

CHINA AUTOMOTIVE SYSTEMS INC  
Form 10-Q  
August 10, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark one)

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

For the quarterly period ended June 30, 2017

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**

(State or other jurisdiction of incorporation or

**33-0885775**

(I.R.S. employer identification  
number)

organization)

**No. 1 Henglong Road, Yu Qiao Development Zone, Shashi District**

**Jing Zhou City, Hubei Province, the People's Republic of China**

**(Address of principal executive offices)**

**(86) 716- 412- 7912**

Issuer's telephone number

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

Yes        ☒        No        ☐

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer (Do not check if a smaller reporting company)	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. "

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 August 10, 2017, the Company had 31,644,004 shares of common stock issued and outstanding.

**CHINA AUTOMOTIVE SYSTEMS, INC.**

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## Cautionary Statement

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or the Company's future financial performance. The Company has attempted to identify forward-looking statements by terminology including "anticipates," "believes," "expects," "can," "continues," "could," "estimates," "expects," "may," "plans," "potential," "predicts," "should" or "will" or the negative of these terms or other comparable terminology. Such statements are subject to certain risks and uncertainties, including the matters set forth in this Quarterly Report or other reports or documents the Company files with the Securities and Exchange Commission from time to time, which could cause actual results or outcomes to differ materially from those projected. Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements. Undue reliance should not be placed on these forward-looking statements, which speak only as of the date hereof. The Company's expectations are as of the date this Form 10-Q is filed, and the Company does not intend to update any of the forward-looking statements after the date this Quarterly Report on Form 10-Q is filed to conform these statements to actual results, unless required by law. All of the forward-looking statements are qualified in their entirety by reference to the factors discussed under Item 1A. "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the Securities and Exchange Commission.

**PART I — FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS.****China Automotive Systems, Inc. and Subsidiaries****Condensed Unaudited Consolidated Statements of Operations and Comprehensive Income***(In thousands of USD, except share and per share amounts)*

	<b>Three Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Net product sales (\$8,583 and \$10,054 sold to related parties for the three months ended June 30, 2017 and 2016)	\$ 117,660	\$ 101,017
Cost of products sold (\$6,283 and \$6,168 purchased from related parties for the three months ended June 30, 2017 and 2016)	93,599	82,869
Gross profit	24,061	18,148
Gain on other sales	4,555	1,185
Less: Operating expenses		
Selling expenses	4,555	4,128
General and administrative expenses	5,283	3,942
Research and development expenses	7,707	5,987
Total operating expenses	17,545	14,057
Income from operations	11,071	5,276
Other income, net	152	1,219
Interest expense	(644)	(127)
Financial income, net	550	148
Income before income tax expenses and equity in earnings of affiliated companies	11,129	6,516
Less: Income taxes	2,186	1,196
Equity in (loss)/earnings of affiliated companies	(62)	195
Net income	8,881	5,515
Net (loss)/income attributable to non-controlling interests	(40)	151
Net income attributable to parent company's common shareholders	\$ 8,921	\$ 5,364
Comprehensive income:		
Net income	\$ 8,881	\$ 5,515
Other comprehensive income:		
Foreign currency translation gain/(loss), net of tax	5,814	(7,946)
Comprehensive income/(loss)	14,695	(2,431)
Comprehensive income/(loss) attributable to non-controlling interests	155	(164)
Comprehensive income/(loss) attributable to parent company	\$ 14,540	\$ (2,267)

Net income attributable to parent company's common shareholders per share

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Basic –	\$ 0.28	\$ 0.17
Diluted-	\$ 0.28	\$ 0.17
Weighted average number of common shares outstanding		
Basic	31,644,004	32,085,822
Diluted	31,649,322	32,087,634

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

**China Automotive Systems, Inc. and Subsidiaries****Condensed Unaudited Consolidated Statements of Operations and Comprehensive Income***(In thousands of USD, except share and per share amounts)*

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Net product sales (\$18,121 and \$18,639 sold to related parties for the six months ended June 30, 2017 and 2016)	\$ 236,968	\$ 217,871
Cost of products sold (\$13,646 and \$13,043 purchased from related parties for the six months ended June 30, 2017 and 2016)	191,278	178,711
Gross profit	45,690	39,160
Gain on other sales	5,343	1,986
Less: Operating expenses		
Selling expenses	8,623	8,433
General and administrative expenses	9,637	8,257
Research and development expenses	14,472	12,126
Total operating expenses	32,732	28,816
Income from operations	18,301	12,330
Other (expense)/income, net	(102)	) 575
Interest expense	(875)	) (323)
Financial income, net	882	470
Income before income tax expenses and equity in earnings of affiliated companies	18,206	13,052
Less: Income taxes	3,376	2,249
Equity in earnings of affiliated companies	(11)	) 257
Net income	14,819	11,060
Net income/(loss) attributable to non-controlling interests	184	(13)
Net income attributable to parent company's common shareholders	\$ 14,635	\$ 11,073
Comprehensive income:		
Net income	\$ 14,819	\$ 11,060
Other comprehensive income:		
Foreign currency translation gain/(loss), net of tax	7,443	(6,296)
Comprehensive income	22,262	4,764
Comprehensive gain/(loss) attributable to non-controlling interests	433	(249)
Comprehensive income attributable to parent company	\$ 21,829	\$ 5,013
Net income attributable to parent company's common shareholders per share		
Basic –	\$ 0.46	\$ 0.34
Diluted-	\$ 0.46	\$ 0.34
Weighted average number of common shares outstanding		
Basic	31,644,004	32,103,420
Diluted	31,649,615	32,105,611



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

**China Automotive Systems, Inc. and Subsidiaries****Condensed Unaudited Consolidated Balance Sheets***(In thousands of USD unless otherwise indicated)*

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 36,473	\$ 31,092
Pledged cash	34,468	30,799
Short-term investments	27,239	30,475
Accounts and notes receivable, net - unrelated parties	288,985	285,731
Accounts and notes receivable, net - related parties	18,459	20,984
Advance payments and others - unrelated parties	7,473	10,203
Advance payments and others - related parties	30,558	624
Inventories	65,470	68,050
Current deferred tax assets	7,652	7,946
Total current assets	516,777	485,904
Non-current assets:		
Long-term time deposits	6,790	865
Property, plant and equipment, net	108,646	101,478
Intangible assets, net	544	617
Other receivables, net - unrelated parties	2,212	2,252
Advance payment for property, plant and equipment - unrelated parties	13,961	14,506
Advance payment for property, plant and equipment - related parties	3,361	5,005
Long-term investments	17,552	16,431
Non-current deferred tax assets	4,241	4,641
Total assets	\$ 674,084	\$ 631,699
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Bank and government loans	\$ 67,379	\$ 40,820
Accounts and notes payable - unrelated parties	221,371	216,993
Accounts and notes payable - related parties	4,814	6,803
Customer deposits	699	700
Accrued payroll and related costs	7,128	6,971
Accrued expenses and other payables	34,598	35,882
Accrued pension costs	3,919	4,130
Taxes payable	5,397	11,674
Amounts due to shareholders/directors	324	312
Advances payable (current portion)	391	382
Current deferred tax liabilities	171	193
Total current liabilities	346,191	324,860

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Long-term liabilities:		
Long-term bank loan	-	608
Advances payable	347	339
Total liabilities	\$ 346,538	\$ 325,807

Commitments and Contingencies (See Note 29)

Stockholders' equity:

Common stock, \$0.0001 par value - Authorized - 80,000,000 shares; Issued – 32,338,302 and 32,338,302 shares as of June 30, 2017 and December 31, 2016, respectively	\$ 3	\$ 3	
Additional paid-in capital	64,306	64,764	
Retained earnings-			
Appropriated	10,673	10,549	
Unappropriated	243,474	228,963	
Accumulated other comprehensive income/(loss)	6,235	(892	)
Treasury stock – 694,298 and 694,298 shares as of June 30, 2017 and December 31, 2016, respectively	(2,907	)	(2,907 )
Total parent company stockholders' equity	321,784	300,480	
Non-controlling interests	5,762	5,412	
Total stockholders' equity	327,546	305,892	
Total liabilities and stockholders' equity	\$ 674,084	\$ 631,699	

