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

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

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

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

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

The Company's management controls approximately 83.8% of its outstanding common stock and may have conflicts of interest with its minority stockholders.

Members of the Company's management beneficially own approximately 83.8% of the outstanding shares of the Company's common stock. As a result, these majority stockholders have control over decisions to enter into any corporate transaction and have the ability to prevent any transaction that requires the approval of stockholders, which could result in the approval of transactions that might not maximize stockholders' value. Additionally, these stockholders control the election of members of the Company's board, have the ability to appoint new members to the Company's management team and control the outcome of matters submitted to a vote of the holders of the Company's common stock. The interests of these majority stockholders may at times conflict with the interests of the Company's other stockholders.

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

There is a limited public float of the Company's common stock. Of the Company's outstanding common stock, approximately 16.2% is considered part of the public float. The term "public float" refers to shares freely and actively tradable on the NASDAQ SmallCap Market and not owned by officers, directors or affiliates, as such term is defined under the Securities Act. Due to the Company's relatively small public float and the limited trading volume of its common stock, purchases and sales of relatively small amounts of the Company's common stock can have a disproportionate effect on the market price for the Company's common stock. As a result, the market price of the Company's common stock can be volatile. This stock price volatility could prevent a stockholder seeking to sell Company common stock from being able to sell it at or above the price at which the stock was bought.

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

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

Risks Related to Doing Business in China and other International Countries

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sales of the Company’s common stock in the public market following the SEDA could lower the market price of its common stock. Sales may also make it more difficult for the Company to sell equity securities or equity-related securities in the future at a time and price that management deems acceptable, or at all. Of the 23,959,702 shares of common stock outstanding as of February 27, 2007, all such shares are, or will be, freely tradable without restriction, unless held by our “affiliates.” Some of these shares may be resold under Rule 144.

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

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

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

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

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

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

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

This could happen to the Company’s stock price.

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

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

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not Applicable.

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 long-term rights, forty to fifty years, to use the land and owns all of the land improvements.

Name of Entity	Product	Total Area (M^2)	Building Area (M^2)	Original Cost of Equipment	Site
Henglong	Automotive Parts	395,741	20,226	$ 17,383,308	Jingzhou City, Hubei Province
		13,393	13,707	-	Wuhan City, Hubei Province
Jiulong	Power Steering Gears	39,478	23,728	9,851,256	Jingzhou City, Hubei Province
Shenyang	Automotive Steering Gears	35,354	16,369	1,958,812	Shenyang City, Liaoning Province
Zhejiang	Steering Pumps	27,756	7,262	3,369,420	Zhuji City, Zhejiang Province
USAI	Sensor Modular	—	—	368,205	Wuhan City, Hubei Province

Wuhu	Automotive Steering Gears	83,705	15,197		8,472	Wuhu City, Anhue Province
Jielong	Electric Power Steering	—	—		33,000	Wuhan City, Hubei Province
Total		595,427	96,489	$	32,972,473	

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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

During the fiscal year 2006, we held a shareholder meeting, elected 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 Small Cap market under the symbol “CAAS”. The high and low bid intra-day prices of the common stock in 2006 and 2005 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			
	2006		2005	
	High	Low	High	Low
First Quarter	$ 14.04	$ 6.57	$ 12.46	$ 8.53
Second Quarter	11.19	6.41	9.8	6.14
Third Quarter	8.14	6.52	7.85	4.1
Fourth Quarter	$ 12.49	$ 6.68	$ 10.00	$ 4.27

The above quotations reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions.

(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, 2007, there were 23,959,702 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, 2006 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	$ 6.42	2,132,500

The stock options 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 period of 10 years.

ITEM 6. SELECTED FINANCIAL DATA.

The following selected financial data reflects the results of operations and balance sheet data for the years ended 2002 to 2006. The data below should be read in conjunction with, and is qualified by reference to, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto included elsewhere in this report. The financial information presented may not be indicative of our future performance.

	Years Ended December 31,				
	2006	2005	2004	2003	2002(1)
Statement of Operations Data:					
Net sales	$ 95,766,439	$ 63,572,301	$ 58,185,845	$ 53,624,868	$ —
Net income	4,811,704	3,315,478	6,867,337	3,871,269	4,159,000
Basic & Diluted earnings per share	0.21	0.15	0.30	0.18	0.20
Balance Sheet Data:					
Total assets	152,108,538	119,529,723	105,486,645	95,846,750	19,427,000
Total liabilities	75,615,581	60,851,575	55,776,357	51,145,176	13,330,000
Minority interests	23,112,667	21,751,043	17,571,838	18,686,712	—
Shareholders equity	$ 53,380,290	$ 36,927,105	$ 32,138,450	$ 26,014,862	$ 6,097,000

(1). The minority joint venture partners have the right to participate in management before January 1, 2003. Pursuant to EITF 96-16, the Company accounted for its interest in these joint ventures under the equity method for the years ended December 31, 2002 and 2001. During early 2003, the directors of the Company and the other joint ventures in the Company's Sino-foreign joint ventures executed "Act in Concert" agreements, accordingly, the Company has accounted for the above joint ventures on a consolidated basis since January 1, 2003 because the Company has exercised sufficient control over their management and operations.

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 "w 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, engaged in the manufacture and sales of automotive systems and components in the People's Republic of China, the "PRC" or "China", as described below.

The Company owns the following aggregate net interests in seven Sino-foreign joint ventures organized in the PRC as of December 31, 2006.

	Percentage Interest		
Name of Entity	2006	2005	2004
Jingzhou Henglong Automotive Parts Co., Ltd."Henglong"	44.5%	44.5%	44.5%
Shashi Jiulong Power Steering Gears Co., Ltd."Jiulong"	81.0%	81.0%	81.0%
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd."Shenyang"	70.0%	70.0%	70.0%
Zhejiang Henglong & Vie Pump-Manu Co., Ltd."Zhejiang"	51.0%	51.0%	51.0%
Universal Sensor Application Inc."USAI"	60.0%	60.0%	—
Wuhan Jielong Electric Power Steering Co., Ltd. ("Jielong")	85.0%	—	—
Wuhu HengLong Auto Steering System Co., Ltd. ("Wuhu")	77.33%	—	—

Jiulong and Henglong were formed in 1993 and 1997 respectively, and they are mainly engaged in the production of rack and pinion power steering gear and integral power steering gear for cars and light and heavy-duty vehicles. Shenyang and Zhejiang were established in 2002 for the production of power steering parts and power steering pumps, respectively. USAI was established in 2005 and mainly engaged in the production and sales of sensor modular. Jielong and Wuhu were established in 2006, and they are mainly engaged in the production of rack and pinion power steering gear for cars and light vehicles and electric power steering, "EPS". During 2006, USAI has entered into small batch production, Jielong and Wuhu were in the early technology and production preparation stage, and expected to start its small batch production in 2007.

