CHINA AUTOMOTIVE SYSTEMS INC
Form 10-Q
August 09, 2010

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

FORM 10-Q

(Mark one)

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

For the quarterly period ended June 30, 2010

Or

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

For the transition period from ________ to _________
Commission file number: 000-33123

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

Delaware	33-0885775
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

No. 1 Henglong Road, Yu Qiao Development Zone, Shashi District,
Jing Zhou City, Hubei Province, People's Republic of China
(Address of principal executive offices)

Issuer's telephone number: (86) 716- 832- 9196 Issuer's fax number: (86) 716-832-9298
Not Applicable
(Former name, former address and former fiscal year, if changed since last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of June 30, 2010, the Company had 27,110,693 shares of common stock issued and outstanding.

CHINA AUTOMOTIVE SYSTEMS, INC.

INDEX

	Page
Part I — Financial Information	
Item 1. Financial Statements	F-1
Condensed Consolidated Statements of Operations (Unaudited) for the Three Months and Six Months Ended June 30, 2010 and 2009	F-1
Condensed Consolidated Statements of Comprehensive Income (Unaudited) for the Three Months and Six Months Ended June 30, 2010 and 2009	F-3
Condensed Consolidated Balance Sheets at June 30, 2010 (Unaudited) and December 31, 2009	F-4
Consolidated Statements of Stockholders' Equity for the Six Months Ended June 30, 2010 (Unaudited) and December 31, 2009	F-5
Condensed Consolidated Statements of Cash Flows (Unaudited) for the Six Months Ended June 30, 2010 and 2009	F-6
Notes to Condensed Consolidated Financial Statements (Unaudited) for the Three Months and Six Months Ended June 30, 2010 and 2009	F-8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	3
Item 3. Quantitative and Qualitative Disclosures About Market Risk	21
Item 4. Controls and Procedures	21
Part II — Other Information	
Item 1. Legal Proceedings	22
Item 1A. Risk Factors	22
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	27
Item 3. Defaults Upon Senior Securities	27
Item 4. Reserved	27
Item 5. Other Information	27
Item 6. Exhibits	28
Signatures	29

PART 1 — FINANCIAL INFORMATION

Item 1. Financial Statements

China Automotive Systems, Inc.

Condensed Consolidated Statements of Operations (Unaudited)

	Three Months Ended June 30, 2010	2009
Net product sales, including $2,941,718 and $1,314,247 to related parties for the three months ended June 30, 2010 and 2009	$ 85,081,138	$ 62,484,279
Cost of product sold, including $5,248,896 and $2,812,741 purchased from related parties for the three months ended June 30, 2010 and 2009	65,270,878	46,178,351
Gross profit	19,810,260	16,305,928
Add: Gain on other sales	681,999	172,747
Less: Operating expenses-		
Selling expenses	2,903,125	1,620,497
General and administrative expenses	1,846,421	2,246,330
R&D expenses	1,741,405	444,226
Depreciation and amortization	288,352	507,341
Total Operating expenses	6,779,303	4,818,394
Income from operations	13,712,956	11,660,281
Add: Other income, net (note 21)	250,851	-
Financial income (expenses) net (note 22)	(413,349)	(478,228)
Gain (loss) on change in fair value of derivative (note 23)	94,264	(977,435)
Income before income taxes	13,644,722	10,204,618
Less: Income taxes (note 24)	2,291,292	1,474,618
Net income	$ 11,353,430	$ 8,730,000
Net income attributable to noncontrolling interest	2,811,362	2,653,651
Net income attributable to parent company	$ 8,542,068	$ 6,076,349
Net income per common share attributable to parent company–		
Basic (note 25)	$ 0.32	$ 0.23
Diluted (note 25)	$ 0.28	$ 0.21
Weighted average number of common shares outstanding –		
Basic	27,075,607	26,983,244
Diluted	31,541,281	31,466,402

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

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

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Net product sales, including $4,602,111 and $1,873,258 to related parties for the six months ended June 30, 2010 and 2009	$ 169,313,827	$ 107,181,725
Cost of product sold, including $9,596,184 and $4,986,222 purchased from related parties for the six months ended June 30, 2010 and 2009	126,968,550	79,972,452
Gross profit	42,345,277	27,209,273
Add: Gain on other sales	1,133,609	239,626
Less: Operating expenses-		
Selling expenses	4,770,928	2,685,177
General and administrative expenses	5,451,205	4,048,032
R&D expenses	3,043,163	884,148
Depreciation and amortization	610,145	1,078,754
Total Operating expenses	13,875,441	8,696,111
Income from operations	29,603,445	18,752,788
Add: Other income, net (note 21)	266,379	-
Financial income (expenses) net (note 22)	(781,360)	(917,708)
Gain (loss) on change in fair value of derivative (note 23)	243,292	(2,538,283)
Income before income taxes	29,331,756	15,296,797
Less: Income taxes (note 24)	4,576,814	2,924,288
Net income	$ 24,754,942	$ 12,372,509
Net income attributable to noncontrolling interest	5,877,705	4,037,348
Net income attributable to parent company	$ 18,877,237	$ 8,335,161
Net income per common share attributable to parent company–		
Basic (note 25)	$ 0.70	$ 0.31
Diluted (note 25)	$ 0.62	$ 0.29
Weighted average number of common shares outstanding –		
Basic	27,060,925	26,983,244
Diluted	31,527,040	31,719,477

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

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

	Three Months Ended June 30,	
	2010	2009
Net income	$ 11,353,430	$ 8,730,000
Other comprehensive income:		
Foreign currency translation gain (loss)	882,488	(187,750)
Comprehensive income	$ 12,235,918	$ 8,542,250
Comprehensive income attributable to non-controlling interest	2,955,460	2,667,188
Comprehensive income attributable to parent company	$ 9,280,458	$ 5,875,062