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

**China Automotive Systems, Inc. and Subsidiaries****Condensed Unaudited Consolidated Statements of Cash Flows****(In thousands of USD unless otherwise indicated)**

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Cash flows from operating activities:		
Net income	\$ 14,819	\$ 11,060
Adjustments to reconcile net income from operations to net cash provided by operating activities:		
Depreciation and amortization	7,809	7,351
Increase in/(reversal of) provision for doubtful accounts	1,008	(49 )
Inventory write downs	2,101	1,902
Deferred income taxes	971	(27 )
Equity in earnings of affiliated companies	11	(257 )
Gain on disposal of Fujian Qiaolong	-	(698 )
Gain on fixed assets disposals	(2,202 )	(14 )
Changes in operating assets and liabilities		
(Increase) decrease in:		
Pledged cash	(2,881 )	6,528
Accounts and notes receivable	6,570	(50,973 )
Advance payments and others	1,241	(1,437 )
Inventories	2,104	(5,956 )
Increase (decrease) in:		
Accounts and notes payable	(2,932 )	25,885
Customer deposits	(7 )	(908 )
Accrued payroll and related costs	(2 )	152
Accrued expenses and other payables	(3,028 )	456
Accrued pension costs	(307 )	407
Taxes payable	(6,069 )	276
Advance payable	-	(75 )
Net cash provided by/(used in) operating activities	19,206	(6,377 )
Cash flows from investing activities:		
Increase in other receivables	137	1,438
Proceeds from disposition of a subsidiary, net of cash disposed of \$1,063	-	1,953
Cash received from property, plant and equipment sales	2,334	719
Payments to acquire property, plant and equipment (including \$3,497 and \$4,603 paid to related parties for the six months ended June 30, 2017 and 2016, respectively)	(10,178 )	(18,454 )
Payments to acquire intangible assets	-	(60 )
Purchase of short-term investments	(8,069 )	(14,797 )
Purchase of long-term time deposit	(5,836 )	-
Proceeds from maturities of short-term investments	11,923	1,827

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Investment under equity method	(730	)	(3,013	)
Loan to a related party	(29,044	)	-	
Net cash used in investing activities	(39,463	)	(30,387	)
Cash flows from financing activities:				
Proceeds from bank and government loans	59,088		11,541	
Repayments of bank and government loans	(34,128	)	(5,138	)
Repurchases of common stock	-		(454	)
Net cash provided by financing activities	24,960		5,949	
Effects of exchange rate on cash and cash equivalents	678		(997	)
Net increase/(decrease) in cash and cash equivalents	5,381		(31,812	)
Cash and cash equivalents at beginning of period	31,092		69,676	
Cash and cash equivalents at end of period	\$ 36,473		\$ 37,864	

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

**China Automotive Systems, Inc. and Subsidiaries**

**Condensed Unaudited Consolidated Statements of Cash Flows (continued)**

*(In thousands of USD unless otherwise indicated)*

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:**

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Cash paid for interest	\$ 354	\$ 180
Cash paid for income taxes	4,172	1,253

**SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:**

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Property, plant and equipment recorded during the period for which there previously were advance payments	\$ 10,310	\$ 7,580
Accounts payable for acquiring property, plant and equipment	709	845
Dividends payable to non-controlling interests	608	464

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

**China Automotive Systems, Inc. and Subsidiaries****Notes to Condensed Unaudited Consolidated Financial Statements****Three Months and Six Months Ended June 30, 2017 and 2016****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 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 in Hong Kong 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 the following Sino-foreign joint ventures, wholly-owned subsidiaries and joint ventures organized in the People's Republic of China, the “PRC,” and Brazil as of June 30, 2017 and December 31, 2016.

Name of Entity	Percentage Interest			
	June 30, 2017		December 31, 2016	
Shashi Jiulong Power Steering Gears Co., Ltd., “Jiulong <sup>¶</sup> ”	100.00	%	100.00	%
Jingzhou Henglong Automotive Parts Co., Ltd., “Henglong <sup>¶</sup> ”	100.00	%	100.00	%
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., “Shenyang <sup>¶</sup> ”	70.00	%	70.00	%
Universal Sensor Application Inc., “USAF <sup>¶</sup> ”	83.34	%	83.34	%
Wuhan Jielong Electric Power Steering Co., Ltd., “Jielong <sup>¶</sup> ”	85.00	%	85.00	%
Wuhu Henglong Automotive Steering System Co., Ltd., “Wuhu <sup>¶</sup> ”	77.33	%	77.33	%
Hubei Henglong Automotive System Group Co., Ltd, “Hubei Henglong <sup>¶</sup> ”	100.00	%	100.00	%
Jingzhou Henglong Automotive Technology (Testing) Center, “Testing Center <sup>¶</sup> ”	100.00	%	100.00	%

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Beijing Hainachun Henglong Automotive Steering System Co., Ltd., “Beijing Henglong” <sup>9</sup>	50.00	%	50.00	%
Chongqing Henglong Hongyan Automotive System Co., Ltd., “Chongqing Henglong” <sup>10</sup>	70.00	%	70.00	%
CAAS Brazil’s Imports and Trade In Automotive Parts Ltd., “Brazil Henglong” <sup>11</sup>	95.84	%	80.00	%
Fujian Qiaolong Special Purpose Vehicle Co., Ltd., “Fujian Qiaolong” <sup>12</sup>	0.00	%	0.00	%
Wuhan Chuguanjie Automotive Science and Technology Ltd., “Wuhan Chuguanjie” <sup>13</sup>	85.00	%	85.00	%
Hubei Henglong Group Shanghai Automotive Electronics Research and Development Ltd., “Shanghai Henglong” <sup>14</sup>	100.00	%	100.00	%

<sup>1</sup> Jiulong was established in 1993 and mainly engages in the production of integral power steering gears for heavy-duty vehicles.



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

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

4. USAI was established in 2005 and mainly engages in the production and sales of sensor modules.

5. Jielong was established in 2006 and mainly engages in the production and sales of automotive steering columns.

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

7. On March 7, 2007, Genesis established Hubei Henglong, formerly known as Jingzhou Hengsheng Automotive System Co., Ltd., its wholly-owned subsidiary, to engage in the production and sales of automotive steering systems. On July 8, 2012, Hubei Henglong changed its name to Hubei Henglong Automotive System Group Co., Ltd.

8. In December 2009, Henglong, a subsidiary of Genesis, formed the Testing Center, which mainly engages in the research and development of new products.

9. Beijing Henglong was established in 2010 and mainly engages in the design, development and manufacture of both hydraulic and electric power steering systems and parts. According to the joint venture agreement, the Company does not have voting control of Beijing Henglong. Therefore, the Company's consolidated financial statements do not include Beijing Henglong, and such investment is accounted for using the equity accounting method.

10. On February 21, 2012, Hubei Henglong and SAIC-IVECO Hongyan Company, "SAIC-IVECO," established a Sino-foreign joint venture company, Chongqing Henglong, to design, develop and manufacture both hydraulic and electric power steering systems and parts.

11. On August 21, 2012, Brazil Henglong was established as a Sino-foreign joint venture company by Hubei Henglong and two Brazilian citizens, Ozias Gaia Da Silva and Ademir Dal' Evedove. Brazil Henglong engages mainly in the import and sales of automotive parts in Brazil. In May 2017, the Company obtained an additional 15.84% equity interest in Brazil Henglong for nil consideration. The Company retained its controlling interest in Brazil Henglong and the acquisition of the non-controlling interest was accounted for as an equity transaction.