Jingzhou Henglong Fulida Textile Co., Ltd. ("Jingzhou") was formed in February 2003 to produce environmental textiles and raw materials, and was owned 51% by the Company. Effective August 31, 2004, in order to concentrate on its main products, namely steering and automotive parts, the Company disposed of its 51% interest in Jingzhou by entering into an equity exchange agreement with Hubei Wanlong Investment Co., Ltd., for its 2.5% equity interest in Henglong.

The divested non-core business of Jingzhou has been treated as a discontinued operation under SFAS No. 144. Jingzhou's results of operation and related charges have been reclassified as discontinued operations in the Company's consolidated statements of operations in 2004.

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 December 31,			Change in percentage	
	2006	2005	2004	2005 to 2006	2004 to 2005
Income from continued operations:					
Net sales	100.0%	100.0%	100.0%	50.6%	9.3%
Cost of sales	65.6	64.7	60.2	52.9	17.3
Gross profit	34.4	35.3	39.8	46.5	(2.9)
Gain on other sales (a)	0.3	0.6	1.4	(22.4)	(54.7)
Less: operating expenses					
Selling expenses (a)	8.1	9.1	6.6	33.9	50.2
General and administrative expenses (a)	8.2	8.0	10.6	53.3	(17.1)
R & D expenses	1.1	1.5	2.6	10.3	(36.3)
Depreciation and amortization	3.9	4.1	1.5	46.5	204.0
Total operating expenses	21.3	22.7	21.3	41.4	16.7
Operating income	13.3	13.2	19.9	52.3	(27.5)
Other income (a)	0.1	0.2	1.5	(37.5)	(82.4)
Financial expenses	(0.9)	(1.8)	(1.3)	(28.6)	59.5
Income before income tax from continued operations	12.6	11.6	20.1	63.2	(37.0)
Income tax	1.7	2.2	1.1	21.7	121.8
Income before minority interests from continued operations	10.8	9.4	19.0	72.7	(45.8)
Minority interests	5.8	4.2	7.2	106.9	(35.9)
Net income from continued operations	5.0	5.2	—	45.1	(51.9)
Net loss from discontinued operations					
Net loss from discontinued operations	—	—	(0.04)	—	(100.0)
Net income	5.0%	5.2%	11.8%	45.1%	(51.7%)

(a) For the convenience of comparability, the Company has reclassified warranty expenses from general and administrative expenses into selling expenses, also reclassified non-cash compensation into general and administrative expenses, and part of non-operating income which was attributable to operating income into Gain on other sales, to be consistent with the presentation of its financial statement for the year 2006.

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RESULTS OF OPERATIONS: 2006 VERSUS 2005

NET SALES

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

Item	2006 Amount ($)	2005 Amount ($)	Increase (Decrease) Amount ($)	Percentage %
Steering gear for commercial vehicles	$ 25,135,726	$ 17,534,929	$ 7,600,797	43.3%
Steering gear for passenger vehicles	60,248,178	40,044,635	20,203,543	50.5
Steering pumps	10,221,478	5,992,737	4,228,741	70.6
Sensor modular	161,057	-	161,057	-
Total	$ 95,766,439	$ 63,572,301	$ 32,194,138	50.6%

For the year ended December 31, 2006, net product sales were $95,766,439, as compared to $63,572,301 for the year ended December 31, 2005, an increase of $32,194,138 or 50.6%. The increase in net sales in 2006 as compared to 2005 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 and the increase in the Company’s sales of steering gear and pumps was due to these factors. As a result, sales of steering gear and pumps for domestic passenger vehicles for the year ended December 31, 2006 increased 50.5% and 70.6% over the same periods of 2005, respectively.

(2) Increased investments in China led to an increase in sales of commercial vehicles. For the year ended December 31, 2006, sales of steering gears and accessories for commercial vehicles increased by 43.3% as compared to the same period of 2005, mainly due to the Company having expanded its market share by adopting technical innovation.

(3) Through technological improvement to the Company’s production lines, the technological contents in, and production efficiency, of the Company’s products were raised, thus satisfying market needs.

Based on the above reasons, the Company’s increase of net sales was 50.6% in 2006, which exceeded the anticipated increase of 15%-20%. In 2007, the Company intends to strive to increase net sales by 15%-20% by expanding its sales market both domestically and internationally. In the domestic market, the Company will strive to reach the sales targets for new model 323 sedan of Hainan Mazda Co., Ltd., LIONCEL sedan of Southeast Motor Co., Ltd. and ZX sedan of Dongfeng Peugeot Citroen Automobile Company Ltd. As for the international market, the Company will strive to reach the sales targets for the City Mini system and the commercial system of TATA motors, one of the biggest automakers in India.

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, 2006, gain on other sales were $279,216, as compared to $359,986 for the year ended December 31, 2005, a decrease of $80,770 or 22.4%. Sales of materials for the year ended December 31, 2006 were $295,826, which decreased by $23,579 or 7.4%, as compared with $319,405 for the same period of 2005, due to decreased sales volume of materials. Loss from sales of other assets for the year ended December 31, 2006 was $16,610, which decreased by $57,191, as compared with profit from sales of other assets of $40,581 for the same period of 2005.

GROSS PROFIT FROM PRODUCT SALES

For the year ended December 31, 2006, the gross profit was $32,909,814, as compared to $22,466,823 for the year ended December 31, 2005, an increase of $10,422,991 or 46.5%, as a result of following factors:

1. Increased product sales: In the domestic passenger vehicles and commercial vehicles markets, the output and sales in 2006 greatly increased as compared to 2005 as a result of rapid and steady growth in consumption demand and government investment. Accordingly, the Company’s sales of steering parts of 2006 increased by 50.6% as compared with the corresponding period in 2005. Increased product sales contributed $11,454,944 or 51.0% to the increase on gross profit.

