CHINA AUTOMOTIVE SYSTEMS INC
Form 10-Q
November 13, 2006

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

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

For the quarterly period ended September 30, 2006

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

For the transition period from ________ to _________

Commission file number: 000- 33123

China Automotive Systems, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**33-0885775**
(State or other jurisdiction of incorporation or organization)	(IRS employer identification number)

No. 1 Henglong Road, Yu Qiao Development Zone Shashi District,
Jing Zhou City, Hubei Province, People's Republic of China
(Address of principal executive offices)
Issuer's telephone number: (86) 716- 832- 9196
Issuer's fax number: (86) 716- 832-9298

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No 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

As of September 30, 2006, the Company had 23,289,495 shares of common stock issued and outstanding.

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PART 1 — FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended September 30, 2006	2005
Operating revenue:		
Net product sales, including $1,100,320 and $360,433 to related parties at September 30, 2006 and 2005, respectively	$ 22,399,673	$ 14,262,933
Net other sales (See Note 15)	341,225	525,167
	22,740,898	14,788,100
Operating cost:		
Cost of product sales, including $602,127 and $337,108 purchased from related parties at September 30, 2006 and 2005, respectively	14,266,514	8,754,017
Cost of other sales (See Note 15)	284,991	373,010
	14,551,505	9,127,027
Gross profit	8,189,393	5,661,073
Operating expenses:		
Selling expenses (See Note 15)	1,540,030	1,151,638
General and administrative expenses (See Note 15)	2,139,440	846,238
R&D expenses (See Note 15)	206,732	261,711
Depreciation and amortization (See Note 15)	904,622	607,392
	4,790,824	2,866,979
Income from operations	3,398,569	2,794,094
Non-operating income (See Note 15)	93,632	18,518
Financial (expenses)	(295,121)	(333,885)
Income before income taxes	3,197,080	2,478,727
Income taxes	470,617	597,427
Income before minority interests	2,726,463	1,881,300
Minority interests	1,194,340	804,388
Net income	$ 1,532,123	$ 1,076,912
Basic	$ 0.07	$ 0.05
Diluted	$ 0.07	$ 0.05
Weighted average number of common shares outstanding -		
Basic	23,287,049	22,574,542
Diluted	23,287,782	22,574,207

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

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

	Nine Months Ended September 30,	
	2006	**2005**
Operating revenue:		
Net product sales, including $2,478,059 and $1,360,293 to related parties at September 30, 2006 and 2005, respectively	$ 68,112,037	$ 45,002,692
Net other sales (See Note 15)	1,154,242	1,248,758
	69,266,279	46,251,450
Operating cost:		
Cost of product sales, including $1,932,329 and $1,232,897 purchased from related parties at September 30, 2006 and 2005, respectively	43,762,536	28,496,684
Cost of other sales (See Note 15)	897,406	1,048,245
	44,659,942	29,544,929
Gross profit	24,606,337	16,706,521
Operating expenses:		
Selling expenses (See Note 15)	5,419,420	3,818,669
General and administrative expenses (See Note 15)	6,529,130	4,010,754
R&D expenses (See Note 15)	647,873	757,660
Depreciation and amortization (See Note 15)	2,846,716	1,992,163
	15,443,139	10,579,246
Income from operations	9,163,198	6,127,275
Non-operating income (See Note 15)	94,257	27,183
Financial (expenses)	(806,984)	(941,486)
Income before income taxes	8,450,471	5,212,972
Income taxes	1,522,067	1,150,750
Income before minority interests	6,928,404	4,062,222
Minority interests	3,550,247	1,617,073
Net income	$ 3,378,157	$ 2,445,149
Basic	$ 0.15	$ 0.11
Diluted	$ 0.15	$ 0.11
Weighted average number of common shares outstanding -		
Basic	23,076,215	22,574,542
Diluted	23,084,675	22,585,732

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

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

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005
Net income	$ 1,532,123	$ 1,076,912
Other comprehensive income:		
Foreign currency translation gain	—	1,329,624
Comprehensive income	$ 1,532,123	$ 2,406,536

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Net income	$ 3,378,157	$ 2,445,149
Other comprehensive income:		
Foreign currency translation gain	601,399	1,329,624
Comprehensive income	$ 3,979,556	$ 3,774,773