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

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

	Six Months Ended June 30,	
	2010	2009
Net income	$ 24,754,942	$ 12,372,509
Other comprehensive income:		
Foreign currency translation gain (loss)	927,828	(202,329)
Comprehensive income	$ 25,682,770	$ 12,170,180
Comprehensive income attributable to non-controlling interest	6,029,366	4,046,468
Comprehensive income attributable to parent company	$ 19,653,404	$ 8,123,712

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

China Automotive Systems, Inc.
Condensed Consolidated Balance Sheets

	June 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 45,246,219	$ 43,480,176
Pledged cash deposits (note 3)	19,340,337	12,742,187
Accounts and notes receivable, net, including $3,386,976 and $1,441,939 from related parties at June 30, 2010 and December 31, 2009 (note 4)	180,688,519	154,863,292
Advance payments and other, including $930,007 and $0 to related parties at June 30, 2010 and December 31, 2009	3,246,037	2,413,556
Inventories (note 6)	39,595,346	27,415,697
Current deferred tax assets (note 9)	2,617,570	1,381,868
Total current assets	$ 290,734,028	$ 242,296,776
Long-term Assets:		
Property, plant and equipment, net (note 7)	$ 62,645,020	$ 60,489,798
Intangible assets, net (note 8)	506,158	561,389
Other receivables, net, including $218,699 and $65,416 from related parties at June 30, 2010 and December 31, 2009 (note 5)	1,644,413	1,064,224
Advance payments for property, plant and equipment, including $5,676,085 and $2,579,319 to related parties at June 30, 2010 and December 31, 2009	13,508,244	6,369,043
Long-term investments	79,518	79,084
Non-current deferred tax assets (note 9)	1,351,409	2,172,643
Total assets	$ 370,468,790	$ 313,032,957
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Bank loans (note 10)	$ 8,835,353	$ 5,125,802
Accounts and notes payable, including $2,570,035 and $1,537,827 to related parties at June 30, 2010 and December 31, 2009 (note 11)	136,129,101	107,495,833
Convertible notes payable (note 12)	28,854,024	28,640,755
Compound derivative liabilities (note 13)	636,717	880,009
Customer deposits	2,370,888	1,918,835
Accrued payroll and related costs	3,022,380	3,040,705
Accrued expenses and other payables(note 14)	15,375,965	17,708,681
Accrued pension costs (note 15)	3,814,440	3,778,187
Taxes payable (note 16)	10,582,698	11,365,016
Amounts due to shareholders/directors (note 17)	112,209	-
Total current liabilities	$ 209,733,775	$ 179,953,823
Long-term liabilities:		
Other long-term liabilities (note 18)	4,986,459	233,941
Total liabilities	$ 214,720,234	$ 180,187,764
Significant concentrations (note 26)		
Related party transactions (note 27)		
Commitments and contingencies (note 28)		
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 – 27,110,693 and 27,046,244 shares at June 30, 2010 and December 31, 2009 (note 19)	2,711	2,704
Additional paid-in capital (note 19)	28,024,559	27,515,064
Retained earnings-		
Appropriated	8,767,797	8,324,533
Unappropriated	77,075,996	58,642,023
Accumulated other comprehensive income	11,963,911	11,187,744
Total parent company stockholders' equity	125,834,974	105,672,068
Non-controlling interests (note 20)	29,913,582	27,173,125
Total stockholders' equity	$ 155,748,556	$ 132,845,193
Total liabilities and stockholders' equity	$ 370,468,790	$ 313,032,957

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

China Automotive Systems, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity
Period Ended June 30, 2010 (unaudited) and December 31, 2009

	Common Stock	Additional Paid-in Capital	Retained Earnings Appropriated	Retained Earnings Unappropriated	Accumulated Other Comprehensive Income (Loss)	Total parent company stockholders ' Equity	Non-controlling interests	Total stockholders' equity
Balance at January 1, 2009	$ 2,698	$ 26,648,154	$ 7,525,777	$ 36,026,516	$ 11,127,505	$ 81,330,650	$ 23,222,566	$ 104,553,216
Foreign currency translation gain	–	–	–	–	60,239	60,239	22,365	82,604
Shares issued for stock options exercised	6	420,234	–	–	–	420,240	–	420,240
Share-based compensation	-	446,676	–	–	–	446,676	–	446,676
Appropriation of retained earnings	-	-	798,756	(798,756)	–	–	(3,944,619)	(3,944,619)
Net income for the year ended December 31, 2009	–	–	–	23,414,263	–	23,414,263	7,872,813	31,287,076
Balance at December 31, 2009	$ 2,704	$ 27,515,064	$ 8,324,533	$ 58,642,023	$ 11,187,744	$ 105,672,068	$ 27,173,125	$ 132,845,193
Foreign currency translation gain	–	–	–	–	776,167	776,167	151,661	927,828
Shares issued for stock options exercised	7	259,469	–	–	–	259,476	–	259,476
Share-based compensation	–	250,026	–	–	–	250,026	–	250,026
Appropriation of retained earnings	–	–	443,264	(443,264)	–	–	(3,288,909)	(3,288,909)
Net income for the period ended June 30, 2010	–	–	–	18,877,237	–	18,877,237	5,877,705	24,754,942

Balance at June 30, 2010	$ 2,711	28,024,559	8,767,797	77,075,996	11,963,911	125,834,974	29,913,582	155,748,556