2. Lower price. The year 2006 was still a “low price” year for the Chinese auto industry with an average price reduction of 5.6% during that period, and low prices have become the norm for many automobile manufacturers. To expand its market share, the Company also reduced the prices of its principal products by 9.5% on average in 2006. Lower prices led a decreased gross profit of $6,013,393 or 26.8% in 2006.

3. Costs of goods sold: The advanced production equipment, which the Company acquired recently, has achieved the expected positive effects. In 2006, manufacturing efficiency was improved, and cost control over the production process was enhanced, resulting in a cost reduction of the Company’s products by 8.8% on average. The effect of cost reductions was to increase the Company’s gross profit by $5,001,440 or 22.3% for the year ended December 31, 2006.

In 2006, the overall gross margin decreased to 34.4% from 35.3% in 2005 because the decline in selling price was higher than the cost reductions.

It is estimated that the sales of passenger vehicles and commercial vehicles will increase in quantity at the rate of 15% in 2007 as a result of rapid and steady growth in consumption demand and government investment. The Company will want to seize the opportunity to stabilize the commercial vehicle market and expand the passenger vehicles market, and to increase its gross margin steadily by increasing output and sales.

In 2007, the Chinese automobile manufacturers will continue to use price reductions to keep and enhance their market share. China National Information Center made a projection for the Chinese automobile market in 2007 that automobile prices will decline approximate 5%-7% as compared to 2006, and the Company, as an auto parts supplier, would be adversely affected with a reduction in its gross margins. The Company estimates that auto parts prices will be cut back following similar reductions in automobile prices. The Company intends to take the following measures to reduce costs in order to meet its target of 30% gross profit.

1. Reduce manufacturing costs by optimizing product design and production techniques. During 2007, the Company’s technical personnel will improve product design and production techniques to reduce wastage in the production process and improve manufacturing efficiency, thus reducing costs. The Company estimates the manufacturing costs will be reduced by 1.5% as compared to 2006 as a result of the optimized product design and production techniques.

2. Reduce the cost of raw materials. In 2007, the Company plans to continue controlling the costs of raw materials by two means: Firstly, volume purchase of major raw materials will be made through a bidding process, and for purchases of other smaller quantities of non major materials, “target prices” will be set to guide such purchases. Secondly, to set “target profit” to further control purchase cost of raw materials. The Company estimated that material cost will be reduced by 1.6% as a result of these measures.

SELLING EXPENSES

For the years ended December 31, 2006 and 2005, selling expenses are summarized as follows:

Item	2006 Amount ($)	2005(a) Amount ($)	Increase (Decrease) Amount ($)	Percentage %
Salaries and wages	$ 1,489,699	$ 182,165	$ 1,307,534	717.8%
Supplies expense	34,062	11,570	22,492	194.4
Travel expense	302,052	347,072	(45,020)	(13.0)
Transportation expense	1,495,765	856,087	639,678	74.7
After sales service expense	3,770,432	3,960,468	(190,036)	(4.8)
Rent expense	230,240	214,532	15,708	7.3
Office expense	103,172	76,232	26,940	35.3
Advertising expense	30,297	15,484	14,813	95.7
Entertainment expense	230,939	86,718	144,221	166.3
Insurance expense	5,618	18,062	(12,444)	(68.9)
Other expense	79,792	36,288	43,504	119.9
Total	$ 7,772,068	$ 5,804,678	$ 1,967,390	33.9%

(a) For the convenience of comparability, the warranty reserve of $1,219,108, which was classified under general and administrative expenses in 2005, has been merged into after sales service expense under selling expenses, to be consistent with the presentation of the Company’s financial statement for the year 2006.

Selling expenses were $7,772,068 for the year ended December 31, 2006, as compared to $ 5,804,678 for 2005, an increase of $1,967,390 or 33.9%. Significant expense items that increased by more than $100,000 in 2006 as compared to 2005 were salaries and wages, transportation expense, and entertainment expenses.

The increase in salaries and wages expense was due to bonuses paid to sales staff for exceeding the sales target of 2006, while in 2005 there was no bonus paid because they failed to achieve the sales target for that year.

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.

The increase in entertainment expenses was due to increased customer visits.

After sales service expense for the year ended December 31, 2006 decreased by $190,036 or 4.8% as compared with the same period of last year, mainly due to the Company strengthening quality control in the production process and resulting in the enhancement of product quality.

GENERAL AND ADMINISTRATIVE EXPENSES

For the years ended December 31, 2006 and 2005, general and administrative expenses are summarized as follows:

Item	2006 Amount ($)	2005(a) Amount ($)	Increase (Decrease) Amount ($)	Percentage %
Salaries and wages	$ 2,788,494	$ 1,777,985	$ 1,010,509	56.8%
Travel expenses	316,565	413,630	(97,065)	(23.5)
Office expenses	379,345	188,483	190,862	101.3
Supplies expenses	232,853	351,103	(118,250)	(33.7)
Repairs expenses	226,779	100,450	126,329	125.8
Entertainment expenses	142,496	84,661	57,835	68.3
Labor insurance expenses	761,971	593,940	168,031	28.3
Labor union dues expenses	33,360	55,045	(21,685)	(39.4)
Board of directors expense	100,476	39,475	61,001	154.5
Taxes	453,337	170,094	283,243	166.5
Provision for bad debts	995,440	90,214	905,226	1,003.4
Impairment of inventories	(1,520)	248,907	(250,427)	(100.6)
Training expenses	43,498	60,897	(17,399)	(28.6)
Listing expenses	875,103	590,010	285,093	48.3
Others expenses	461,990	329,494	132,496	40.2
Total	$ 7,810,187	$ 5,094,388	$ 2,715,799	53.3%

(a) For the convenience of comparability, warranty reserve of $1,219,108, which was classified under general and administrative expenses in 2005, has been reclassified into after sales service expense under selling expenses, and non-cash compensation of $68,850 has been merged into salaries under general and administrative expenses, to be consistent with the presentation of the Company's financial statement for the year 2006.

General and administrative expenses were $7,810,187 for the year ended December 31, 2006, as compared to $5,094,388 for the year ended December 31, 2005, an increase of $2,715,799 or 53.3%.