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

China Automotive Systems, Inc.
Condensed Consolidated Balance Sheets

	September 30, 2006 (Unaudited)		December 31, 2005	
ASSETS				
Current assets:				
Cash and cash equivalents	$	18,424,513	$	12,374,944
Pledged cash deposits		3,533,732		1,185,660
Accounts and notes receivable, net, including $3,583,158 and $1,829,075 from related parties at September 30, 2006 and December 31, 2005, respectively, net of an allowance for doubtful accounts of $3,677,533 and $2,856,025 at September 30, 2006 and December 31, 2005, respectively		50,702,026		41,580,320
Advance payments and other, including $342,135 and $312,036 to related parties at September 30, 2006 and December 31, 2005, respectively (See note 15)		1,475,131		1,029,892
Inventories		17,514,260		12,385,833
Total current assets		91,649,662		68,556,649
Long-term Assets:				
Property, plant and equipment, net		38,349,268		39,796,033
Intangible assets, net		3,111,854		3,503,217
Other receivables, net, including $4,274,201 and $3,570,461 from related parties at September 30, 2006 and December 31, 2005, respectively, net of an allowance for doubtful accounts of $2,123,525 and $1,040,169 at September 30, 2006 and December 31, 2005, respectively		5,104,002		6,503,629
Advance payment for property, plant and equipment, including $705,388 and $599,729 to related parties at September 30, 2006 and December 31, 2005, respectively (See note 15)		3,040,858		1,096,121
Long-term investments		67,832		74,074
Total assets	$	141,323,476	$	119,529,723
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Bank loans	$	16,229,713	$	14,814,815
Accounts and notes payable, including $541,233 and $383,578 to related parties at September 30, 2006 and December 31, 2005, respectively		35,103,991		31,375,599
Customer deposits		288,564		157,919
Accrued payroll and related costs		1,504,462		1,418,093
Accrued expenses and other payables		6,119,563		5,191,617
Accrued pension costs		2,900,333		2,653,064

Taxes payable		5,206,614		4,172,212
Amounts due to shareholders/directors		259,525		766,642
Total current liabilities		67,612,765		60,549,961
Long-term liabilities:				
Advances payable		301,552		301,614
Total liabilities	$	67,914,317	$	60,851,575
Minority interests		27,343,634		21,751,043
Stockholders' equity:				
Preferred stock, $0.0001 par value-				
Authorized - 20,000,000 shares				
Issued and outstanding - None				
Common stock, $0.0001 par value-				
Authorized - 80,000,000 shares				
Issued and outstanding-				
23,289,495 and 22,574,543 shares at September 30, 2006 and December 31, 2005, respectively				
Common stock, $0.0001 par value-		2,329		2,257
Additional paid-in capital		23,305,514		18,146,721
Retained earnings-				
Appropriated		5,078,584		4,923,262
Unappropriated		15,745,015		12,522,181
Accumulated other comprehensive income		1,934,083		1,332,684
Total stockholders' equity		46,065,525		36,927,105
Total liabilities and stockholders' equity	$	141,323,476	$	119,529,723

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

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

	Three Months Ended September 30, 2006	2005
Cash flows from operating activities:		
Net income from continuing operations	$ 1,532,123	$ 1,076,912
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Minority interests	1,194,340	804,388
Stock-based compensation	131,625	—
Depreciation and amortization	1,542,239	1,369,361
Allowance for doubtful accounts (Recovered)	597,562	(200,064)
Provision for long-term investment	6,242	—
Changes in operating assets and liabilities:		
Increase (decrease) in:		
Pledged deposits	(1,686,315)	351,506
Accounts and notes receivable	1,906,905	(210,405)
Advance payments and others (See Note 15)	(491,501)	(190,466)
Inventories	(2,761,466)	(582,850)
Increase (decrease) in:		
Accounts and notes payable	(392,539)	(506,416)
Customer deposits	(478,404)	(30,844)
Accrued payroll and related costs	37,869	98,878
Accrued expenses and other payables	130,925	490,683
Accrued pension costs	66,395	46,947
Taxes payable	(41,763)	548,184
Advances payable		4,845
Net cash provided by (used in) operating activities (See Note 15)	1,294,237	3,070,659
Cash flows from investing activities:		
(Increase) decrease in other receivables	181,408	(244,453)
Cash paid to acquire property, plant and equipment (See Note 15)	(2,723,803)	(3,003,243)
Cash paid to acquire intangible assets	(1,437)	(4,794)
Cash received from other investing activities	(3,920)	—
Net cash provided by (used in) investing activities (See Note 15)	(2,547,752)	(3,252,490)
Cash flows from financing activities:		
Increase (decrease) in proceeds from bank loans	—	1,802,767
Dividends be paid to the minority interest holders of Joint-venture companies	(124,844)	—
Increase (decrease) in amounts due to shareholders/directors	(55,979)	23,712
Proceeds from issuance of common stock	67,500	—
Capital Contribution from the minority interest holders of Joint-venture companies	(1,149)	—
Net cash provided by (used in) financing activities (See Note 15)	(114,472)	1,826,479
Cash and cash equivalents effected by foreign currency (See Note 15)	—	1,327,839
Increase (decrease) in cash and cash equivalents	(1,367,987)	2,972,487
Cash and cash equivalents at the beginning of period	19,792,500	11,055,235
Cash and cash equivalents at the end of period	$ 18,424,513	$ 14,027,722