12. In the second quarter of 2014, the Company acquired a 51.0% ownership interest in Fujian Qiaolong Special Purpose Vehicle Co., Ltd., "Fujian Qiaolong", a special purpose vehicle manufacturer and dealer with automobile repacking qualifications, based in Fujian, China. Fujian Qiaolong mainly manufactures and distributes drainage and rescue vehicles with mass flow, drainage vehicles with vertical downhole operation, crawler-type mobile pump stations, high-altitude water supply and discharge drainage vehicles, long-range control crawler-type mobile pump stations and other vehicles. On April 17, 2016, Hubei Henglong entered into a share purchase agreement, the "Share Purchase Agreement", with Longyan Huanyu Emergency Equipment Technology Co., Ltd., "Longyan Huanyu". Pursuant to the Share Purchase Agreement, Hubei Henglong transferred its 51% equity interests in Fujian Qiaolong to Longyan Huanyu for total consideration of RMB 20.0 million, equivalent to \$3.0 million, in the second quarter of 2016. The Company recognized a gain on disposal of Fujian Qiaolong of \$0.7 million, which is included in other income in the consolidated statement of operations and comprehensive income for the year ended December 31, 2016.

13. In May 2014, together with Hubei Wanlong, Jielong formed a subsidiary, Wuhan Chuguanjie Automotive Science and Technology Ltd., "Wuhan Chuguanjie", which mainly engages in research and development, manufacture and sales of automobile electronic systems and parts. Wuhan Chuguanjie is located in Wuhan, China.

14. In January 2015, Hubei Henglong formed Hubei Henglong Group Shanghai Automotive Electronics Research and Development Ltd., "Shanghai Henglong", which mainly engages in the design and sales of automotive electronics.

## **2. Basis of presentation and significant accounting policies**

### *(a) Basis of Presentation*

Basis of Presentation – The accompanying condensed unaudited consolidated financial statements include the accounts of the Company and its subsidiaries. The details of subsidiaries are disclosed in Note 1. Significant inter-company balances and transactions have been eliminated upon consolidation. The condensed unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) for interim financial information and with the instructions in Article 10 of Regulation S-X. Accordingly they do not include all of the information and footnotes required by such accounting principles for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016.

The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of the Company’s management, contain all necessary adjustments, which include normal recurring adjustments, for a fair statement of the results of operations, financial position and cash flows for the interim periods presented.

The condensed consolidated balance sheet as of December 31, 2016 is derived from the Company’s audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with U.S. GAAP 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 herein not misleading. For further information, please refer to the financial statements and the notes thereto included in the Company’s 2016 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

The results of operations for the three months and six months ended June 30, 2017 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2017.

Estimation - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and

liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Foreign Currencies - China Automotive, the parent company, and HLUSA maintain their books and records in United States Dollars, “USD,” their functional currency. The Company’s subsidiaries based in the PRC and Genesis maintain their books and records in Renminbi, “RMB,” their functional currency. The Company’s subsidiary based in Brazil maintains its books and records in Brazilian reais, “BRL,” its functional currency. In accordance with ASC Topic 830, “FASB Accounting Standards Codification”, foreign currency transactions denominated in currencies other than the functional currency are remeasured into the functional currency at the rate of exchange prevailing at the balance sheet date for monetary items. Nonmonetary items are remeasured at historical rates. Income and expenses are remeasured 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.

*(b) Recent Accounting Pronouncements*

In January 2017, the FASB issued ASU 2017-04: Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. To simplify the subsequent measurement of goodwill, the Board eliminated Step 2 from the goodwill impairment test. Under the amendments in this Update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity should apply the amendments in this Update on a prospective basis. An entity is required to disclose the nature of and reason for the change in accounting principle upon transition. A public business entity that is a U.S. Securities and Exchange Commission (SEC) filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In February 2017, the FASB issued ASU 2017-05: Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. ASU 2017-05 is designed to provide guidance on how to recognize gain and losses on sales, including partial sales, of nonfinancial assets to noncustomers. ASU 2017-05 is effective beginning January 1, 2018. Early adoption is permitted but the standard is required to be adopted concurrently with ASU 2014-09. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In May 2017, the FASB issued guidance within ASU 2017-09: Scope of Modification Accounting. The amendments in ASU 2017-09 to Topic 718, Compensation - Stock Compensation, provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. An entity should account for the effects of a modification unless all of the following conditions are met: the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The amendments should be applied prospectively to an award modified on or after the adoption date. The amendments are effective for annual periods, and interim periods within those annual periods, beginning after December 31, 2017. Early adoption is permitted, including adoption in any interim period. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

*(c) Significant Accounting Policies*

There have been no updates to the significant accounting policies set forth in the notes to the consolidated financial statements for the year ended December 31, 2016.

**3.Short-term investments**

Short-term investments comprise time deposits with terms of three months or more which are due within one year. The carrying values of time deposits approximate fair value because of their short maturities. The interest earned is recognized in the consolidated statements of income over the contractual term of the deposits.

As of June 30, 2017, the Company had pledged short-term investments of RMB 43.9 million, equivalent to approximately \$6.5 million, to secure standby letters of credit under HSBC Bank and China CITIC Bank (Note 13). The use of the pledged short-term investments is restricted.

**4.Accounts and notes receivable, net**

The Company's accounts and notes receivable as of June 30, 2017 and December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Accounts receivable - unrelated parties	\$ 147,556	\$ 154,403
Notes receivable - unrelated parties <sup>(1) (2)</sup>	142,572	132,409
Total accounts and notes receivable- unrelated parties	290,128	286,812
Less: allowance for doubtful accounts - unrelated parties	(1,143 )	(1,081 )
Accounts and notes receivable, net - unrelated parties	288,985	285,731
Accounts and notes receivable, net - related parties	18,459	20,984
Accounts and notes receivable, net	\$ 307,444	\$ 306,715

(1) Notes receivable represent accounts receivable in the form of bills of exchange for which acceptances are guaranteed and settlements are handled by banks.

As of June 30, 2017, the Company collateralized its notes receivable in an amount of RMB 247.5 million, equivalent to approximately \$36.5 million, as security for the credit facilities with banks in China and the Chinese government, including RMB 158.5 million, equivalent to approximately \$23.4 million, in favor of Industrial and Commercial Bank of China, Jingzhou Branch, “ICBC Jingzhou”, for the purpose of obtaining the Henglong Standby Letter of Credit (as defined in Note 13), which is used as security for the non-revolving credit facility in the amount of \$23.4 million provided by Industrial and Commercial Bank of China (Macau) Limited, “ICBC Macau”, RMB 10.0 million, equivalent to approximately \$1.5 million, as security in favor of the Chinese government for the low interest government loan (See Note 13), and RMB 79.0 million, equivalent to approximately \$11.7 million, in favor of China CITIC Bank, Wuhan Branch, “CITIC Wuhan”, for the purpose of obtaining the Henglong Standby Letter of Credit (as defined in Note 13), which was used to obtain the facility of Taishin Bank in the amount of \$10.0 million (See Note 13).

As of December 31, 2016, the Company collateralized its notes receivable in an amount of RMB 249.9 million, equivalent to approximately \$36.0 million, as security for the credit facilities with banks in China and the Chinese government, including RMB 224.6 million, equivalent to approximately \$32.4 million, in favor of Industrial and Commercial Bank of China, Jingzhou Branch, “ICBC Jingzhou”, for the purpose of obtaining the Henglong Standby Letter of Credit (as defined in Note 13), which is used as security for the non-revolving credit facility in the amount of \$30.0 million provided by Industrial and Commercial Bank of China (Macau) Limited, “ICBC Macau”, and RMB 25.2 million, equivalent to approximately \$3.6 million, as security in favor of the Chinese government for the low-interest government loan (See Note 13).