The expense items that increased more than $100,000 in 2006 as compared to 2005 were salaries and wages, office expenses, repair expenses, labor insurance expenses, taxes, provision for bad debts and listing expenses. Significant expense items that decreased more than $100,000 in 2006 were supplies expenses and impairment of inventories. Listing expenses consisted of the costs associated with legal, accounting and auditing fees for operating a public company.

The increase in salaries and wages expense was due to bonuses paid to management for their exceeding the business target of 2006, while in 2005 there was no bonus paid because they failed to achieve the business target for that year.

The increase in office expenses was attributable to additional management organization and staff due to expanded business, and corresponding increases in office expenses such as utility, meeting costs, entertainment and transportation costs. The two joint-ventures which were established in 2006 also increased office expenses.

The increase in repairs expense was due to a more significant repair on property, plant and equipment in 2006.

The increase in labor insurance expenses was attributable to additional employees due to expanded business.

The increase in tax expenses was due to payment of more real estate tax due to acquisition of additional real estate property.

The increase in the provision for bad debts was due to increased accounts receivable arising from increased sales. Management believes that additional provision for bad debts should be made to avoid credit loss.

The increase in listing expenses was due to increased costs associated with legal, accounting and auditing fees for operating a public company, as a result of expanded business.

The decrease in supplies expenses was attributed to our control on consumption of supplies. Slightly damaged supplies are now repaired instead of replaced.

The decrease in impairment of inventories was attributable to further control on supplies, which accelerated turnover; reduced idled supplies, and led to a decrease in provision for loss in value in inventories.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were $1,066,050 for the year ended December 31, 2006, as compared to $966,782 for the year ended December 31, 2005, an increase of $99,268 or 10.3%, as a result of the Company's enhanced research and development activities on steering columns.

DEPRECIATION AND AMORTIZATION EXPENSE

For the year ended December 31, 2006, depreciation and amortization expenses excluded from that recorded under cost of sales were $3,776,003, as compared to $2,577,944 for the year ended December 31, 2005, an increase of $1,198,059 or 46.5%, as a result of the Company's increasing ownership of property, plant and equipment and intangible assets, which resulted in additional depreciation and amortization expenses of $679,489 and $518,570 respectively.

INCOME FROM OPERATIONS

Income from operations was $12,764,722 for the year ended December 31, 2006, as compared to $8,383,017 for the year ended December 31, 2005, an increase of $4,381,705 or 52.3%, mainly consisting of a decrease of $80,770 or 22.4% from net sales from materials and others; an increase of $10,442,991 or 46.5% from gross profit from increased product sales, and a decrease of operating profit of $5,980,516 or 41.4% as a result of increased costs and expenses.

OTHER INCOME

Other income was $94,257 for the year ended December 31, 2006, as compared to $150,809 for the year ended December 31, 2005, a decrease of $56,552 or 37.5%, primarily as a result of decreased government subsidies.

Interest subsidies mean the refunds by the Chinese Government of interest charged by banks to companies which are entitled to such subsidies. This kind of subsidies applies only to loan interest related to production facilities expansion. During 2003 and 2004, 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 2004 and 2005 respectively.

During 2005 and 2006, 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.

FINANCIAL EXPENSES

Financial expenses were $832,844 for the year ended December 31, 2006, as compared to $1,166,167 for the year ended December 31, 2005, a decrease of $333,323 or 28.6%, primarily as a result of a decrease on note discounting expenses. During 2006, the Company generated cash from stock issuance, which led to a reduction in cash generated from note discounting.

INCOME BEFORE INCOME TAXES

Income before income taxes was $12,026,135 for the year ended December 31, 2006, as compared to $7,367,659 for the year ended December 31, 2005, an increase of $4,658,476 or 63.2%, consisting of increased income from operations of $4,381,705 or 52.3%, decreased other income of $56,552 or 37.5%, and decreased finance expenses of $333,323 or 28.6%.

INCOME TAXES

Income tax expense was $1,669,081 for the year ended December 31, 2006, as compared to $1,371,863 for the year ended December 31, 2005, an increase of $297,218 or 21.7%, mainly because of:

1. Increased income before income taxed resulted in increased income tax of $798,858

2. One of the Company’s Sino-foreign joint ventures, Zhejiang, has finished its tax holiday by December 31, 2005. In 2006, Zhejiang has an income tax payable of $426,468.

3. The Company has received an income tax refund of $928,108 during 2006. In 2005, because the income tax paid by the Company was less than that in 2004, the Company did not qualify to receive any income tax refund for domestic equipment purchased. In accordance with the relevant regulations of income taxes stipulated by the Ministry of Finance and Administration of Taxation, 40% of domestic equipment purchases can be refundable from increased income taxes for the purchasing year over those of the previous year.

INCOME BEFORE MINORITY INTEREST

Income before minority interest was $10,357,054 for the year ended December 31, 2006, as compared to $5,995,796 for the year ended December 31, 2005, an increase of $4,361,258 or 72.7%, in income before income taxes of $4,658,476 or 63.2%, and a decrease of $297,218 or 21.7% due to increased income tax expenses.

MINORITY INTEREST

The Company recorded minority interests’ share in the earnings of the Sino-foreign joint ventures aggregating $5,545,350 for the year ended December 31, 2006, and compared to $2,680,318 for the year ended December 31, 2005, an increase of $2,865,032 or 106.9%.

The Company owns different equity interests in seven Sino-foreign joint ventures, through which it conducts its operations. All the operating results of these seven Sino-foreign joint ventures were consolidated in the Company’s financial statements of December 31, 2006 and 2005. The Company records the minority interests' share in the earnings of the respective Sino-foreign joint ventures for each period.

In 2006, minority interest increased greatly as compared to 2005, primarily as income from Henglong, one of the Company’s joint ventures, which was owned 55.5% by minority interest holders increased greatly.

NET INCOME

Net income was $4,811,704 for the year ended December 31, 2006, as compared to $3,315,478 for the year ended December 31, 2005, an increase of $1,496,226 or 45.1%, consisting of increased income before minority interest of $4,361,258 or 72.7%, and a increased minority interest of $2,865,032 or 106.9%, which decreased net income.