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

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

	Six Months Ended June 30, 2010	2009
Cash flows from operating activities:		
Net income	$ 24,754,942	$ 12,372,509
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Stock-based compensation	250,026	125,013
Depreciation and amortization	4,909,679	3,886,332
Allowance for doubtful accounts (Recovered)	(599,863)	(1,117,881)
Deferred income taxes assets	(392,613)	(253,521)
Amortization for discount of convertible note payable	213,269	506,985
(Gain) loss on change in fair value of derivative	(243,292)	2,538,283
Other operating adjustments	14,275	(227,474)
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Pledged deposits	(6,521,746)	(1,537,010)
Accounts and notes receivable	(24,024,295)	(23,776,920)
Advance payments and other	(814,827)	(813,196)
Inventories	(11,987,567)	(171,352)
Accounts and notes payable	27,953,517	19,639,466
Customer deposits	448,291	21,744
Accrued payroll and related costs	(35,015)	170,135
Accrued expenses and other payables	737,146	1,512,206
Accrued pension costs	15,083	(13,754)
Taxes payable	(852,725)	2,901,849
Net cash provided by operating activities	$ 13,824,285	$ 15,763,414
Cash flows from investing activities:		
(Increase) decrease in other receivables	(830,493)	(55,386)
Cash received from equipment sales	374,399	458,950
Cash paid to acquire property, plant and equipment	(14,134,717)	(6,341,035)
Cash paid to acquire intangible assets	(38,498)	(321,671)
Net cash (used in) investing activities	$ (14,629,309)	$ (6,259,142)
Cash flows from financing activities:		
Proceeds from bank loans	3,685,215	1,465,006
Dividends paid to the non-controlling interest holders of Joint-venture companies	(1,744,982)	(3,768,668)
Repayment of convertible note payable	-	(5,000,000)
Shares issued for stock options exercised	259,476	
Increase in amounts due to shareholders/directors	110,271	226,717
Net cash provided by (used in) financing activities	$ 2,309,980	$ (7,076,945)
Cash and cash equivalents affected by foreign currency	$ 261,087	$ 14,607
Net increase in cash and cash equivalents	1,766,043	2,441,934
Cash and cash equivalents at beginning of period	43,480,176	37,113,375
Cash and cash equivalents at end of period	$ 45,246,219	$ 39,555,309

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

F-6

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

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

	Six Months Ended June 30,	
	2010	2009
Cash paid for interest	$ 407,296	$ 989,247
Cash paid for income taxes	$ 3,972,306	$ 1,403,715

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

China Automotive Systems, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
Three Months and Six Months Ended June 30, 2010 and 2009

1. Organization and Business

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

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

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

The Company owns the following aggregate net interests in nine Sino-foreign joint ventures organized in the PRC as of June 30, 2010 and 2009.

	Percentage Interest	
Name of Entity	June 30, 2010	June 30, 2009
Shashi Jiulong Power Steering Gears Co., Ltd., "Jiulong"	81.00%	81.00%
Jingzhou Henglong Automotive Parts Co., Ltd., "Henglong"	80.00%	80.00%
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., "Shenyang"	70.00%	70.00%
Zhejiang Henglong & Vie Pump-Manu Co., Ltd., "Zhejiang"	51.00%	51.00%
Universal Sensor Application Inc., "USAI"	83.34%	83.34%
Wuhan Jielong Electric Power Steering Co., Ltd., "Jielong"	85.00%	85.00%
Wuhu HengLong Automotive Steering System Co., Ltd., "Wuhu"	77.33%	77.33%
Jingzhou Hengsheng Automotive System Co., Ltd, "Hengsheng"	100.00%	100.00%
Jingzhou Henglong Automotive Technology (Testing) Center, "Testing Center"	80.00%	-%

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

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

In December 2009, Henglong, a subsidiary of Genesis, formed Jingzhou Henglong Automotive Technology (Testing) Center, "Testing Center", which is mainly engaged in research and development of new products. The registered capital of Testing Center is RMB 30,000,000 ($4,393,544 equivalent).

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

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

USAI was established in 2005 and mainly engages in production and sales of sensor modulars.

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

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

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

On February 11, 2010, the registered capital of Hengsheng was increased to $16,000,000 from $10,000,000.

On January 24, 2010, Genesis entered into a sino-foreign equity joint venture contract with Beijing Hainachuan Auto Parts Co., Ltd., to establish a sino-foreign joint venture company, Beijing Henglong Automotive System Co., Ltd., “Beijing Henglong”, to design, develop and manufacture both hydraulic and electric power steering systems and parts. Under PRC laws, the establishment of Beijing Henglong and the effectiveness of the equity joint venture contract are subject to approval by the local Ministry of Commerce and the registration of the same with the local Administration of Industries and Commerce in Beijing.

2. Basis of Presentation and Significant Accounting Policies

(a) Basis of Presentation

Basis of Presentation - For the three months and six months ended June 30, 2010 and 2009, the accompanying unaudited consolidated financial statements include the accounts of the Company and its subsidiaries. The subsidiaries include nine Sino-foreign Joint-ventures mentioned in Note 1. Significant inter-company balances and transactions have been eliminated upon consolidation. The unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America.

Comments - The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of the Company’s management, contain all adjustments, which include normal recurring adjustments, necessary to present fairly the financial position, the results of operations and cash flows for the three months and six months ended June 30, 2010 and 2009 respectively.

The consolidated balance sheet as of December 31, 2009 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 2009 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

The results of operations for the six months ended June 30, 2010 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2010.