## 5. Advance payments and others

The Company’s advance payments and others as of June 30, 2017 and December 31, 2016 consisted of the following:

	June 30, 2017	December 31, 2016
Advance payments and others - unrelated parties	\$ 8,523	\$ 10,203
Less: allowance for doubtful accounts – unrelated parties	(1,050 )	-
Advance payments and others, net – unrelated parties	7,473	10,203
Advance payments and others - related parties <sup>(1)</sup>	30,558	624
Total advance payments and others	38,031	10,827

On March 16, 2017, in order to generate higher returns for the Company’s idle cash, one of the Company’s subsidiaries, Hubei Henglong, lent RMB 200.0 million (equivalent to \$28.8 million) to Henglong Real Estate, one of the Company’s related parties, through an independent financial institution by way of an entrusted loan. The term of the loan is one year and the annual interest rate is 6.35%.

<sup>(2)</sup> Provision for the doubtful accounts amounted to \$1.1 million and nil for the six months ended June 30, 2017 and 2016, respectively.





**6. Inventories**

The Company's inventories as of June 30, 2017 and December 31, 2016 consisted of the following (figures are in thousands of USD):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Raw materials	\$ 16,069	\$ 15,007
Work in process	13,299	10,852
Finished goods	36,102	42,191
Total	\$ 65,470	\$ 68,050

Provision for inventories amounted to \$2.1 million and \$1.9 million for the six months ended June 30, 2017 and 2016, respectively.

**7. Other receivables, net**

The Company's other receivables as of June 30, 2017 and December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Other receivables - unrelated parties <sup>(1)</sup>	\$ 889	\$ 738
Other receivables - employee housing loans <sup>(2)</sup>	1,388	1,577
Less: allowance for doubtful accounts - unrelated parties	(65)	(63)
Other receivables, net - unrelated parties	\$ 2,212	\$ 2,252

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Other receivables - related parties <sup>(1)</sup>	\$ 565	\$ 559
Less: allowance for doubtful accounts - related parties	(565)	(559)
Other receivables, net - related parties	\$ -	\$ -

Other receivables consist of amounts advanced to both related and unrelated parties, primarily as unsecured (1) demand loans. These receivables originate as part of the Company's normal operating activities and are periodically settled in cash.

(2) On May 28, 2014, the board of directors of the Company approved a loan program under which the Company will lend an aggregate of up to RMB 50.0 million, equivalent to approximately \$7.4 million, to the employees of the Company to assist them in purchasing houses. Employees are required to pay interest at an annual rate of 3.8%.

These loans are unsecured and the term of the loans is generally five years.

#### **8. Long-term time deposits**

Long-term time deposits are time deposits with maturities of longer than one year. Time deposits with original maturities of longer than one year but due within the next 12 months are included in short-term investments. As of June 30, 2017 and December 31, 2016, short-term investments include \$4.8 million and \$4.8 million, respectively, of time deposits with original maturities of longer than one year but due within the next 12 months.

As of June 30, 2017 and December 31, 2016, the Company had pledged long-term time deposits of RMB 6.0 million (equivalent to approximately \$0.9 million) to secure loans under the credit facility issued by ICBC Brazil. The use of the pledged long-term time deposits is restricted (See Note 13).

## **9. Long-term investments**

On January 24, 2010, the Company invested \$3.1 million to establish a joint venture company, Beijing Henglong, with Hainachuan. The Company owns 50% of the equity in Beijing Henglong and can exercise significant influence over Beijing Henglong's operating and financial policies. The Company accounted for Beijing Henglong's operational results using the equity method. As of June 30, 2017 and December 31, 2016, the Company had \$4.0 million and \$3.8 million, respectively, of net equity in Beijing Henglong.

On September 22, 2014, Hubei Henglong entered into an agreement with other parties to establish a venture capital fund, the "Suzhou Venture Fund", which mainly focuses on investments in emerging automobiles and parts industries. Hubei Henglong has committed to make investments of RMB 50.0 million, equivalent to approximately \$7.2 million, in the Suzhou Venture Fund in three installments. As of June 30, 2017, Hubei Henglong has completed a capital contribution of RMB 40.0 million, equivalent to approximately \$5.9 million, representing 11.8% of the Suzhou Venture Fund's shares. As a limited partner, Hubei Henglong has more than virtually no influence over the Suzhou Venture Fund's operating and financial policies. The investment is accounted for using the equity method. As of June 30, 2017 and December 31, 2016, the Company had \$6.0 million and \$5.3 million, respectively, of net equity in the Suzhou Venture Fund.

In May 2016, Hubei Henglong entered into an agreement with other parties to establish a venture capital fund, the "Chongqing Venture Fund". Hubei Henglong has committed to make investments of RMB 120.0 million, equivalent to approximately \$18.0 million, in the Chongqing Venture Fund in three installments. As of June 30, 2017, Hubei Henglong has completed a capital contribution of RMB 48.0 million, equivalent to approximately \$7.1 million, representing 23.5% of the Chongqing Venture Fund's shares. As a limited partner, Hubei Henglong has more than virtually no influence over the Chongqing Venture Fund's operating and financial policies. The investment is accounted for using the equity method. As of June 30, 2017 and December 31, 2016, the Company had \$6.9 million and \$6.8 million, respectively, of net equity in the Chongqing Venture Fund.

In October 2016, Hubei Henglong invested RMB 3.0 million, equivalent to approximately \$0.4 million, to establish a joint venture company, Chongqing Jinghua Automotive Intelligent Manufacturing Technology Research Co., Ltd., "Chongqing Jinghua", with five other parties. The Company owns 30% of the equity in Chongqing Jinghua, and can exercise significant influence over Chongqing Jinghua's operating and financial policies. The Company accounts for Chongqing Jinghua's operational results with the equity method. As of June 30, 2017, the Company had \$0.3 million of net equity in Chongqing Jinghua.



The Company's consolidated financial statements reflect the net loss of non-consolidated affiliates of \$0.01 million and net income of non-consolidated affiliates of \$0.3 million for the six months ended June 30, 2017 and 2016, respectively.

## 10. Property, plant and equipment, net

The Company's property, plant and equipment as of June 30, 2017 and December 31, 2016 are summarized as follows (figures are in thousands of USD):

	June 30, 2017	December 31, 2016
Land use rights and buildings	\$ 48,256	\$ 47,448
Machinery and equipment	144,148	134,361
Electronic equipment	5,438	4,979
Motor vehicles	4,542	4,395
Construction in progress	30,763	24,890
Total amount of property, plant and equipment	233,147	216,073
Less: Accumulated depreciation <sup>(1)</sup>	(124,501 )	(114,595 )
Total amount of property, plant and equipment, net <sup>(2)(3)</sup>	\$ 108,646	\$ 101,478

As of June 30, 2017 and December 31, 2016, the Company pledged property, plant and equipment with a net book value of approximately \$27.0 million and \$28.5 million, respectively as security for its comprehensive credit facilities with banks in China.

(2) Depreciation charges were \$3.6 million and \$3.5 million for the three months ended June 30, 2017 and 2016, respectively, and \$7.7 million and \$7.1 million for the six months ended June 30, 2017 and 2016, respectively.

Interest costs capitalized for the three months ended June 30, 2017 and 2016, were \$0.2 million and \$0.1 million, respectively, and \$0.3 million and \$0.2 million were capitalized for the six months ended June 30, 2017 and 2016, respectively.

## 11. Intangible assets

The Company's intangible assets as of June 30, 2017 and December 31, 2016 are summarized as follows (figures are in thousands of USD):

	June 30, 2017	December 31, 2016
Costs:		
Patent technology	\$ 2,034	\$ 1,986
Management software license	1,194	1,165

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Total intangible assets	3,228		3,151	
Less: Amortization <sup>(1)</sup>	(2,684	)	(2,534	)
Total intangible assets, net	\$ 544		\$ 617	

(1) Amortization expenses were \$0.1 million and \$0.1 million for the three months ended June 30, 2017 and 2016, respectively, and \$0.1 million and \$0.2 million for the six months ended June 30, 2017 and 2016, respectively.