RESULTS OF OPERATIONS: 2005 VERSUS 2004

NET SALES FROM PRODUCT

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

Item	2005 Amount ($)	2004 Amount ($)	Increase (Decrease) Amount ($)	%
Steering gear for commercial vehicles	$ 17,534,929	$ 26,656,495	($9,121,566)	(34.2%)
Steering gear for passenger vehicles	40,044,635	27,269,558	12,775,077	46.9
Steering pumps	5,992,737	4,259,792	1,732,945	40.6
Total	$ 63,572,301	$ 58,185,845	$ 5,386,456	9.3%

For the year ended December 31, 2005, net sales were $63,572,301, as compared to $58,185,845 for the year ended December 31, 2004, an increase of $5,386,456 or 9.3%. The increase in net sales in 2005 as compared to 2004 was a result of several factors.

1. Primarily, the increase in sales was due to an increase in sales of passenger vehicles. In 2005, the unfavorable conditions of price decline and sales turndown for passenger vehicles which commenced in 2004 have been reversed. Therefore, the Company has adjusted its marketing strategies accordingly and concentrated on manufacturing and selling of steering gears for passenger vehicles and steering pumps, which led to sales from steering gears and pumps for the year ended December 31, 2005 increasing 46.9% and 40.6% over the same period of 2004, respectively.

2. During 2005, sales of steering gear and accessories for commercial vehicles decreased by 34.2% as compared to 2004, as a result of the adjustment of the real estate and coal markets by the Government, which resulted in a significant slowdown in growth in demand for commercial vehicles, accordingly the Company as a supplier of steering gears for commercial vehicles was also affected.

GAIN ON OTHER SALES

Gain on other sales consisted of the net amount retained of sales of materials and other assets. For the year ended December 31, 2005, gain on other sales was $359,986, as compared to $794,621 for the year ended December 31, 2004, a decrease of $434,635 or 54.7%. Sales of materials for the year ended December 31, 2005 were $319,405, which decreased by $379,702 or 54.3%, as compared with $699,107 for the same period of 2004, due to decreased sales volume of materials. Profit from sales on other assets for the year ended December 31, 2005 were $40,581, which decreased by $54,933 or 57.5%, as compared with $95,514 for the same period of 2004.

GROSS PROFIT FROM PRODUCT

For the year ended December 31, 2005, the gross profit from product was $22,466,823, as compared to $23,143,493 for the year ended December 31, 2004, a decrease of $676,670 or 2.9%, as a result of following factors:

1. Decreased sales: In the domestic commercial vehicles market, the output and sales in 2005 have greatly decreased as compared to 2004 as a result of a number of factors, including increased prices of gasoline and raw materials, the Government's influence on rectifying the over-sized and over-loaded commercial vehicle market, the adjustment of the real estate and coal markets by the Government, etc. During 2005, sales of steering gears for commercial vehicles decreased by 34.2% as compared to 2004, which led to a decrease of gross profit of $3,283,764.

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In 2005, the demand of the domestic passenger vehicles market has recovered to a steady and rapid growth trend after "the blowout period" in 2002 and 2003 and a significant drop in 2004. Therefore, the Company has adjusted its marketing strategies accordingly and concentrated on manufacturing and selling of steering gears for passenger vehicles and steering pumps, which led to sales for the year ended December 31, 2005 increasing 46.9% and 40.6% over the same period of 2004 respectively, and the gross profit increasing $5,155,144. The gross profit for the year ended December 31, 2005 increased $1,871,380 as compared to the same period of 2004, because increased sales of steering gear and steering pumps for passenger vehicles more than compensated for decreased sales of steering gear for commercial vehicles.

2. Lower prices. The year 2005 was still a "low price" year for the Chinese auto industry with an average price reduction of 10.2% during that period, and low prices have become the norm for many automobile manufacturers. To keep its market share, the Company also reduced the prices of its principal products: steering gear by 10.6%, steering pumps by 28.3%, and steering accessories by 4.9% at the request of its customers. Lower prices lead a decrease of gross profit of $8,342,905 in 2005.

3. Costs of goods sold: The advanced production equipment, which the Company acquired in 2003 has achieved the expected positive effects. In 2005, manufacturing efficiency was improved, and cost control over the production process was enhanced, resulting in a cost reduction of the Company's main products, steering gears were reduced by 5%; steering pumps were reduced by 1% and steering accessories were reduced by 6%. The effect of these cost reductions was to increase the company's gross profit by $5,794,856 for the year ended December 31, 2005.

In 2005, the overall gross margin decreased to 35% from 40% in 2004 because the decline in selling price was higher than cost reduction.

SELLING EXPENSES

For the years ended December 31, 2005 and 2004, selling expenses are summarized as follows:

Item	2005(a) Amount ($)	2004(a) Amount ($)	Increase (Decrease) Amount ($)	Percentage %
Salaries and wages	$ 182,165	$ 872,720	($690,555)	(79.1%)
Supplies expense	11,570	29,698	(18,128)	(61.0)
Travel expense	347,072	300,082	46,990	15.7
Transportation expense	856,087	793,474	62,613	7.9
After sales service expense	3,960,468	1,591,078	2,369,390	148.9
Rent expense	214,532	103,451	111,081	107.4
Office expense	76,232	78,979	(2,747)	(3.5)
Advertising expense	15,484	18,666	(3,182)	(17.0)
Entertainment expense	86,718	37,617	49,101	130.5
Insurance expense	18,062	18,813	(751)	(4.0)
Other expense	36,288	20,576	15,712	76.4
Total	$ 5,804,678	$ 3,865,154	$ 1,939,524	50.2%

(a) For the convenience of comparability, warranty reserve of $1,219,108 and $391,350, which were classified under general and administrative expenses in the years 2005 and 2004, respectively, has been merged into after sales service expenses under selling expenses, to be consistent with the presentation of the Company's financial statement for the year 2006.

Selling expenses were $5,804,678 for the year ended December 31, 2005, as compared to $3,865,154 for 2004, an increase of $1,939,524 or 50.2%. Significant expense items that increased by more than $50,000 in 2005 as compared to 2004 were transportation expense, after sales service expense and rent expense.

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

After sales service expense includes "3-R Guarantees" service charge and estimated warranty reserve. After sales service expense for the year ended December 31, 2005 was increased $2,369,390 or 148.9% as compared with the same period of last year, consisting of an increased "3-R Guarantees" service charge of $1,541,632 or 128.5%, and an increased warranty reserve of $827,758 or 211.5%.