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

	Three Months Ended September 30,	
	2006	**2005**
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$ 154,787	$ 268,141
Cash paid for income taxes	$ 556,212	$ 116,192

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

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

	Nine months Ended September 30, 2006	Nine months Ended September 30, 2005
Cash flows from operating activities:		
Net income	$ 3,378,157	$ 2,445,149
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Minority interests	3,550,247	1,617,073
Stock-based compensation	131,625	68,850
Depreciation and amortization	4,876,558	3,661,800
Allowance for doubtful accounts (Recovered)	1,861,107	(2,743)
Provision for long-term investment	6,242	—
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Pledged deposits	(2,348,072)	(671,834)
Accounts and notes receivable	(9,911,144)	3,663,852
Advance payments and others (See Note 15)	(445,239)	72,155
Inventories	(5,128,427)	(2,611,827)
Increase (decrease) in:		
Accounts and notes payable	3,728,392	1,264,891
Customer deposits	130,645	(105,194)
Accrued payroll and related costs	86,369	120,371
Accrued expenses and other payables	2,413,794	178,328
Accrued pension costs	247,269	701,083
Taxes payable	1,034,402	347,760
Advances payable	(62)	4,689
Net cash provided by (used in) operating activities (See Note 15)	3,611,863	10,754,403
Cash flows from investing activities:		
(Increase) decrease in other receivables	275,791	(1,510,417)
Cash paid to acquire property, plant and equipment (See Note 15)	(4,790,102)	(8,001,096)
Cash paid to acquire intangible assets	(140,899)	(198,939)
Net cash provided by (used in) investing activities (See Note 15)	(4,655,210)	(9,710,452)
Cash flows from financing activities:		
Increase (decrease) in proceeds from bank loans	1,414,898	1,200,357
Dividends be paid to the minority interest holders of Joint-venture companies	(864,430)	(787,321)
Increase (decrease) in amounts due to shareholders/directors	(507,117)	78,257
Proceeds from issuance of common stock	5,027,240	—
Capital Contribution from the minority interest holders of Joint-venture companies	1,420,926	—
Net cash provided by (used in) financing activities (See Note 15)	6,491,517	491,293
Effect of exchange rate fluctuations on cash and cash equivalents (See Note 15)	601,399	1,327,839
Increase (decrease) in cash and cash equivalents	6,049,569	2,863,083
Cash and cash equivalents at the beginning of period	12,374,944	11,164,639

Cash and cash equivalents at the end of period	$	18,424,513	$	14,027,722

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

	Nine months Ended September 30, 2006		Nine months Ended September 30, 2005	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest	$	596,871	$	649,424
Cash paid for income taxes	$	958,507	$	789,537
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Issuance of common shares on a non-cash basis	$	4	$	—
Financing services fee related to issuance of common shares	$	(4)	$	—
Increase in capital by minority shareholders of Joint-venture Companies	$	921,785	$	—
Dividends payable to minority shareholders of Joint-venture Companies being converted into capital	$	(921,785)	$	—

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

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

1. ORGANIZATION AND BASIS OF PRESENTATION

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

China Automotive Systems, Inc., including, when the context so requires, its subsidiaries and the subsidiaries’ interests in the Sino-foreign Joint-ventures described below, is referred to herein as the “Company”. The Company, through its Sino-foreign Joint-ventures described below, is engaged in the manufacture and sale of automotive systems and components in the People’s Republic of China, the “PRC” or “China”, as described below.

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

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

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

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

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

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

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

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

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

Basis of Presentation - For the three months and nine months ended September 30, 2006 and 2005, the accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. The subsidiaries include the seven Sino-foreign Joint-ventures mentioned in Note 1. Significant inter-company balances and transactions have been eliminated upon consolidation. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America.

Foreign Currencies - The Company maintains its books and records in Renminbi, "RMB", the currency of the PRC, its functional currency. Foreign currency transactions in RMB are reflected using the temporal method. Under this method, all monetary items are translated into the functional currency at the rate of exchange prevailing at the balance sheet date. Non-monetary items are translated at historical rates. Income and expenses are translated at the rate in effect on the transaction dates. Transaction gains and losses, if any, are included in the determination of net income (loss) for the period.

In translating the financial statements of the Company from its functional currency into its reporting currency in United States dollars, balance sheet accounts are translated using the closing exchange rate in effect at the balance sheet date and income and expense accounts are translated using an average exchange rate prevailing during the reporting period. Adjustments resulting from the translation, if any, are included in cumulative other comprehensive income (loss) in stockholders' equity.