**12. Deferred income tax assets**

In accordance with the provisions of *ASC Topic 740, "Income Taxes"*, 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 by tax authorities; 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 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 as of June 30, 2017 and December 31, 2016 are as follows (figures are in thousands of USD):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Losses carry forward (U.S.) <sup>(1)</sup>	\$ 6,188	\$ 6,216
Losses carry forward (Non-U.S.) <sup>(1)</sup>	2,367	2,887
Product warranties and other reserves	4,646	4,766
Property, plant and equipment	4,453	4,204
Share-based compensation	247	247
Bonus accrual	187	231
Other accruals	1,432	1,551
Deductible temporary difference related to revenue recognition	96	191
Others	1,291	1,206
Total deferred tax assets, net	20,907	21,499
Less: Valuation allowance	(9,014)	(8,912)
Total deferred tax assets, net of valuation allowance <sup>(2)</sup>	\$ 11,893	\$ 12,587

The net operating losses carry forward for the U.S. entities for income tax purposes are available to reduce future years' taxable income. These carry forward losses will expire, if not utilized, at various times over the next 20 years. Net operating losses carry forward for China entities can be carried forward for 5 years to offset taxable income. However, as of June 30, 2017, the valuation allowance was \$9.0 million, including \$6.4 million allowance (1) for the Company's deferred tax assets in the United States and \$2.6 million allowance for the Company's non-U.S. deferred tax assets. Based on the Company's current operations in the United States, management believes that the deferred tax assets in the United States are not likely to be realized in the future. For the deferred tax assets in other countries, pursuant to certain tax laws and regulations, management believes such amount will not be used to offset future taxable income.

Approximately \$4.2 million and \$4.6 million of net deferred income tax assets as of June 30, 2017 and December 31, 2016, respectively, are included in non-current deferred tax assets in the accompanying condensed unaudited consolidated balance sheets. The remaining \$7.7 million and \$6.6 million of net deferred income tax assets as of June 30, 2017 and December 31, 2016, respectively, are included in current deferred tax assets.



**13. Bank and government loans**

Loans consist of the following as of June 30, 2017 and December 31, 2016 (figures are in thousands of USD):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Short-term bank loans <sup>(1)</sup>	\$ 2,214	\$ 2,162
Short-term bank loans <sup>(2) (3) (4) (5)</sup>	35,478	35,054
Short-term bank loans <sup>(6)</sup>	28,211	-
Short-term government loan <sup>(7)</sup>	1,476	3,604
Bank and government loans	\$ 67,379	\$ 40,820

(1) These loans are secured by property, plant and equipment of the Company and are repayable within one year (See Note 10). As of June 30, 2017 and December 31, 2016, the weighted average interest rate was 5.2% and 5.2% per annum, respectively. Interest is to be paid monthly or quarterly on the twentieth day of the applicable month or quarter and the principal repayment is at maturity.

(2) On May 18, 2012, the Company entered into a credit facility agreement, the “Credit Agreement,” with ICBC Macau to obtain a non-revolving credit facility in the amount of \$30.0 million, the “Credit Facility”. The Credit Facility would have expired on November 3, 2012 unless the Company drew down the line of credit in full prior to such expiration date, and the maturity date for the loan drawdown was the earlier of (i) 18 months from the drawdown or (ii) one month before the expiry of the standby letter of credit obtained by Henglong from ICBC Jingzhou as security for the Credit Facility, the “Henglong Standby Letter of Credit”. The interest rate of the Credit Facility is calculated based on a three-month LIBOR plus 2.25% per annum, subject to the availability of funds and fluctuation at ICBC Macau’s discretion. The interest is calculated daily based on a 360-day year and it is fixed one day before the first day of each interest period. The interest period is defined as three months from the date of drawdown. As security for the Credit Facility, the Company was required to provide ICBC Macau with the Henglong Standby Letter of Credit for a total amount of not less than \$31.6 million if the Credit Facility is fully drawn.

On May 22, 2012, the Company drew down the full amount of \$30.0 million under the Credit Facility and provided the Henglong Standby Letter of Credit for an amount of \$31.6 million in favor of ICBC Macau. The Henglong Standby Letter of Credit issued by ICBC Jingzhou is collateralized by Henglong’s notes receivable of RMB 207.1 million, equivalent to approximately \$32.6 million. The Company also paid an arrangement fee of \$0.1 million to ICBC Macau and \$0.1 million to ICBC Jingzhou. The original maturity date of the Credit Facility was May 22, 2013 and was extended to May 12, 2017. The interest rate of the Credit Facility under the extended term is three-month LIBOR plus 0.7% per annum. Except for the above, all other terms and conditions as stipulated in the Credit Agreement remained unchanged. As of December 31, 2016, the interest rate of the Credit Facility was 1.7% per annum.

On April 20, 2017, the Company entered into a credit facility agreement, the “Credit Agreement,” with ICBC Macau to obtain a non-revolving credit facility in the amount of \$20.0 million, the “Credit Facility”. The Credit Facility will expire on May 12, 2018 unless the Company draws down the line of credit in full prior to such expiration date, and the maturity date for the loan drawdown is the earlier of (i) 12 months from the date of drawdown or (ii) one month before the expiry of the standby letter of credit obtained by Henglong from ICBC Jingzhou as security for the Credit Facility, the “Henglong Standby Letter of Credit”. The interest rate of the Credit Facility is calculated based on a three-month LIBOR plus 1.30% per annum, subject to the availability of funds and fluctuation at ICBC Macau’s discretion. Interest is calculated daily based on a 360-day year and it is fixed one day before the first day of each interest period. The interest period is defined as three months from the date of drawdown. As security for the Credit Facility, the Company was required to provide ICBC Macau with the Henglong Standby Letter of Credit for a total amount of not less than \$23.4 million if the Credit Facility is fully drawn.

On May 5, 2017, the Company drew down the full amount of \$20.0 million under the Credit Facility and provided the Henglong Standby Letter of Credit for an amount of \$23.4 million in favor of ICBC Macau. The Henglong Standby Letter of Credit issued by ICBC Jingzhou is collateralized by Henglong's notes receivable of RMB 158.5 million, equivalent to approximately \$23.4 million. The Company also paid an arrangement fee of \$0.04 million to ICBC Jingzhou. The maturity date of the Credit Facility is May 12, 2018.

On April 25, 2017, Great Genesis entered into a credit facility agreement, the "Taishin Bank Credit Facility", with Taishin Bank to obtain a non-revolving credit facility in the amount of \$10.0 million. The Taishin Bank Credit Facility will expire on April 25, 2018 and has an annual interest rate of 2.7%. Interest is paid quarterly and the principal repayment is payable at maturity. As security for the Taishin Bank Credit Facility, the Company's subsidiary Henglong was required to provide Taishin Bank with the Standby Letter of Credit for a total amount of (3) not less than \$10.0 million if the Taishin Bank Credit Facility is fully drawn. On April 28, 2017, Great Genesis drew down the full amount of \$9.9 million under the Taishin Bank Credit Facility and provided the Henglong Standby Letter of Credit for an amount of \$10.0 million in favor of Taishin Bank. Henglong's Standby Letter of Credit issued by China CITIC Bank Wuchang branch is collateralized by Henglong's short-term investments of RMB 4.0 million, equivalent to approximately \$0.6 million, and notes receivable of RMB 79.0 million, equivalent to approximately \$11.7 million.