The increase in "3-R Guarantees" service charge was due to the consumer rights protection policies of "recall" issued by the Chinese Government in 2004, which was fully implemented in 2005, including the recalling of flawed vehicles policy. Accordingly, the automobile manufacturers introduced a policy unilaterally requiring the automotive parts suppliers to pay a "3-R Guarantees " service charge (for repair, replacement and refund) in an amount equal to one percent (1%) of the total value of parts supplied.

Warranty reserves represent the Company's obligation to repair or replace defective products under certain conditions. The estimate of the warranty reserves is based on historical experience. In 2005, the warranty rate was determined to be 2.78% of net sales, while in 2004 it was determined to be 0.9% of net sales. The significant increase in warranty reserves was due to the increased rate of warranty reserves adjusted by the Company.

The Company increased its warranty rate mainly due to the following factors:

1. The Company extended the term of service from one year to three years in order to improve its product competitiveness in the market. Management estimated that it could result in an increase of warranty reserves.

2. In 2005 the Chinese Government had fully implemented the consumer rights protection policies of "recall" which began in 2004 (including the recalling of flawed vehicles policy), which led to increased warranty reserves.

The increase in rent expense was due to the addition of new service branches to enhance service quality, which was increased nearly 50% as compared to the prior year. All the new offices in new service branches were rented, which led to increased rent expense.

Significant expense items that decreased more than $50,000 in 2005 as compared to 2004 were salaries and wages. The decrease in salaries and wages was due to the failure of sales personnel to achieve the sales growth target of 20%. Therefore, the Company reduced their sales bonus.

GENERAL AND ADMINISTRATIVE EXPENSES

For the years ended December 31, 2005 and 2004, general and administrative expenses are summarized as follows:

Item	2005(a) Amount ($)	2004(a) Amount ($)	Increase (Decrease) Amount ($)	Percentage %
Salaries and wages	$ 1,777,985	$ 1,952,067	($174,082)	(8.9%)
Travel expenses	413,630	377,452	36,178	9.6
Office expenses	188,483	196,058	(7,575)	(3.9)
Supplies expenses	351,103	329,323	21,780	6.6
Repairs expenses	100,450	235,400	(134,950)	(57.3)
Entertainment expenses	84,661	37,966	46,695	123.0
Labor insurance expenses	593,940	1,105,911	(511,971)	(46.3)
Labor union dues expenses	55,045	84,663	(29,618)	(35.0)
Board of directors expense	39,475	56,330	(16,855)	(29.9)
Taxes	170,094	196,619	(26,525)	(13.5)
Provision for bad debts	90,214	136,205	(45,991)	(33.8)
Impairment of inventories	248,907	187,871	61,036	32.5
Training expenses	60,897	68,272	(7,375)	(10.8)
Listing expenses	590,010	823,852	(233,842)	(28.4)
Others expenses	329,494	354,645	(25,151)	(7.1)
	$ 5,094,388	$ 6,142,634	($1,048,246)	(17.1%)

(a) For the convenience of comparability, warranty reserve of $1,219,108 and $391,350, which were classified under general and administrative expenses in the years 2005 and 2004, respectively, has been reclassified into after sales service expenses under selling expenses, and non-cash compensation of $68,850 and $55,125 has been merged into salaries under general and administrative expenses, to be consistent with the presentation of the Company’s financial statement for the year 2006.

General and administrative expenses were $5,094,388 for the year ended December 31, 2005, as compared to $6,142,634 for the year ended December 31, 2004, a decrease of $1,048,246 or 17.1%.

Significant expense items that decreased more than $100,000 in 2005 were salaries and wages, repairs expense, labor insurance expense and listing expenses. Listing expenses consisted of the costs associated with legal, accounting and auditing fees for operating a public company.

The decrease in salaries and wages was due to the failure of management to achieve a net income growth target. Therefore, the Company reduced their management bonuses.

The decrease in repair expenses was a result of the Company’s comprehensive maintenance of all the operating sites and equipment in 2004, while in 2005 the Company carried out normal maintenance for only part of its operating sites and equipment.

The decrease in labor insurance expenses was due to Henglong and Jiulong, two of the Company’s subsidiaries, changing their calculation base for endowment insurance expenses set by the local Government policy, which was 20% of the minimum salary ratified by the authority in 2005. In 2004, the endowment insurance expenses were recorded as 20% of the salary actually paid.

The decrease in listing expenses was due to the Company's payment of $70,000 of reverse merger costs for the acquisition of a controlling interest in a public company in 2004, while there were no such expenses in 2005. In addition, the Company also reduced its consulting service expenses and general and administrative expenses for the year ended December 31, 2005.

Although the entertainment expenses did not increase by more than $100,000, they increased by 123% to $84,661 in 2005, due to there are more visitors visiting the Company as compared to last year, including Government officers, technology experts, and economists etc. .

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses were $966,782 for the year ended December 31, 2005, as compared to $1,518,512 for the year ended December 31, 2004, a decrease of $551,730 or 36.0%, as a result of the Company's R&D department focusing on applications of prior purchased technologies and hence reducing the R&D expenses for the year ended December 31, 2005.

DEPRECIATION AND AMORTIZATION EXPENSE

For the year ended December 31, 2005, the depreciation and amortization expenses excluded from that recorded in cost of sales were $2,577,944, as compared to $848,009 for the year ended December 31, 2004, an increase of $1,729,935 or 204.0%. The main reasons are:

1. The new office building constructed in 2004 was completed and came into use in 2005, which led to an additional depreciation of approximately $310,000.

2. The equipment purchased in 2004 was delivered and came into use in 2005, which led to additional depreciation of approximately $1,320,000.

INCOME FROM OPERATIONS

Income from operations was $8,383,017 for the year ended December 31, 2005, as compared to $11,563,805 for the year ended December 31, 2004, a decrease of $3,180,788 or 27.5%, consisting of a decrease of net sales from material and others of $434,635 or 54.7%, a decrease of gross profit from product sales of $676,670 or 2.9%, and increased costs and expenses of $2,069,483 or 16.7%.

OTHER INCOME

Other income consisted of Government subsidy income and income arising from the write off of accounts payable

For the year ended December 31, 2005, other income was $150,809, as compared to $856,939 for the same period of 2004, a decrease of $706,130 or 82.4%, mainly due to decreased income arising from the write off of accounts payable.

During 2004, the Company recorded $680,980 income arising from the write off of amounts payable related to trial products obtained from various suppliers 2 or 3 years ago for the purpose of product development. It was determined by the Company's management in 2004 that these amounts payable would no longer be payable and since these recoveries happened very infrequently and did not relate to the normal operations of the company in 2004, we recorded them in other income rather than income from operations. There was no such income during 2005.