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

Reporting Period		**Renminbi**		**US Dollars**
Prior to July 1, 2005	$	1	$	0.1205
From July 1, 2005 to December 31, 2005	$	1	$	0.1233
From January 1, 2006 to September 30, 2006	$	1	$	0.1248

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

The consolidated balance sheet as of December 31, 2005 is derived from the Company's audited financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although the Company's management believes that the disclosures contained in these financial statements are adequate to make the information presented therein not misleading. For further information, refer to the financial statements and the notes thereto included in the Company's 2005 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The results of operations for the three months and nine months ended September 30, 2006 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2006.

Income Per Share - Basic income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated assuming the issuance of common shares, if dilutive, resulting from the exercise of warrants.

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

	Three Months Ended September 30,	
	2006	**2005**
Weighted average shares outstanding	23,287,049	22,574,542
Effect of dilutive securities	733	665
Diluted shares outstanding	23,287,782	22,575,207

	Nine months Ended September 30,	
	2006	**2005**
Weighted average shares outstanding	23,076,215	22,574,542
Effect of dilutive securities	8,460	11,190
Diluted shares outstanding	23,084,675	22,585,732

The 156,250 shares underlying warrants issued to Cornell Capital Partners, LP on March 20, 2006 and 22,500 shares options issued to three independent directors on July 6, 2006 have not been included in the computation of diluted earnings (loss) per share because such inclusion would have had an anti-dilutive effect:

	Three Months Ended September 30,	
	2006	**2005**
Anti-dilutive securities	200,819	—

	Nine months Ended September 30,	
	2006	**2005**
Anti-dilutive securities	131,719	—

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

On March 20, 2006, the Company issued 37,863 shares of common stock to Cornell Capital Partners, LP and a placement agent in non-capital raising transactions, collectively at an exercise price of $11.885 per share as a commitment fee and a placement agent fee of $450,000 in connection with the establishment of a $15,000,000 equity line of credit under a Standby Equity Distribution Agreement with Cornell Capital Partners, LP. The exercise value of $450,000 by issuing 37,863 shares of common stock were regarded as financing expenses and has been debited to additional paid-in capital. The excess of exercise value over par value, $449,996 has been credited to additional paid-in capital.

The Company has adopted Statement of Financial Accounting Standards (“SFAS”) No. 123R, “Accounting for Stock-Based Compensation”, which establishes a fair value method of accounting for stock-based compensation plans. In accordance with SFAS No. 123R, the cost of stock options and warrants issued to employees and non-employees is measured at the grant date based on the fair value. The fair value is determined using the Black-Scholes option pricing model. The resulting amount is charged to expense on the straight-line basis over the period in which the Company expects to receive benefit, which is generally the vesting period.

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The weighted-average fair value of options granted during the periods 2006, 2005 and 2004 was $5.85, $3.06 and $2.45, respectively. The fair value of each option grant was estimated on the date of grant using option valuation model and assumptions noted in the table:

	2006	2005	2004
Expected volatility	93.19%	46.0%	121.6%
Risk-free rate	4.75%	3.6%	4.0%
Expected term (years)	5	5	2
Dividend yield	0.0%	0.0%	0.0%

The weighted average fair value of warranties issued during the periods 2006 was $5.33. The fair value of warrant grant was estimated on the date of grant using option valuation model and assumptions noted in the table:

Expected volatility	Risk-free rate	Expected term (years)	Dividend yield
82.20%	4.66%	3	0%

On March 20, 2006, the Company raised a gross amount of $5,000,000 in a private placement (PIPE) to Cornell Capital Partners, LP, “Investor” by issuing 625,000 shares of common stock. As part of the financing cost, the Company issued a warrant to purchase 86,806 shares of common stock, exercisable for three years at an exercise price of $14.40 per share, and a warrant to purchase 69,444 shares of common stock, exercisable for three years at an exercise price of $18.00 per share, to Cornell Capital Partners, LP. The fair value of above-mentioned warrant at the grant date is $832,639, which was measured based on Black-Scholes option pricing model. This amount was recorded as financing expenses and debited to additional paid-in capital. Additionally, the same amount was credited to additional paid-in capital, resulting in zero effect on additional paid-in capital and the Consolidated Financial Statements.

On July 6, 2006, the Company issued options to purchase 7,500 shares of common stock to each of its three independent directors. Such stock options vest immediately upon grant and are exercisable at $7.94 per share over a period of five years. The fair value of the options at the grant date being $131,625 which was measured based on Black-Scholes option pricing model. The fair value was recorded as compensation expenses. This amount has been debited to operating expenses and credited to additional paid-in capital.