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

(b) Significant Accounting Policies

Recent Accounting Pronouncements- In June 2009, the Financial Accounting Standards Board (FASB) approved the “FASB Accounting Standards Codification” (“Codification”, “FASB ASC”) as the single source of authoritative generally accepted accounting principles (GAAP) and created a new Topic 105, Generally Accepted Accounting Principles , in the General Principles and Objective Section of the Codification. Topic 105 is effective for interim and annual periods ending after September 15, 2009, and its adoption did not have an impact on our financial condition or results of operations.

In October 2009, the FASB issued ASU No. 2009-13, Revenue Recognition (ASC Topic 605) - Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force. This guidance modifies the fair value requirements of ASC subtopic 605-25, Revenue Recognition-Multiple Element Arrangements by allowing the use of the "best estimate of selling price" in addition to vendor-specific objective evidence (VSOE) and verifiable objective evidence (VOE) (now referred to as TPE standing for third-party evidence) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when VSOE or TPE of the selling price cannot be determined. This update is effective for fiscal years beginning on or after June 15, 2010. However, early adoption is allowed. The Company has adopted this guidance. The adoption of this guidance did not have a material impact on the Company's consolidated results of operations and financial position.

In January 2010, FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC Topic 820) — Improving Disclosures About Fair Value Measurements. The ASU requires new disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Other than requiring additional disclosures, the adoption of this new guidance will not have a material impact on the Company's consolidated results of operations and financial position.

In February 2010, FASB issued ASU 2010-09 Subsequent Event (Topic 855) Amendments to Certain Recognition and Disclosure Requirements. ASU 2010-09 removes the requirement for a SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of GAAP. All of the amendments in ASU 2010-09 are effective upon issuance of the final ASU, except for the use of the issued date for conduit debt obligors. That amendment is effective for interim or annual periods ending after June 15, 2010. The Company adopted ASU 2010-09 in February 2010 and did not disclose the date through which subsequent events have been evaluated.

Foreign Currencies - The Company maintains its books and records in Renminbi, "RMB", the currency of the PRC, its functional currency. In accordance with guidance now incorporated in ASC Topic 830 (formerly FAS 52), foreign currency transactions in RMB are reflected using the temporal method. Under this method, all monetary items are translated into the functional currency at the rate of exchange prevailing at the balance sheet date. Non-monetary items are translated at historical rates. Income and expenses are translated at the rate in effect on the transaction dates. Transaction gains and losses, if any, are included in the determination of net income for the period.

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

Stock-Based Compensation - The Company may periodically issue shares of common stock for services rendered or for financing costs. Such shares will be valued based on the market price on the transaction date. The Company may periodically issue stock options to employees and stock options or warrants to non-employees in non-capital raising transactions for services and for financing costs.

In July 2004, the Company adopted a stock incentive plan. The maximum number of common shares for issuance under this plan is 2,200,000 with a period of 10 years. The stock incentive plan provides for the issuance, to the Company's officers, directors, management and employees, of options to purchase shares of the Company's common stock. Since the adoption of the stock incentive plan, the Company has issued 433,850 stock options under this plan, and there remain 1,766,150 stock options issuable in the future. As of June 30, 2010, the Company had 279,401 stock options outstanding.

The Company has adopted ASC Topic 718 (formerly SFAS 123R), "Accounting for Stock-Based Compensation", which establishes a fair value method of accounting for stock-based compensation plans. In accordance with guidance now incorporated in ASC Topic 718, the cost of stock options and warrants issued to employees and non-employees is measured on the grant date based on the fair value. The fair value is determined using the Black-Scholes option pricing model. The resulting amount is charged to expense on the straight-line basis over the period in which the Company expects to receive benefit, which is generally the vesting period.

Comprehensive Income - The Company has adopted ASC Topic 220 (formerly SFAS No. 130), “Reporting Comprehensive Income”. ASC Topic 220 establishes standards for the reporting and display of comprehensive income, its components and accumulated balances in a full set of general purpose financial statements. ASC Topic 220 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.

Financial instruments - Derivative financial instruments, as defined in ASC Topic 815 (formerly FAS 133), Accounting for Derivative Financial Instruments and Hedging Activities (ASC Topic 815), consist of financial instruments or other contracts that contain a notional amount and one or more underlying, e.g. interest rate, security price or other variable, require no initial net investment and permit net settlement. Derivative financial instruments may be free-standing or embedded in other financial instruments. Further, derivative financial instruments are initially, and subsequently, measured at fair value and recorded as liabilities or, in rare instances, assets.

The Company generally does not use derivative financial instruments to hedge exposures to cash-flow, market or foreign-currency risks. However, the Company has entered into certain other financial instruments and contracts, such as debt financing arrangements that embody features that are either (i) not afforded equity classification, (ii) embody risks not clearly and closely related to host contracts, or (iii) may be net-cash settled by the counterparty. As required by ASC Topic 815 (formerly FAS 133), these instruments are required to be carried as derivative liabilities, at fair value, in the Company's financial statements.

Registration Payment Arrangements - The Company has entered into registration payment arrangements with certain investors that provide for the payment of damages for failures to register common shares underlying the investor's financial instruments. ASC Topic 825 (formerly FASB Staff Position 00-19-2), Accounting for Registration Payment Arrangements, provides for the exclusion of registration payments, such as the liquidated damages, from the consideration of classification of financial instruments. Rather, such registration payments would be accounted for pursuant to ASC Topic 450 (formerly FASB No. 5), "Accounting for Contingencies", which is the Company's current accounting practice. That is, all registration payments will require recognition when they are both probable and reasonably estimable. The Company does not currently believe that damages are probable.