FINANCIAL EXPENSES

Financial expenses were $1,166,167 for the year ended December 31, 2005, as compared to $730,962 for the year ended December 31, 2004, an increase of $435,205 or 59.5%, primarily as a result of an increase of interest payments of $134,180 due to increased amount of loans and increased interest rates, and an increase of $301,025 due to increased note discount expenses.

INCOME BEFORE INCOME TAXES

Income before income taxes was $7,367,659 for the year ended December 31, 2005, as compared to $11,689,782 for the year ended December 31, 2004, a decrease of $4,322,123 or 37.0%, consisting of decreased income from operations of $3,180,788 or 27.5%, decreased other income of $706,130 or 82.4%, and increased finance expenses of $435,205 or 59.5%.

INCOME TAXES

Income tax expense was $1,371,863 for the year ended December 31, 2005, as compared to $618,400 for the year ended December 31, 2004, an increase of $753,463 or 121.8%, mainly because of:

(1) The Chinese Government provides enterprise income tax preferences to joint ventures for purchasing domestic equipment, and the regulations are as follows: The allowable tax credit of an enterprise with foreign investment or foreign enterprise shall not exceed its newly increased enterprise income tax of the purchasing year over that of the year before. If the amount of newly increased enterprise income tax is not sufficient for tax credit, the remaining part of investment outside tax credit shall be refundable from the newly increased tax of the next year over that of the year before the purchasing year. However, the period for continuous tax credit shall not exceed five years.

Two of the Company's Sino-foreign joint ventures, Henglong and Jiulong, received an income tax benefit of $901,600 in 2004 for purchase of domestic equipment, which has been reflected as a reduction to income tax expense in the Company's consolidated statements of operations for the year ended December 31, 2004. In 2005, as a result of the fact that income taxes in Henglong and Jiulong were less than 2004, they were not entitled to the tax refund benefit policy.

(2) The tax holiday of Shenyang, one of the Company's Sino-foreign joint ventures, matured in 2005, therefore increasing the Company's income taxes by $177,226.

(3) The consolidated income before income taxes of Jiulong in 2005 was less than that in 2004, which led to a decrease of $325,363 in income taxes.

INCOME BEFORE MINORITY INTEREST

Income before minority interest was $5,995,796 for the year ended December 31, 2005, as compared to $11,071,382 for the year ended December 31, 2004, a decrease of $5,075,586 or 45.8%, due to decreased income before income taxes of $4,322,123 or 37%, and increased income tax expenses of $753,463 or 121.8%.

MINORITY INTEREST

The Company recorded the minority interests' share in the earnings of the Sino-foreign joint ventures aggregating $2,680,318 for the year ended December 31, 2005, as compared to $4,182,454 for the year ended December 31, 2004, a decrease of $1,502,136 or 35.9%.

The Company owned equity interests in five Sino-foreign joint ventures, through which it conducts its operations. All of the operating results of these five Sino-foreign joint ventures were consolidated in the Company's financial statements of December 31, 2005 and 2004. USAI has not generated any operating income/loss for the year ended December 31,2005. The equity interest of Jingzhou was sold effective August 31, 2004. The Company records the minority interests' share in the earnings of the respective Sino-foreign joint ventures for each period.

As compared with 2004, the decreased minority interest for the year ended December 31, 2005 consisted of a decrease of $1,144,880 caused by decreased income before minority interest of Sino-foreign joint ventures, and a decrease of $357,256 caused by decreased minority interest percentage in Sino-foreign joint ventures.

NET INCOME FROM CONTINUED OPERATIONS.

Net income was $3,315,478 for the year ended December 31, 2005, as compared to $6,888,928 for the year ended December 31, 2004, a decrease of $3,573,450 or 51.9%, consisting a decreased income before minority interest of $5,075,586 or 45.8%, and a decreased minority interest of $1,502,136 or 35.9%, which increased net income.

NET LOSS FROM DISCONTINUED OPERATIONS

Effective August 31, 2004, in order to concentrate on its main products, namely steering and other automotive parts, the Company disposed of its 51% interest in Jingzhou by entering into the Exchange Agreement with HBWL**,** which is controlled by Mr. Hanlin Chen, the Company's Chairman. Pursuant to the Exchange Agreement, the 51% equity interest in Jingzhou owned by Ji Long was exchanged for 2.5% of Hubei Wanlong's equity interest in Henglong based on their respective fair market values as determined by an independent appraisal firm. Accordingly, the Company does not own any Jingzhou equity.

The divested non-core business of Jingzhou has been treated as a discontinued operation under SFAS No. 144. The net loss of $21,591 from discontinued operations of Jingzhou was included in the consolidated statements of operations of 2004.

NET INCOME

Net income was $3,315,478 for the year ended December 31, 2005, as compared to $6,867,337 for the year ended December 31, 2004, a decrease of $3,551,859 or 51.7%, consisting of decreased net income from continued operations of $3,573,450 or 51.9%, and decreased net loss from discontinued operations of $21,591.

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, 2006, the Company had cash and cash equivalents of $27,418,500, as compared to $12,374,944 as of December 31, 2005, an increase of $15,043,556 or 121.6%.

The Company had working capital of $29,136,373 as of December 31, 2006, as compared to $8,006,688 as of December 31, 2005, an increase of $21,129,685 or 263.9%.

The Company can obtain bank loans and banker's acceptance bills line of credit agreement, which will have a one year term . On the condition that the Company can provide adequate mortgage security and does not violate the terms of the line of credit agreement , it can extend the one year term.

The Company had bank loans maturing in less than one year of $15,384,615 and bankers' acceptances of $15,130,653 as of December 31, 2006, including $1,246,175 which was not part of the line of credit and was mortgaged by notes receivable.

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. 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. Due to depreciation, the value of the mortgages securing the above-mentioned bank loans and banker's acceptance bills will be devalued by

$3,820,792. If the Company wishes to obtain the same amount of bank loans and banker's acceptance bills, it will have to provide $3,820,792 additional mortgages. The Company can obtain a reduced line of credit with a reduction of $1,996,560 if it cannot provide additional mortgages ($3,820,792 at 52% mortgage rates). The Company anticipates that the reduction of bank loans will not have a material adverse effect on its liquidity. On March 20, 2006, the Company has entered into a $15,000,000 equity line through a Standby Equity Distribution Agreement with Cornell Capital Partners, LP. As of December 31, 2006, the Company has adequate working capital, as well as $9,000,000 available under the above-mentioned equity line of credit. The Company views these capitals as providing an ample available source of back-up liquidity in case of an unanticipated event.