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

	Shares	Weighted-Average Exercise Price	Weighted-Average Contractual Term (years)
Outstanding - January 1, 2005	22,500	$ 4.50	2
Granted	22,500	6.83	5
Exercised	—	—	—
Cancelled	—	—	—
Outstanding - December 31, 2005	45,000	5.67	3.5
Granted	178,750	14.99	3.3
Exercised	(22,500)	4.50	—
Cancelled	—	—	—
Outstanding - September 30, 2006	201,250	14.07	3.4
Exercisable options-September 30, 2006	22,500	$ 6.83	5

The following is a summary of the range of exercise prices for stock options that are outstanding and exercisable at September 30, 2006:

Range of Exercise Prices	Outstanding Stock Options	Weighted Average Remaining Life	Weighted Average Exercise Price	Number of Stock Options Exercisable	Weighted Average Exercise Price
$4.50 - $10.00	45,000	4.26	$ 7.39	22,500	$ 6.83
$10.01 - $20.00	156,250	2.47	16.00	—	—
	201,250		$ 14.07	22,500	$ 6.83

Product Warranties - The Company provided for the estimated cost of product warranties when the products were sold. Such estimates of product warranties were based on, among other things, historical experience, product changes, material expenses, service and transportation expenses arising from the changed product. Our estimates will be adjusted on the basis of actual claims and circumstances.

For the year ended December 31, 2005 and nine months ended September 30, 2006, the warranties activities were as follows:

	September 30, 2006	December 31, 2005
Balance at the beginning of year	$ 1,787,869	$ 548,390
Additions during the reporting period	2,346,672	1,787,870
Previous record for warranty, including estimation change	433,359	—
Settlement within reporting period, by cash or actual material	(1,500,220)	(561,931)
Foreign currency translation	20,088	13,540
Balance at the end of period	$ 3,087,768	$ 1,787,869

The Company has recorded $ 3,087,768 and $1,787,869 product warranty reserves for the periods ended September 30, 2006 and December 31, 2005, which were included in the accrued liabilities in the accompanying consolidated financial statements.

Comprehensive Income - The Company has adopted the provisions of Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"). SFAS No. 130 which establishes standards for the reporting and disclosure of comprehensive income, its components and accumulated balances in a full set of general purpose financial statements. SFAS No. 130 defines comprehensive income to include all changes in equity except those resulting from investments by owners and distributions to owners, including adjustments to minimum pension liabilities, accumulated foreign currency translation, and unrealized gains or losses on marketable securities.

For the three months and nine months ended September 30, 2006, the Company's only component of other comprehensive income is foreign currency translation gain of $0 and $601,399. These amounts have been recorded as a separate component of stockholders' equity. For the three months and nine months ended September 30, 2005, the Company's only component of other comprehensive income is foreign currency translation gain of $1,329,624 and $1,329,624.

Reclassifications - Certain reclassifications have been made to the Consolidated Statements of OperationsôConsolidated Statements of Cash Flows and Consolidated Balance Sheets for the three months and nine months ended September 30, 2005 to conform to the current year presentation. (See Note 15)

2. CERTAIN SIGNIFICANT RISKS AND UNCERTAINTIES

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

The economy of the PRC differs significantly from the economies of the “western” industrialized nations in structure, level of development, gross national product, growth rate, capital investment, resource allocation, self-sufficiency, rate of inflation and balance of payments position, among others. Only recently has the PRC government encouraged substantial private economic activities. The Chinese economy has experienced significant growth in the past several years, but such growth has been uneven among various sectors of the economy and geographic regions. Actions by the PRC government to control inflation have significantly restrained economic expansion in the recent past. Similar actions by the PRC government in the future could have a significant adverse effect on economic conditions in the PRC.

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

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

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

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

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

On July 21, 2005, the People's Bank of China changed its exchange rate system from its previous fixed exchange rate announced on January 1, 1994 to a unitary and well-managed floating exchange rate based on market supply and demand. No representation is made that the RMB amounts could be freely converted into other foreign currencies. All foreign exchange transactions continue to take place either through the Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rate quoted by the People’s Bank of China. Approval of foreign currency payments by the People’s Bank of China or other institutions requires submission of a payment application form together with suppliers’ invoices, shipping documents and signed contracts.

3. RECENT ACCOUNTING PRONOUNCEMENTS

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

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

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

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

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

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

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

In February 2006, the FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments”. This Statement amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, “Application of Statement 133 to

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

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

4. ACCOUNTS AND NOTES RECEIVABLE

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

	September 30, 2006	December 31, 2005
Accounts receivable	$ 36,769,824	$ 31,866,156
Notes receivable	17,609,755	12,570,189
	54,379,579	44,436,345
Less: allowance for doubtful accounts	(3,677,553)	(2,856,025)
	$ 50,702,026	$ 41,580,320

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

5. OTHER RECEIVABLES

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

	September 30, 2006	December 31, 2005
Other receivable	$ 7,227,527	$ 7,543,798
Less: allowance for doubtful accounts	(2,123,525)	(1,040,169)
	$ 5,104,002	$ 6,503,629

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

Loan amounts receivable from related parties: As of September 30, 2006 (unaudited) and December 31, 2005, the loan amounts receivable from related parties are as follows:

Description	September 30, 2006	December 31, 2005

Amounts loaded to related parties controlled by Mr. Hanlin Chen, the Company's Chairman*	$	3,182,244	$	3,570,461
Amounts loaned to minority shareholders of Joint-venture Companies**		1,091,957		—
	$	4,274,201	$	3,570,461

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

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

6. INVENTORIES

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

	September 30, 2006	December 31, 2005
Raw materials	$ 5,354,736	$ 3,025,467
Work-in-process	3,391,663	2,559,626
Finished goods	9,263,056	7,295,082
	18,009,455	12,880,175
Less: provision for loss	(495,195)	(494,342)
	$ 17,514,260	$ 12,385,833

The Company intends to increase the inventory to meet the demands of production and sales, resulting from the significant increase of sales.

7. PROPERTY, PLANT AND EQUIPMENT

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

	September 30, 2006	December 31, 2005
Land	$ 6,081,581	$ 5,043,046
Buildings	11,962,441	11,782,552
Machinery and equipment	32,000,252	30,980,053
Electronic equipment	2,176,909	2,023,457
Motor vehicles	2,129,799	2,179,161
Construction in progress	436,647	73,400
	54,787,629	52,081,669
Less: Accumulated depreciation	(16,438,361)	(12,285,636)
	$ 38,349,268	$ 39,796,033

8. INTANGIBLE ASSETS

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

	September 30, 2006	December 31, 2005
Balance at the beginning of year	$ 3,503,217	$ 392,552
Add: Additions during the period -		
Management software license	61,798	3,147,867
Mapping design software license	39,739	93,827
Foreign currency translation gain	39,362	9,693
	3,644,116	3,643,939
Less: Amortization during the period	(532,262)	(140,722)
Balance at the end of the period	$ 3,111,854	$ 3,503,217

9. ACCOUNTS AND NOTES PAYABLE

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

	September 30, 2006	December 31, 2005
Accounts payable	$ 22,415,955	$ 15,615,402
Notes payable	12,688,036	15,760,197
	$ 35,103,991	$ 31,375,599

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

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

10. BANK LOANS

At September 30, 2006, the Company through its Sino-foreign Joint-ventures had outstanding fixed-rate short-term bank loans of $16,229,713. The weighted average interest rate for the nine months ended September 30, 2006 was 5.88% per annum. Henglong, one of the Company's joint ventures, provided Jiulong, another of the Company's Joint-ventures, with loan guarantees covering bank loans of $6,242,197. The remaining bank loan of $9,987,516 was secured by mortgages on certain plant and equipment of the Company. There were no charges for these guarantee.

At December 31, 2005, the Company through its Sino-foreign Joint-ventures had outstanding fixed-rate short-term bank loans of $14,814,815. The weighted average interest rate for the year ended December 31, 2005 was 5.92% per annum. Jiulong, one of the Company's Joint-ventures, provided Henglong, another of the Company's Joint-ventures, with loan guarantees covering bank loans of $3,086,420. Henglong provided Jiulong with loan guarantees covering bank loans of $4,938,272. The remaining bank loan of $6,790,123 was secured by mortgages on certain plant and equipment of the Company. There were no charges for these guarantee.

11. AMOUNTS DUE TO SHAREHOLDERS/DIRECTORS

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

Balance, December 31, 2004	$ 589,594
Cash advances from shareholders	177,048
Balance, December 31, 2005	766,642
Cash repaid to shareholder	(507,117)
Balance, September 30, 2006	$ 259,525

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

12. MINORITY INTERESTS

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

Balance, December 31, 2005	$ 21,751,043
Add: contribution by minority shareholders	2,342,710
Minority interests' income	3,550,247

Less: dividends paid to the minority stockholders’ equity of Joint-venture companies	(300,367)
Balance, September 30, 2006	$ 27,343,633

On February 25, 2006, Jiulong, one of the Joint-ventures of the Company, held a meeting of the board and approved an increase in its capital stock of $1,897,628, the equivalent of RMB15,200,000, of which the Company subscribed $1,537,079, the equivalent of RMB12,312,000, and capital stock of $360,549, the equivalent of RMB2,888,000, subscribed by the minority shareholder was deducted from dividends payable.

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

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

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

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

On March 31, 2006, as amended on May 2, 2006, Great Genesis, the wholly-owned subsidiary of the Company, entered into a Joint-venture agreement with Wuhu Chery Technology Co., Ltd., “Chery Technology”, to establish a Joint-venture, Wuhu Henglong Automotive Steering System Co., Ltd in the Wuhu Technological Development Zone. As of September 30, 2006, Great Genesis and minority stockholders have contributed $2,900,300 and $848,936 in cash, the equivalent of RMB23,200,000 and RMB6,800,000 respectively.