Fair Value Measurements - The Company has adopted the provisions of ASC Topic 820 (formerly SFAS 157), "Fair Value Measurements", except as it applies to those nonfinancial assets and nonfinancial liabilities. ASC Topic 820 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. In February 2008, FASB Staff delayed the effective date of ASC Topic 820 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

Noncontrolling Interests in Consolidated Financial Statements - In December 2007, the FASB issued guidance now incorporated in ASC Topic 810 "Consolidation" (formerly Statement of Financial Accounting Standards ("SFAS") 160). The guidance clarifies the accounting for noncontrolling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of stockholders' equity. This guidance was effective for the Company's fiscal year beginning January 1, 2009. The Company has adopted this guidance in its consolidated financial statements for the period ended June 30, 2010.

Accounting for Convertible Debt Instruments - The Company has adopted the provisions of ASC Topic 470, originally issued as FSP APB 14-1, "Accounting for Convertible Debt Instruments That May be Settled in Cash upon Conversion (Including Partial Cash Settlement). ASC Topic 470 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's non-convertible debt borrowing rate when interest cost is recognized in subsequent periods. ASC Topic 470, formerly FSP APB 14-1, is effective beginning from January 1, 2009 for the Company, and this standard must be applied on a retrospective basis. Since the Company's Convertible Notes agreements do not have a term for cash, or other assets, settlement upon conversion (Including Partial Cash Settlement), the adoption of ASC 480 did not have an impact on the Company's consolidated financial position and results of operations.

3. Pledged cash deposits

Pledged as guarantee for its notes payable, the Company regularly pays some of its suppliers by bank notes. The Company has to deposit a cash deposit, equivalent to 30% - 40% of the face value of the relevant bank note, at a bank in order to obtain the bank note.

F-11

4. Accounts and notes receivable

The Company's accounts receivable at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Accounts receivable	$ 109,097,616	$ 104,120,926
Notes receivable	75,954,136	56,062,744
	185,051,752	160,183,670
Less: allowance for doubtful accounts	(4,363,233)	(5,320,378)
Balance at the end of the period	$ 180,688,519	$ 154,863,292

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

The activity in the Company's allowance for doubtful accounts during the six months ended June 30, 2010 (unaudited) and the year ended December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Balance at beginning of period	$ 5,320,378	$ 4,910,478
Amounts provided (recovered) during the period	(876,872)	406,228
Foreign currency translation gain (loss)	(80,273)	3,672
Balance at the end of the period	$ 4,363,233	$ 5,320,378

5. Other receivables

The Company's other receivables at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Other receivables	$ 2,556,150	$ 1,804,334
Less: allowance for doubtful accounts	(911,737)	(740,110)
Balance at the end of the period	$ 1,644,413	$ 1,064,224

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

The activity in the Company's allowance for doubtful accounts of other receivable during the six months ended June 30, 2010 (unaudited) and the year ended December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Balance at beginning of the period	$ 740,110	$ 659,837
Amounts provided during the period	260,720	79,618
Foreign currency translation gain (loss)	(89,093)	655
Balance at the end of the period	$ 911,737	$ 740,110

6. Inventories

The Company's inventories at June 30, 2010 (Unaudited) and December 31, 2009 consisted of the following:

	June 30, 2010	December 31, 2009
Raw materials	$ 15,154,343	$ 10,683,448
Work in process	8,231,247	6,824,137
Finished goods	18,356,069	12,017,195
	41,741,659	29,524,780
Less: provision for loss	(2,146,313)	(2,109,083)
Balance at the end of the period	$ 39,595,346	$ 27,415,697

7. Property, plant and equipment

The Company's property, plant and equipment at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Land use rights and buildings	$ 33,659,604	$ 33,100,702
Machinery and equipment	68,538,569	62,982,885
Electronic equipment	5,299,803	5,054,502
Motor vehicles	2,773,265	2,634,696
Construction in progress	2,564,378	1,939,256
	112,835,619	105,712,041
Less: Accumulated depreciation	(50,190,599)	(45,222,243)
Balance at the end of the period	$ 62,645,020	$ 60,489,798

Depreciation charge for the six months ended June 30, 2010 and the year ended December 31, 2009 are $4,861,101 and $8,429,863, respectively.

8. Intangible assets

The activities in the Company's intangible asset account at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Costs:		
Patent technology	$ 1,391,639	$ 1,384,037
Management software license	476,134	438,359
	1,867,773	1,822,396
Less: Amortization	(1,361,615)	(1,261,007)
Balance at the end of the period	$ 506,158	$ 561,389

9. Deferred Income Tax Assets

In accordance with the provisions of ASC Topic 740 "Income Taxes" (formerly SFAS 109), the Company assesses, on a quarterly basis, its ability to realize its deferred tax assets. Based on the more likely than not standard in the guidance and the weight of available evidence, the Company believes a valuation allowance against its deferred tax assets is necessary. In determining the need for a valuation allowance, the Company considered the following significant factors: an assessment of recent years' profitability and losses; the Company's expectation of profits based on margins and volumes expected to be realized (which are based on current pricing and volume trends); the long period - ten years or more in all significant operating jurisdictions — before the expiry of net operating losses, noting further that a portion of the deferred tax asset is composed of deductible temporary differences that are subject to an expiry period until realized under tax law. The Company will continue to evaluate the provision of valuation allowance in future periods.