On July 16, 2014, Great Genesis entered into a credit facility agreement with HSBC HK to obtain a non-revolving credit facility in the amount of \$5.0 million, the "HSBC Credit Facility". The HSBC Credit Facility expired on July (4) 1, 2015 and had an annual interest rate of 1.7%. Interest was paid on the twentieth day of each month and the principal repayment was at maturity. As security for the HSBC Credit Facility, the Company's subsidiary Hubei Henglong was required to provide HSBC HK with the Standby Letter of Credit for a total amount of not less than \$5.4 million if the HSBC Credit Facility was fully drawn.

On July 22, 2014, Great Genesis drew down a loan amounting to \$5.0 million provided by HSBC HK and Hubei Henglong provided a Standby Letter of Credit for an amount of \$5.4 million in favor of HSBC HK. Hubei Henglong's Standby Letter of Credit was issued by HSBC Bank (China) Company Limited Wuhan branch and is collateralized by long-term time deposits of Hubei Henglong of RMB 33.0 million, equivalent to approximately \$4.8 million.

On July 7, 2016, HSBC HK agreed to extend the maturity date of the HSBC Credit Facility to July 1, 2017. Hubei Henglong provided a Standby Letter of Credit in an amount of \$5.1 million in favor of HSBC HK. The Standby Letter of Credit was issued by HSBC Bank (China) Company Limited Wuhan branch and was collateralized by short-term time deposits of Hubei Henglong of RMB 36.0 million, equivalent to approximately \$5.2 million. The interest rate of the HSBC Credit Facility under the extended term was revised as three-month LIBOR plus 0.8% per annum, i.e. 1.95% per annum. Except for the above, all other terms and conditions as stipulated in the Credit Agreement remained unchanged.

(5)

On April 1, 2016, Brazil Henglong entered into a credit facility agreement with HSBC Brazil to obtain a credit facility in the amount of \$0.1 million, the “HSBC Brazil Credit Facility”. The HSBC Brazil Credit Facility will expire on October 27, 2017. As security for the HSBC Credit Facility, the Company’s subsidiary Hubei Henglong was required to provide HSBC Brazil with the Standby Letter of Credit for a total amount of \$0.1 million if the HSBC Brazil Credit Facility is fully drawn.

On May 6, 2016, Brazil Henglong drew down a loan amounting to \$0.1 million provided by HSBC Brazil. The loan will mature on October 9, 2017 and has an annual interest rate of 8.2%. The principal and interest are paid each month. Hubei Henglong provided a Standby Letter of Credit for an amount of \$0.1 million in favor of HSBC Brazil. Hubei Henglong’s Standby Letter of Credit was issued by China CITIC Bank Wuhan branch and is collateralized by short-term investments of Hubei Henglong of RMB 0.5 million, equivalent to approximately \$0.1 million.

On August 26, 2016, Brazil Henglong entered into a credit facility agreement with Bank of China (Brazil) to obtain a credit facility in the amount of \$0.6 million, the “Bank of China Credit Facility”. The Bank of China Credit Facility will expire on January 15, 2018. As security for the Bank of China Credit Facility, the Company’s subsidiary Hubei Henglong was required to provide Bank of China (Brazil) with a Standby Letter of Credit for a total amount of \$0.9 million if the Bank of China Credit Facility is fully drawn.

On August 26, 2016, Brazil Henglong drew down a loan amounting to \$0.6 million provided by Bank of China (Brazil). The loan will mature on January 15, 2018 and has an annual interest rate of 3.9%. Interest is paid semiannually and the principal repayment is at maturity. Hubei Henglong provided a Standby Letter of Credit for an amount of \$0.9 million in favor of Bank of China (Brazil). Hubei Henglong’s Standby Letter of Credit was issued by Bank of China Jingzhou branch and is collateralized by long-term time deposits of Hubei Henglong of RMB 6.0 million, equivalent to approximately \$0.9 million.

On September 26, 2016, Henglong entered into a credit facility agreement with China CITIC Bank to obtain credit facilities in the amount of \$25.5 million, the “Henglong CITIC Credit Facility”. The Henglong CITIC Credit Facility will expire on September 26, 2017. As security for the Henglong CITIC Credit Facility, Henglong’s property, plant and equipment were pledged and Hubei Henglong provided a guarantee. On March 3, 2017, Henglong drew down loans amounting to \$4.7 million, \$4.7 million and \$4.4 million, respectively. The loans will mature on February 5, 6 and 7, 2018, respectively. The annual interest rate of the loans is 4.99%. The principal and interest will be paid at maturity.

On September 26, 2016, Hubei Henglong entered into a credit facility agreement with China CITIC Bank to obtain credit facilities in the amount of \$15.0 million, the “Hubei Henglong CITIC Credit Facility”. The Hubei Henglong CITIC Credit Facility will expire on September 26, 2017. Henglong provided a guarantee for the Hubei Henglong CITIC Credit Facility. On March 3, 2017, Hubei Henglong drew down loans amounting to \$4.2 million, \$ 4.2 million and \$5.5 million, respectively. The loans will mature on February 2, 8 and 9, 2018, respectively. The annual interest rate of the loans is 5.0%. The principal and interest will be paid at maturity.

On April 21, 2017, the Company received an interest-free Chinese government loan of RMB 10.0 million, equivalent to approximately \$1.5 million, which will mature on December 8, 2017. Jiulong pledged RMB 10.0 million, equivalent to approximately \$1.5 million, of notes receivable as security for the Chinese government loan (See Note 4).

#### **14. Accounts and notes payable**

The Company’s accounts and notes payable as of June 30, 2017 and December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Accounts payable - unrelated parties	\$ 134,325	\$ 138,053
Notes payable - unrelated parties <sup>(1)</sup>	87,046	78,940
Accounts and notes payable - unrelated parties	221,371	216,993
Accounts payable - related parties	4,814	6,803
Balance at end of period	\$ 226,185	\$ 223,796

Notes payable represent accounts payable in the form of notes issued by the Company. The notes are endorsed by (1) banks to ensure that noteholders will be paid after maturity. The Company has pledged cash deposits, short-term investments, notes receivable and certain property, plant and equipment to secure notes payable granted by banks.

**15. Accrued expenses and other payables**

The Company's accrued expenses and other payables as of June 30, 2017 and December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Accrued expenses	\$ 7,520	\$ 8,605
Accrued interest	577	88
Dividends payable to holders of non-controlling interests <sup>(3)</sup>	608	-
Other payables	1,995	964
Warranty reserves <sup>(1) (2)</sup>	23,898	26,225
Total	\$ 34,598	\$ 35,882

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

In January 2017, the Company initiated two recalls related to the Company's products. The Company has accrued anticipated costs for handling the recalls amounting to \$5.0 million in warranty reserves for the year ended December 31, 2016.

In accordance with the resolution of the Board of Directors of Shenyang, in the second quarter of 2017, Shenyang declared a dividend amounting to \$2.0 million to its shareholders, of which \$0.6 million was payable to the holders of the non-controlling interests. As of June 30, 2017, the dividends have not been paid.

For the three months ended June 30, 2017 and 2016, the warranties activities were as follows (figures are in thousands of USD):

	<b>Three Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Balance at beginning of the period	\$ 25,738	\$ 23,187
Additions during the period	3,680	1,945
Settlement within period, by cash or actual materials	(5,189 )	(4,505 )
Foreign currency translation (gain)/loss	(331 )	611
Balance at end of the period	\$ 23,898	\$ 21,238

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For the six months ended June 30, 2017 and 2016, and for the year ended December 31, 2016, the warranties activities were as follows (figures are in thousands of USD):

	<b>Six Months Ended June 30,</b>		<b>Year Ended</b>
	<b>2017</b>	<b>2016</b>	<b>December 31,</b>
			<b>2016</b>
Balance at beginning of the period	\$ 26,225	\$ 23,059	\$ 23,059
Additions during the period	6,756	3,740	16,522
Settlement within period, by cash or actual materials	(8,608 )	(6,056 )	(11,781 )
Foreign currency translation loss	(475 )	495	(1,575 )
Balance at end of the period	\$ 23,898	\$ 21,238	\$ 26,225



**16. Taxes payable**

The Company's taxes payable as of June 30, 2017 and December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Value-added tax payable	\$ 3,541	\$ 7,662
Income tax payable	1,428	3,390
Other tax payable	428	622
Total	\$ 5,397	\$ 11,674

**17. Advances payable**

As of June 30, 2017 and December 31, 2016, advances payable by the Company were \$0.7 million and \$0.7 million, respectively.