13. STOCKHOLDERS’ EQUITY

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

	Common Stock		**Preferred Stock**		
	Shares	**Par Value**	**Shares**	**Par Value**	**Additional Paid- in Capital**
Balance, December 31, 2005	22,574,543	$ 2,257	—	$ —	$ 18,146,720
Sale of common stock	677,089	68	—	—	5,027,173
Issuance of common shares related to financing services	37,863	4	—	—	(4)
Issuance of options for independent directors	—	—	—	—	131,625
Foreign currency translation gain	—	—	—	—	—
Net income for the period ended September 30, 2006	—	—	—	—	—
Balance, September 30, 2006	23,289,495	$ 2,329	—	$ —	$ 23,305,514

	Retained Earnings			
	Appropriated	**Unappropriated**	**Accumulated Other Comprehensive**	**Total**

						Income (Loss)		
Balance, December 31, 2005	$	4,923,262	$	12,522,180	$	1,332,684	$	36,927,103
Sale of common stock		—		—		—		5,027,241
Issuance of common shares related to financing services		—		—		—		—
Issuance of options for independent directors								131,625
Foreign currency translation gain		—		—		601,399		601,399
Net income for the period ended September 30, 2006		—		3,378,157		—		3,378,157
Appropriation of retained earnings		155,322		(155,322)		—		—
Balance, September 30, 2006	$	5,078,584	$	15,745,015	$	1,934,083	$	46,065,525

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14. INCOME TAXES

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

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

No provision for Hong Kong profits tax has been made as Ji Long and Great Genesis are investment holding companies and did not have any assessable profits in Hong Kong during three months and nine months ended September 30, 2006 and 2005.

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

15. RECLASSIFICATIONS

Certain reclassifications have been made to the Consolidated Statements of OperationsôConsolidated Statements of Cash Flows and Consolidated Balance Sheets for the three months and nine months ended September 30, 2005 to conform to the current year presentation.

Reclassification of Consolidated Statements of Operations:

	Three months ended September 30, 2005		**Nine months ended September 30, 2005**	
Item	**Original**	**Present**	**Original**	**Present**
Revenues (costs and expenses):				
General and administrative expenses - warranty	(128,366)	—	(405,024)	—
Operating expenses - "3-R Guarantees" service charge	—	(128,366)	—	(405,024)
General and administrative expenses - Depreciation and amortization expenses	(364,933)	—	(1,396,414)	—
Depreciation and amortization	—	(364,933)	—	(1,396,414)
General and administrative expenses - R & D expenses	(261,711)	—	(757,660)	—
R & D expenses	—	(261,711)	—	(757,660)
Stock-based compensation	—	—	(68,850)	—
General and administrative expenses - Compensation	—	—	—	(68,850)
Non-operating income	152,157	—	200,513	—
Net other sales	—	525,167	—	1,248,758
Cost of other sales	—	(373,010)	—	(1,048,245)

Total	(602,853)	(602,853)	(2,427,435)	(2,427,435)

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Reclassification of Consolidated Balance Sheets:

	December 31, 2005	
Item	**Original**	**Present**
Advances to suppliers	2,126,013	—
Prepayment of property and equipment	—	1,096,121
Prepaid expenses and other	—	1,029,892
Total	2,126,013	2,126,013

Reclassification of Statements of Cash Flows

	Three months ended September 30, 2005		Nine months ended September 30, 2005	
Item	**Original**	**Present**	**Original**	**Present**
Net cash provided by (used in) operating activities	2,807,989	3,070,659	7,720,812	10,754,403
Net cash provided by (used in) investing activities	(1,311,264)	(3,252,490)	(4,998,305)	(9,710,452)
Net cash provided by (used in) financing activities	1,475,762	1,826,479	140,576	491,293
Effect of exchange rate fluctuations on cash and cash equivalents	—	1,327,839	—	1,327,839
Total	2,972,487	2,972,487	2,863,083	2,863,083

16. SIGNIFICANT CONCENTRATIONS

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

During the three months ended September 30, 2006, the Company's ten largest customers accounted for 58.7% of the Company's consolidated net sales, with each of two customers individually accounting for more than 10% of consolidated net sales, i.e. 14.4% and 13.5% individually, or an aggregate of 27.9%. At September 30, 2006, approximately 19.1% of accounts receivable were from trade transactions with the aforementioned two customers.

During the nine months ended September 30, 2006, the Company's ten largest customers accounted for 65.5% of the Company's consolidated net sales, with each of four customers individually accounting for more than 10% of consolidated net sales, i.e. 15.6%, 13.9%, 11.0% and 10.5% individually, or an aggregate of 51.0%. At September 30, 2006, approximately 34.1% of accounts receivable were from trade transactions with the aforementioned four customers.