Financing activities:

(a) Bank loans

As of December 31, 2006, the principal outstanding under the Company's credit facilities and lines of credit was as follows:

	Bank	Amount available	Amount borrowed
Comprehensive credit facilities*	Bank of China	$ 9,487,179	$ 11,249,170
Comprehensive credit facilities	China Construction Bank	8,974,359	7,051,282
Comprehensive credit facilities	CITIC Industrial Bank	2,564,102	2,564,102
Comprehensive credit facilities	Shanghai Pudong Development Bank	5,128,205	4,699,538
Comprehensive credit facilities	Jingzhou Commercial Bank	6,410,256	2,560,769
Comprehensive credit facilities	Industrial and Commercial Bank of China	1,410,256	1,144,231
Total		$ 33,974,359	$ 29,269,092

* The Bank of China has renewed its line of credit agreement with the Company. The Company will repay $1,761,999 without replacing the amount available. As discussed above, the Company anticipates it will not have a material adverse effect on its liquidity.

The Company may request 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 2006 at annual interest rates of 5.58% to 7.25%, and for terms of six to twelve months. Pursuant to the refinancing arrangement, the Company pledged $18,918,617 of equipment, $5,134,718 land use right and $3,706,462 building as security for its comprehensive credit facility with Bank of China; pledged $2,616,218 land use and $2,188,744 building as security for its comprehensive credit facility with CITIC Industrial Bank; pledged $1,534,256 land use right and $6,656,397 building as security for its comprehensive credit facility with Shanghai Pudong Development Bank; pledged $8,572,115 land use right as security for its comprehensive credit facility with Jingzhou Commercial Bank; pledged $1,380,683 land use right and $932,767 building as security for its comprehensive credit facility with Industrial and Commercial Bank of China; and pledged $1,034,872 land use right and $3,207,872 building as security for its comprehensive credit facility with China Construction Bank.

(b) Financing from investors:

On March 20, 2006, the Company entered into a Standby Equity Distribution Agreement with Cornell Capital Partners, LP for a total amount of $15 million. The Company has utilized $6,000,000 as of December 31, 2006. Under the agreement, Cornell Capital Partners, LP has committed to provide funding to be drawn down over a stated period at the Company's discretion.

If the Company fails to obtain the same or similar terms for any debt or equity refinancing to meet its debt obligations, e.g. the financing terms with China Construction Bank have changed into security mortgages instead of a guarantee, it will result in a shortage of approximately $4,700,000. The Company intends to pledge more equipment, but there is no assurance that it will succeed, or if the Company fails to obtain extensions of the maturity dates of these obligations as they become due, its overall 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 being 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	$ 15,384,615	$ 15,384,615	$ —	$ —	$ —
Notes payable	15,130,653	15,130,653	—	—	—
Other contractual purchase commitments, including information technology	6,046,684	4,481,999	1,344,685	220,000	—
Total	$ 36,561,952	$ 34,997,267	$ 1,344,685	$ 220,000	$ —

Short-term bank loans:

The following table summarizes the contract information of short-term borrowings between the banks and the Company during 2006:

Bank	**Purpose**	**Borrowing Date**	**Borrowing Term (Year)**	**Annual Percentage Rate**	**Date of Interest Payment**	**Date of payment**	**Amount**
Bank of China	Working Capital	7-Feb-06	1	5.58%	Pay monthly	7-Feb-07	$641,026
Bank of China	Working Capital	8-Mar-06	1	5.58%	Pay monthly	7-Mar-07	1,923,077
Bank of China	Working Capital	16-May-06	1	5.58%	Pay monthly	15-May-07	2,564,103
Jingzhou Commercial Bank	Working Capital	28-Mar-06	1	7.25%	Pay monthly	28-Mar-07	1,282,050
CITIC Industrial Bank	Working Capital	15-Jun-06	1	5.58%	Pay monthly	14-Jun-07	2,564,103
Shanghai Pudong Development Bank	Working Capital	14-Sep-06	1	6.12%	Pay monthly	13-Sep-07	2,564,103
China Construction Bank	Working Capital	20-Jan-06	1	5.58%	Pay monthly	19-Jan-07	2,564,103
China Construction Bank	Working Capital	16-Feb-06	1	5.58%	Pay monthly	15-Feb-07	1,282,050
Total							$15,384,615

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 under 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, 2006, and will continue to comply with them.

The following table summarizes the contract information of issuing notes payable between the banks and the Company:

Purpose	**Term (Month)**	**Due Date**		**Amount Payable on Due Date**
Working Capital	3-6	Jan, 2007	$	4,771,945
Working Capital	3-6	Feb, 2007		2,580,769
Working Capital	3-6	Mar, 2007		1,537,051
Working Capital	6	April, 2007		2,046,974
Working Capital	6	May, 2007		1,550,690
Working Capital	6	Jun, 2007		2,643,224
Total			$	15,130,653

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, 2006, and will continue to comply with them.

The Company had approximately $6,046,684 of capital commitment as of December 31, 2006, arising from equipment purchases for expanding production capacity. The Company intends to pay off $4,481,999 in 2007 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

The Company's operations provided cash of $7,969,150 during the year ended December 31, 2006, $12,320,207 during the same period of 2005, and $21,365,367 for during same period of 2004.

Net cash generated from operations in 2006 decreased by $4,351,057 compared with that in 2005, primarily due to increased accounts and notes receivable. First, cash outflow increased by $9,300,000 along with increased accounts receivables, mainly due to an increase in sales this year of 50.6% as compared to the same period of 2005. 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 increased by $7,600,000 along with increased notes receivable, mainly due to the Company having sufficient working capital this year and reducing the discount on notes receivable to save interest expenses. 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.

Cash generated from operations in 2005 decreased by $9,045,160 as compared to that in 2004, primarily due to a decreased operational income of $5,000,000 as a result of the Government's policy on investment control. The Company's accounts receivable increased $3,400,000 due to the deferred payment from automobile