The components of estimated deferred income tax assets at June 30, 2010 (unaudited) and December 31, 2009 were as follows:

	June 30, 2010	December 31, 2009
Losses carryforward (U.S.)	$ 4,298,005	$ 3,855,426
Losses carryforward (PRC)	485,924	421,629
Product warranties and other reserves	2,757,268	2,313,728
Property, plant and equipment	2,930,637	2,818,497
Bonus accrual	190,687	306,030
Other	382,300	395,649
	11,044,821	10,110,959
Valuation allowance *	(7,075,842)	(6,556,448)
Total deferred tax assets**	$ 3,968,979	$ 3,554,511

*As of June 30, 2010, valuation allowance was $7,075,842, including $4,298,005 allowance for the Company's deferred tax assets in the U.S. and $2,777,837 allowance for the Company's non-U.S. deferred tax assets. Based on the Company's current operations in the U.S., the management believes that the deferred tax assets in the U.S. are not likely to be realized in the future. For the non-U.S. deferred tax assets, pursuant to certain tax laws and regulations in China, the management believes such amount will not be used to offset future taxable income.

** Approximately $1,351,409 and $2,172,643 of deferred income tax asset as of June 30, 2010 and December 31, 2009, respectively, is included in non-current deferred tax assets in the accompanying consolidated balance sheets. The remaining $2,617,570 and $1,381,868 of deferred income tax asset as of June 30, 2010 and December 31, 2009, respectively, is included in the current deferred tax assets.

10. Bank loans

At June 30, 2010, the Company, through its Sino-foreign joint ventures, had outstanding fixed-rate short-term bank loans of $8,835,353, with weighted average interest rate at 5.31% per annum. These loans are secured with some of the property and equipment of the Company, and are repayable within one year.

At December 31, 2009, the Company, through its Sino-foreign joint ventures, had outstanding fixed-rate short-term bank loans of $5,125,802, with weighted average interest rate at 5.68% per annum. These loans are secured with some of the property and equipment of the Company and are repayable within one year.

11. Accounts and notes payable

The Company's accounts and notes payable at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Accounts payable	$ 91,399,792	$ 69,454,231
Notes payable	44,729,309	38,041,602
Balance at the end of the period	$ 136,129,101	$ 107,495,833

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

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

12. Convertible notes payable

The Company's Convertible notes payable at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Convertible notes payable, face value	$ 30,000,000	$ 30,000,000
Less: discount of Convertible notes payable	(1,145,976)	(1,359,245)
Balance at the end of the period	$ 28,854,024	$ 28,640,755

The Company's discount of Convertible notes payable at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Balance at beginning of year	$ 1,359,245	$ 2,077,923
Less: amortization during the period	(213,269)	(718,678)
Balance at the end of the period	$ 1,145,976	$ 1,359,245

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

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

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

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

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

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

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

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

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

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

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

In the event that the Company has not completed the necessary filings to list the conversion shares on its principal market by the date that is ninety (90) days after the issuance date or has not so listed the conversion shares by the date that is ninety (90) days after the issuance date or the shares of the Company's common stock are terminated from registration under the Securities Act of 1933, the Convertible Note holders will have the right, in its sole discretion, to require that the Company redeem all or any portion of the Convertible Notes. The portion of the Convertible Notes subject to redemption in connection with this listing default will be redeemed by the Company in cash at a price equal to the sum of the conversion amount being redeemed and the Other Make Whole Amount as mentioned above.

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

Since the Company's stock Weighted Average Price for twenty (20) consecutive trading days ended on March 16, 2009 was below $3.187, which is less than 45% of the Conversion Price in effect of the Issuance Date, as adjusted, the " WAP Default" , each Convertible Note holder had the right, at its sole discretion, to require that the Company redeem all or any portion of the Convertible Notes by delivering written redemption notice to the Company within five (5) business days after the receipt of the Company's notice of the WAP Default.

On March 17, 2009, the Company delivered two WAP Default notices to the Convertible Note holders. On March 27, 2009, the Company received a letter from YA Global, one of the Convertible Note holders, electing to require the Company to redeem all the three Convertible Notes it held in the total principal amount of $5,000,000, together with interest, late charges, if any, and the Other Make Whole Amount as defined in Section 5(d) of the Convertible Notes. After negotiation, the Company and YA Global reached a settlement agreement on April 8, 2009 and under the terms of the settlement agreement, the Company paid on April 15, 2009 a redemption amount of $5,041,667 to YA Global and YA Global waived its entitlement to the Other Make Whole Amount.

Following the WAP Default notices, the Company received a letter from the provisional liquidator acting on behalf of Lehman Brothers Commercial Corporation Asia Limited, the "LBCCA Liquidator", the other Convertible Note holder, requesting an extension until April 24, 2009 to consider its rights under the Convertible Notes. The Company granted an extension to April 15, 2009. The LBCCA Liquidator further requested another extension to April 24, 2009. On April 24, 2009, LBCCA's lawyers sent three Holder Redemption Notices via fax electing to redeem the entire outstanding principal of $30,000,000, together with interest, late charges, if any, and the Other Make Whole Amount, to be paid on July 23, 2009. The Company discussed settlement with the LBCCA Liquidator, and on or about July 22, 2009, the Company and the LBCCA Liquidator agreed to extend the applicable holder mandatory redemption date for two months to September 23, 2009 to give more time to pursue settlement discussion. The Company received a letter dated September 22, 2009 from the LBCCA Liquidator stating that upon the Company's acceptance of the revocation, all holder redemption notices dated April 24, 2009 shall be immediately revoked as if they were never issued, and the letter and the revocation did not purport to amend, restate or supplement any other terms and conditions under the three Notes and the Securities Purchase Agreement dated 1 February 2008 between the Company and LBCCA Liquidator. The Company accepted such revocation on September 23, 2009.