During the three months ended September 30, 2005, the Company's ten largest customers accounted for 68.3% of the Company's consolidated net sales, with three customers individually accounting for more than 10% of consolidated net sales, i.e. 16.3%, 14.9% and 10.6% individually, or an aggregate of 41.8%. At September 30, 2005, approximately 26.0% of accounts receivable were from trade transactions with the aforementioned three customers.

During the nine months ended September 30, 2005, the Company's ten largest customers accounted for an aggregate of 72.4% of its consolidated net sales, with four customers individually accounting for more than 10% of consolidated net sales, i.e. 15%, 11.3%, 10.9% and 10.7% individually, or an aggregate of 47.9%. At September 30, 2005, approximately 26% of accounts receivable were from trade transactions with the aforementioned four customers.

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17. RELATED PARTY TRANSACTIONS

Henglong, one of the Joint-ventures of the Company, has constructed seven buildings dedicated to research and administration for its operations in Wuhan. Due to the unified building guidance and planning on floor and building areas by the government of Wuhan, the actual building areas were greater than the areas the Company needed. The Company decided to dispose of two of its seven buildings to WuHan Geological University Information S&T Development Co., Ltd. "WuHan Information", a Chinese company controlled by Mr. Hanlin Chen, the Chairman of the Company, at fair market value of $2,636,444, which was determined by an independent appraisal firm. The amount is secured by a mortgage in favor of the Company to assure payment of the receivable. As of September 30, 2006, this amount has not been repaid, but WuHan Information has paid the interest of $95,000 at an agreed conventional bank rate on November 10, 2006.

Related sales and purchases: During the three months and nine months ended September 30, 2006 and 2005, the Joint-ventures entered into related party transactions with companies with common directors as shown below:

	Three Months Ended September 30,			
		2006		2005
Sales	$	1,100,320	$	360,433
Purchases	$	602,127	$	337,108

	Nine months Ended September 30,			
		2006		2005
Sales	$	2,478,059	$	1,360,293
Purchases	$	1,932,329	$	1,232,897

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

18. OFF-BALANCE SHEET ARRANGEMENTS
At September 30, 2006 and December 31, 2005, the Company did not have any transactions, obligations or relationships that could be considered off-balance sheet arrangements.

19. COMMITMENTS AND CONTINGENCIES:
The following table summarizes our major contractual payment obligations and commitments as of September 30, 2006:

	Payment Obligations by Period						
	2006 (a)	**2007**	**2008**	**2009**	**2010**	**Thereafter**	**Total**
Obligations for service agreement	$ —	$ 110,000	$ 110,000	$ 110,000	$ 110,000	$ 110,000	$ 550,000
Obligations for purchasing agreement	$ 510,990	$ 565,109	$ —	$ —	$ —	$ —	$ 1,076,099
Total	$ 510,990	$ 675,109	$ 110,000	$ 110,000	$ 110,000	$ 110,000	$ 1,626,099

(a) Remaining 3 months in 2006.

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

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

	Parent Company		**Henglong**	
	Three Months Ended September 30, (Unit: US Dollars, except ownership percentage)			
	2006	2005	2006	2005
Proportionate ownership interest at the end of year	100%	100%	44.5%	44.5%
Net sales	3,826	593	12,906,647	8,919,345
Cost of sales and operating expenses	304,401	138,464	11,329,738	7,328,219
Operating earnings (losses)	(300,575)	(137,871)	1,576,909	1,591,126
Other income (expenses), net	312	(9)	(101,084)	(220,109)
Pretax earnings	(300,263)	(137,880)	1,475,825	1,371,017
Income tax	0	0	382,608	492,397
Income (expenses) before minority interest	(300,263)	(137,880)	1,093,217	878,620
Minority interest income (expenses)	0	0	624,020	475,708
Net earnings (expenses)	(300,263)	(137,880)	469,197	402,912

	Jiulong		**Shenyang**	
	Three Months Ended September 30, (Unit: US Dollars, except ownership percentage)			
	2006	2005	2006	2005
Proportionate ownership interest at the end of year	81%	81%	70%	70%
Net sales	7,616,711	4,086,869	3,736,832	2,803,932
Cost of sales and operating expenses	6,631,839	3,666,296	2,753,573	2,377,898
Operating earnings (losses)	984,872	420,573	983,259	426,034
Other income (expenses), net	(119,145)	(91,699)	5,988	830
Pretax earnings	865,727	328,874	989,247	426,864
Income tax	101,150	69,205	(120,368)	35,825
Income (expenses) before minority interest	764,577	259,669	1,109,615	391,039
Minority interest income (expenses)	126,295	105,404	330,652	117,312
Net earnings (expenses)	638,282	154,265	778,963	273,727

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	Zhejiang		USAI	
	Three Months Ended September 30, (Unit: US Dollars, except ownership percentage)			
	2006	2005	2006	2005
Proportionate ownership interest at the end of year	51%			