The amounts are special subsidies made by the Chinese government to the Company to offset the costs and charges related to the improvement of production capacities and improvement of the quality of products. For the government subsidies with no further conditions to be met, the amounts are recorded as other income when received; for the amounts with certain operating conditions, the government subsidies are recorded as advances payable when received and will be recorded as a deduction of related expenses and cost when the conditions are met.

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

**18. Additional paid-in capital**

The Company's positions in respect of the amounts of additional paid-in capital for the six months ended June 30, 2017 and 2016, and the year ended December 31, 2016 are summarized as follows (figures are in thousands of USD):

<b>Six Months Ended June 30,</b>	<b>Year Ended</b>
<b>2017</b>	<b>December 31,</b>
<b>2016</b>	<b>2016</b>

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Balance at beginning of the period	\$ 64,764	\$ 64,627	\$ 64,627
Acquisition of the non-controlling interest in Brazil Henglong <sup>(1)</sup>	(458 )	-	-
Share-based compensation <sup>(2)</sup>	-	-	137
Balance at end of the period	\$ 64,306	\$ 64,627	\$ 64,764

In May 2017, the Company obtained an additional 15.84% equity interest in Brazil Henglong for nil consideration. (1) The Company retained its controlling interest in Brazil Henglong and the acquisition of the non-controlling interest was accounted for as an equity transaction.

On December 2, 2016, the Company granted 22,500 stock options to the Company's independent directors, with the exercise price equal to the closing price of the Company's common stock traded on NASDAQ on the date of grant. The fair value of the stock options was determined at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option model requires management to make various estimates and assumptions, (2) including expected term, expected volatility, risk-free rate and dividend yield. The expected term represents the period of time that stock-based compensation awards granted are expected to be outstanding and is estimated based on considerations including the vesting period, contractual term and anticipated employee exercise patterns. Expected volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve in relation to the contractual life of stock-based compensation instruments. The dividend yield assumption is based on historical patterns and future expectations for the Company's dividends.

Assumptions used to estimate the fair value of the stock options on the grant dates are as follows:

Issuance Date	Expected volatility	Risk-free rate	Expected term (years)	Dividend yield
December 2, 2016	134.8	% 1.84	% 5	0.00

The stock options granted during 2016 were exercisable immediately. Their fair value on the grant date using the Black-Scholes option pricing model was \$0.1 million. For the year ended December 31, 2016, the Company recognized stock-based compensation expenses of \$0.1 million.

## 19. Retained earnings

### Appropriated

Pursuant to the relevant PRC laws, the profits distribution of the Company's Sino-foreign subsidiaries, which are based on their PRC statutory financial statements, other than the financial statement that was prepared in accordance with generally accepted accounting principles in the United States of America, are available for distribution in the form of cash dividends after these subsidiaries have paid all relevant PRC tax liabilities, provided for losses in previous years, and made appropriations to statutory surplus at 10%.

When the statutory surplus reserve reaches 50% of the registered capital of a company, additional reserve is no longer required. However, the reserve cannot be distributed to joint venture partners. Based on the business licenses of the PRC subsidiaries, the registered capital of Henglong, Jiulong, Shenyang, USAI, Jielong, Wuhu, Hubei Henglong and Chongqing are \$10.0 million, \$4.2 million (equivalent to RMB 35.0 million), \$8.1 million (equivalent to RMB 67.5 million), \$2.6 million, \$6.0 million, \$3.8 million (equivalent to RMB 30.0 million), \$39.0 million and \$9.5 million (equivalent to RMB 60.0 million), respectively.

The Company's activities in respect of the amounts of appropriated retained earnings for the six months ended June 30, 2017 and 2016, and the year ended December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>Six Months Ended June 30,</b>		<b>Year Ended December 31,</b>
	<b>2017</b>	<b>2016</b>	<b>2016</b>
Balance at beginning of the period	\$ 10,549	\$ 10,379	\$ 10,379
Appropriation of retained earnings	124	142	170
Balance at end of the period	\$ 10,673	\$ 10,521	\$ 10,549

### **Unappropriated**

The Company's activities in respect of the amounts of the unappropriated retained earnings for the six months ended June 30, 2017 and 2016, and the year ended December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>Six Months Ended June 30,</b>		<b>Year Ended December 31,</b>
	<b>2017</b>	<b>2016</b>	<b>2016</b>
Balance at beginning of the period	\$ 228,963	\$ 206,622	\$ 206,622
Net income attributable to parent company	14,635	11,073	22,511
Appropriation of retained earnings	(124 )	(142 )	(170 )
Balance at end of the period	\$ 243,474	\$ 217,553	\$ 228,963

### **20. Accumulated other comprehensive income**

The Company's activities in respect of the amounts of the accumulated other comprehensive income for the six months ended June 30, 2017 and 2016, and the year ended December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>Six Months Ended June 30,</b>		<b>Year Ended December 31,</b>
	<b>2017</b>	<b>2016</b>	<b>2016</b>
Balance at beginning of the period	\$ (892 )	\$ 18,412	\$ 18,412
Other comprehensive income related to the non-controlling interests acquired by the Company	(67 )		

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Foreign currency translation adjustment attributable to parent company	7,194	(6,060	)	(19,304	)
Balance at end of the period	\$ 6,235	\$ 12,352	\$ (892	)	

**21. Treasury stock**

Treasury stock represents shares repurchased by the Company that are no longer outstanding and are held by the Company. Treasury stock is accounted for under the cost method. On December 18, 2015, the Board of Directors of the Company approved a share repurchase program under which the Company was permitted to repurchase up to \$5.0 million of its common stock from time to time in the open market at prevailing market prices or in privately negotiated transactions through December 17, 2016. The repurchase program terminated on December 17, 2016. During the year ended December 31, 2016, under the repurchase program, the Company repurchased 477,015 shares of the Company's common stock for cash consideration of \$1.9 million on the open market. The repurchased shares are presented as "treasury stock" on the balance sheet.

**22. Non-controlling interests**

The Company's activities in respect of the amounts of the non-controlling interests' equity for the six months ended June 30, 2017 and 2016, and the year ended December 31, 2016 are summarized as follows (figures are in thousands of USD):

	<b>Six Months Ended June 30,</b>		<b>Year Ended December 31,</b>
	<b>2017</b>	<b>2016</b>	<b>2016</b>
Balance at beginning of the period	\$ 5,412	\$ 8,252	\$ 8,252
Income/(loss) attributable to non-controlling interests	184	(13)	) 466
Dividends declared to the non-controlling interest holders of joint-venture companies (See Note 15)	(608)	) (464)	) (464)
Acquisition of the non-controlling interest in Brazil Henglong <sup>(1)</sup>	458	-	-
Other comprehensive income related to the non-controlling interests acquired by the Company	67		
Non-controlling interests change due to the disposal of Fujian Qiaolong	-	(2,150)	) (2,150)
Foreign currency translation adjustment attributable to non-controlling interests	249	(236)	) (692)
Balance at end of the period	\$ 5,762	\$ 5,389	\$ 5,412

**23. Gain on other sales**

Gain on other sales mainly consisted of net amount retained from sales of materials, property, plant and equipment, and scraps. For the six months ended June 30, 2017, gain on other sales amounted to \$5.3 million as compared to \$2.0 million for the six months ended June 30, 2016, representing an increase of \$3.3 million. During the second quarter of 2017, the Company disposed of a building located in Jingzhou and recognized a gain of \$2.2 million.