In connection with the Convertible Notes, the Company issued 1,317,864 detachable warrants, the "Warrants," to purchase from the Company shares of common stock of the Company at the exercise price of $8.8527 per share. The Warrants are exercisable immediately and expired on February 15, 2009. The Warrants require net cash settlement in the event that there is a fundamental transaction, contractually defined as a merger, sale of substantially all assets, tender offer or share exchange. Due to this contingent redemption provision, in accordance with guidance now incorporated in ASC Topic 480 (formerly SFAS 150), the warrants require liability classification and must be recorded at fair value each reporting period. As of the issuance date, i.e., February 15, 2008, the fair value of warrants was $798,626, which was determined using the Black-Scholes option pricing model.

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

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

On the date of inception, allocation of basis in the financing arrangement to the warrants and derivative liability has resulted in an original issue discount to the face value of the convertible notes in the amount of $2,502,588, which amount is subject to amortization over the Convertible Note’s term using the effective method. As of June 30, 2010, the accumulated amortization expense balance recorded by the Company was $1,356,612, remaining $1,145,976 will be amortized over the remaining life of the instrument.

13. Compound derivative liabilities

The Company has evaluated the convertible notes for terms and conditions that are not clearly and closely associated with the risks of the debt-type host instrument (see Note 12). Generally, such features require separation from the host contract and treatment as derivative financial instruments. Certain features, such as the conversion option, were found to be exempt, as they satisfied the conditions for equity classification in ASC Topic 815, formerly paragraph 11(a) of SFAS 133, for instruments (1) indexed with the Company’s own stock, and (2) classified as equity in financial position statement. Other features, such as puts and redemption features were found to require bifurcation and recognition as derivative liabilities based on the provision of ASC Topic 815, formerly paragraph 12 of SFAS 133. These derivative liabilities are recognized both at inception and the end of each reporting period at fair value, using forward cash-flow valuation techniques, until such liabilities arrangements are eventually settled, converted or paid. As of December 31, 2008, June 30, 2009, December 31, 2009, and June 30, 2010, the compound derivative value amounted to $1,502,596, $4,042,857, $880,009 and $636,717. The income from adjustment of fair value of compound derivative has been recorded in the income statement as gain or loss on change in fair value of derivative. (See note 12 and 23)

The fair value of compound derivative liabilities at inception and the end of each reporting period was calculated based on the following assumptions:

(1) Credit risk adjusted based on publicly available research/investigation: The Company develops credit risk assumptions by reference to corporate bond spreads in the market that the Company's equity security trades. Bond yields were selected as the principal market indicator because such yields are presumed to provide information that assigns yields directly to any company's assumed credit rating. Credit ratings are established through formal analysis of bond inception and trading activity by Standard & Poor, Moody's and Fitch. The Company believes that it is likely that a market-participant would look to this indicator for purposes of assessing the credit risk associated with the investment. The calculation of the risk adjusted yield requires its measurement against a risk-free rate. The Company has chosen the publicly quoted yields on zero-coupon US Government Securities.

(2) Probability of certain default event occurred: Compound derivatives are bifurcated pursuant to SFAS 133.12. The fair value of compound derivatives is predicated on a probability assessment of the likelihood of a triggering event and the incremental value embodied in the hybrid instrument (See Note 12 regarding the assessment of compound derivatives. For example: mandatory redemption requires the gross yield arrived at 13% and annual redemption requires the gross yield arrived at 11%). The Company has assessed the probability of the likelihood of a triggering event at inception and completion of each reporting period:

As of June 30, 2009 and December 31, 2008:

	December 31, 2008	June 30, 2009	Comments
Default put :	0.00%	0.00%	
Service default	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Bankruptcy/liquidation	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Material judgments	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Suspension of listing*	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Non-registration events:	0.50%	0.50%	
Filing*	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Effectiveness*	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Continuous Effectiveness*	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Share non-delivery	0.50%	0.50%	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Mandatory redemption put:	15.0%	100.00%	
Maintenance of share price at a certain level**	15.0%	100.00%	This is not within the Company's control. This put is only available subsequent to February 15, 2009 and only if the stock price is <45% of the conversion price for 20 trading days. On December 31, 2008, the stock price has maintained a value barely above 45% of the adjusted conversion price, so the risk of mandatory redemption was high. On March 16, 2009, the Company has a "WAP default", and then received a mandatory redemption notice form the Convertible Note holder. Thus, the possibility of mandatory redemption was 100%.
Suspension of listing and non-registration events*	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Annual Redemption Rights:	30.0%	0.00%	
Allows for redemption rights on specific dates**	30.0%	0.00%	This is not within the Company's control. On December 31, 2008, the stock prices were below the adjusted conversion price, so the risk of annual redemption was

			high. On June 30, 2009, the Company had a “WAP default”, and then received a mandatory redemption notice form the Convertible Note holder. Thus, the possibility of annual redemption was zero.
Allows for redemption if < 10% of note is outstanding	Low	Low	Please see Financial Statements Note 14 incorporated in the Company’s Form 10-K for the year ended December 31, 2009 filed with the SEC.
Henglong Make Whole Amount and Redemption Right	Low	Low	Please see Financial Statements Note 14 incorporated in the Company’s Form 10-K for the year ended December 31, 2009 filed with the SEC.
Change in Control Put:	0.50%	0.50%	
Change in control**	0.50%	0.50%	Please see Financial Statements Note 14 incorporated in the Company’s Form 10-K for the year ended December 31, 2009 filed with the SEC.

As of June 30, 2010 and December 31, 2009:

	December 31, 2009	June 30, 2010	Comments
Default put:	0.00%	0.00%	
Service default	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Bankruptcy/liquidation	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Material judgments	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Suspension of listing*	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Non-registration events:	0.50%	0.50%	
Filing*	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Effectiveness*	Low	Low	Please see Financial Statements Notes 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Continuous Effectiveness*	Low	Low	Please see Financial Statements Notes 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Share non-delivery	0.50%	0.50%	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Mandatory redemption put:	1.50%	1.50%	
Maintenance of share price at a certain level**	1.50%	1.50%	This is not within the Company's control. This put is only available subsequent to February 15, 2009 and only if the stock price is <45% of the conversion price for 20 trading days. On December 31, 2009 and June 30, 2010, the stock price was 164% and 149% above the adjusted conversion price ($7.0822). Moreover the Company received a revocation of such mandatory redemption notice, so the risk of mandatory redemption was low.
Suspension of listing and non-registration events*	Low	Low	Please see Financial Statements Note 14 incorporated in the Company's Form 10-K for the year ended December 31, 2009 filed with the SEC.
Annual Redemption Rights:	11.7%	7.84%	
Allows for redemption rights on specific dates**	11.7%	7.84%	This is not within the Company's control. On December 31, 2009 and June 30, 2010, the stock price was 164% and 149% above the adjusted conversion price, so the risk of annual redemption was low.
	Low	Low	

Allows for redemption if < 10% of note is outstanding			Please see Financial Statements Note 14 incorporated in the Company’s Form 10-K for the year ended December 31, 2009 filed with the SEC.
Henglong Make Whole Amount and Redemption Right	Low	Low	Please see the Financial Statements Notes 14 incorporated in the Company’s Form 10-K for the year ended December 31, 2009 filed with SEC.
Change in Control Put:	0.50%	0.50%	
Change in control**	0.50%	0.50%	Please see Financial Statements Notes 14 incorporated in the Company’s Form 10-K for the year ended December 31, 2009 filed with the SEC.

*Represent the event is not within the Company's control, but the probability of a triggering event is low.

**Represent the event is not within the Company's control, and the probability of a triggering event is high. The assessment of such probability was based on the probability of the historical trading price of the Company's common stock above or under Strike price for previous periods, same with the remaining period of the instruments. For example, the triggering event of maintaining the stock price at a certain level, a WAP default, is the Company's stock weighted average price for twenty (20) consecutive trading days below $3.187, which is 45% of the reset Conversion Price of $7.0822. The triggering event allowing the note holders to require the Company to redeem the notes on specific dates is when the Company’s stock price becomes $8.6 or lower.

According to the analysis and data above, change of the fair value of compound derivative liabilities for the reporting period was mainly based on the price change of the Company's trading common stock. It was estimated that, if the probability of the stock price above $8.6 was high, the probability of redemption was low, because the Convertible notes holders would gain 11% or more income by converting into common stock at this price level, which was higher than the income from bond market or redemption of Convertible notes upon any occurrence of triggering events as defined in the debt agreement.

As of June 30, 2010, the fair value of compound derivative liabilities of $636,716 decreased by $243,293 as compared to $880,009 on December 31, 2009, mainly as a result of the recent market recovery. As the Company's stock price rose dramatically, the probability of the Company's stock price trading above $8.6 rose, accordingly, the probability of redemption declined.

As of June 30, 2009, the fair value of compound derivative liabilities of $4,042,857 increased by $2,540,260 as compared to $1,502,597 on December 31, 2008, mainly as a result of the Company's stock Weighted Average Price for twenty (20) consecutive trading days ended on March 16, 2009 was below $3.187, which is less than 45% of the Conversion Price in effect of the Issuance Date, as adjusted, the " WAP Default", and the Company received a mandatory redemption notice later, thus the risk of mandatory redemption rose to 100%.

14. Accrued expenses and other payables

The Company's accrued expenses and other payables at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Accrued expenses	$ 2,747,434	$ 4,160,433
Other payables	2,458,415	2,694,447
Warranty reserves*	6,841,601	9,092,462
Dividend payable to non-controlling interest shareholders of Joint-ventures	3,328,515	1,761,339
Balance at the end of the period	$ 15,375,965	$ 17,708,681

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

For the six months ended June 30, 2010 (unaudited) and the year ended December 31, 2009, the warranties activities were as follows:

	June 30, 2010	December 31, 2009
Balance at the beginning of period	$ 9,092,462	$ 6,335,613
Additions during the period-	5,765,935	10,192,749
Settlement within period, by cash or actual material	(3,322,294)	(7,442,984)
Foreign currency translation gain (loss)	56,730	7,084
Balance at end of period	$ 11,592,833	$ 9,092,462

Approximately $6,841,601 and $9,092,462 of warranty reserves, respectively, are included in accrued expenses and other payables in the accompanying consolidated balance sheets. The remaining $4,751,232 of warranty reserves as of June 30, 2010 is included in the other long-term liabilities.

15. Accrued pension costs

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

The activities in the Company's pension account during the six months ended June 30, 2010 (unaudited) and the year ended December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Balance at beginning of the period	$ 3,778,187	$ 3,806,519
Amounts provided during the period	2,391,155	3,738,373
Settlement during the period	(2,376,072)	(3,770,220)
Foreign currency translation gain (loss)	21,170	3,515
Balance at end of period	$ 3,814,440	$ 3,778,187

16. Taxes payable

The Company's taxes payable at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Value-added tax payable	$ 2,702,079	$ 9,290,149
Income tax payable	7,711,055	1,733,942
Other tax payable	169,564	340,925
Balance at end of the period	$ 10,582,698	$ 11,365,016

F-22

17. Amounts due to shareholders/ directors

The activities in the amounts due to shareholders/directors at June 30, 2010 (unaudited) and December 31, 2009 are summarized as follows:

	June 30, 2010	December 31, 2009
Balance at the beginning of period	$ -	