**24. Financial income, net**

During the six months ended June 30, 2017 and 2016, the Company recorded financial income, net which is summarized as follows (figures are in thousands of USD):

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Interest income	\$ (1,481 )	\$ (1,342 )
Foreign exchange loss/(gain), net	242	548
Gain of cash discount, net	-	(3 )
Bank fees	357	327
Total financial income, net	\$ (882 )	\$ (470 )

**25. Income tax rate**

The Company's subsidiaries registered in the PRC are subject to national and local income taxes within the PRC at the applicable tax rate of 25% on the taxable income as reported in their PRC statutory financial statements in accordance with the relevant income tax laws applicable to foreign invested enterprise, unless preferential tax treatment is granted by local tax authorities. If the enterprise meets certain preferential terms according to the China income tax law, such as assessment as a "High & New Technology Enterprise" by the government, the enterprise will be subject to enterprise income tax at a rate of 15%.

Pursuant to the New China Income Tax Law and the Implementing Rules, "New CIT", which became effective as of January 1, 2008, dividends generated after January 1, 2008 and payable by a foreign-invested enterprise to its foreign investors will be subject to a 10% withholding tax if the foreign investors are considered non-resident enterprises without any establishment or place within China or if the dividends payable have no connection with the establishment or place of the foreign investors within China, unless any such foreign investor's jurisdiction of incorporation has a tax treaty with China that provides for a different withholding arrangement.

Genesis, the Company's wholly-owned subsidiary and the direct holder of the equity interests in the Company's subsidiaries in China, is incorporated in Hong Kong. According to the Mainland China and Hong Kong Taxation Arrangement, dividends paid by a foreign-invested enterprise in China to its direct holding company in Hong Kong will be subject to withholding tax at a rate of no more than 5%, if the foreign investor directly owns at least 25% of the shares of the foreign-invested enterprise. Under the New CIT, if Genesis is regarded as a non-resident enterprise, it is required to pay an additional 5% withholding tax for any dividends payable to it from the PRC subsidiaries.



According to PRC tax regulation, the Company should withhold income taxes for the profits distributed from the PRC subsidiaries to Genesis, the subsidiaries' holding company incorporated in Hong Kong. For the profits that the PRC subsidiaries intended to distribute to Genesis, the Company accrues the withholding income tax as deferred tax liabilities. As of June 30, 2017, the Company has recognized deferred tax liabilities of \$0.2 million for the remaining undistributed profits to Genesis of \$4.09 million. The Company intended to re-invest the remaining undistributed profits generated from the PRC subsidiaries in those subsidiaries permanently. As of June 30, 2017 and December 31, 2016, the Company still had undistributed earnings of approximately \$259.2 million and \$239.8million, respectively, from investment in the PRC subsidiaries that are considered permanently reinvested. Had the undistributed earnings been distributed to Genesis and not permanently reinvested, the tax provision as of June 30, 2017 and December 31, 2016 of approximately \$13.0 million and \$12.0 million, respectively, would have been recorded. Such undistributed profits will be reinvested in Genesis and not further distributed to the parent company incorporated in the United States going forward.

In 2014, Jiulong was awarded the title of "High & New Technology Enterprise" and, based on the PRC income tax law, it is subject to enterprise income tax at a rate of 15% from 2014 to 2016. The Company estimated the applied tax rate in 2017 to be 15% as it is probable to pass the re-assessment in 2017 and continue to qualify as "High & New Technology Enterprise".

In 2014, Henglong was awarded the title of "High & New Technology Enterprise" and, based on the PRC income tax law, it is subject to enterprise income tax at a rate of 15% from 2014 to 2016. The Company estimated the applied tax rate in 2017 to be 15% as it is probable to pass the re-assessment in 2017 and continue to qualify as "High & New Technology Enterprise".

In 2009, Shenyang was awarded the title of "High & New Technology Enterprise" and, based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2009, 2010 and 2011. In 2012, the Company passed the re-assessment of the government based on PRC income tax laws. Accordingly, it continued to be taxed at the 15% tax rate in 2012, 2013 and 2014. In 2015, the Company passed the re-assessment of the government based on PRC income tax laws. Accordingly, it continues to be taxed at the 15% tax rate in 2015, 2016 and 2017.

In 2012, Wuhu was awarded the title of "High & New Technology Enterprise" and, based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2013 and 2014. In 2015, the Company passed the re-assessment of the government based on PRC income tax laws. Accordingly, it continues to be taxed at the 15% tax rate in 2015 and 2016. The Company estimated the applied tax rate in 2017 to be 15% as it is probable to pass the re-assessment in 2017 and continue to qualify as "High & New Technology Enterprise".

In 2013, Jielong was awarded the title of "High & New Technology Enterprise" and, based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2013, 2014 and 2015. In 2016, the Company passed the

re-assessment of the government based on PRC income tax laws. Accordingly, it continues to be taxed at the 15% tax rate from 2016 to 2018.

In 2011, Hubei Henglong was awarded the title of “High & New Technology Enterprise”. Based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% for 2013. The Company has passed the re-assessment in 2014 and continues to qualify as a “High & New Technology Enterprise”. Accordingly, it continues to be taxed at the 15% tax rate in 2014, 2015 and 2016. The Company estimated the applied tax rate in 2017 to be 15% as it is probable to pass the re-assessment in 2017 and continue to qualify as “High & New Technology Enterprise”.

According to the New CIT, USAI, Wuhan Chuguanjie, Shanghai Henglong and Testing Center are subject to income tax at a rate of 25% in 2016 and 2017.

Chongqing Henglong was established in 2012. According to the New CIT, Chongqing Henglong is subject to income tax at a uniform rate of 25%. No provision for Chongqing Henglong is made as it had no assessable income for the six months ended June 30, 2017 and 2016.

Based on Brazilian income tax laws, Brazil Henglong is subject to income tax at a uniform rate of 15%, and a resident legal person is subject to additional tax at a rate of 10% for the part of taxable income over \$0.12 million, equivalent to approximately BRL 0.24 million. The Company had no assessable income in Brazil for the six months ended June 30, 2017 and 2016.

The profits tax rate of Hong Kong is 16.5%. No provision for Hong Kong tax is made as Genesis is an investment holding company, and had no assessable income in Hong Kong for the six months ended June 30, 2017 and 2016.

The enterprise income tax rate of the United States is 35%. No provision for U.S. tax is made for CAAS and HLUSA as a whole, as the Company had no assessable income in the United States for the six months ended June 30, 2017 and 2016.

The Company’s effective tax rate was 19.6% and 18.5% for the three months and six months ended June 30, 2017, respectively, compared with 18.4% and 17.2% for the three months and six months ended June 30, 2016, respectively.

## **26. Income per share**

Basic income per share is computed using the weighted average number of ordinary shares outstanding during the period. Diluted income per share is computed using the weighted average number of ordinary shares and dilutive

ordinary share equivalents outstanding during the period. The dilutive effect of outstanding stock options is determined based on the treasury stock method.

The calculation of basic and diluted income per share attributable to the parent company for the three months ended June 30, 2017 and 2016, was (figures are in thousands of USD, except share and per share amounts):

	<b>Three Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Numerator:		
Net income attributable to the parent company's common shareholders – Basic and Diluted	\$ 8,921	\$ 5,364
Denominator:		
Weighted average shares outstanding	31,644,004	32,085,822
Dilutive effects of stock options	5,318	1,812
Denominator for dilutive income per share – Diluted	31,649,322	32,087,634
Net income per share attributable to parent company's common shareholders – Basic	\$ 0.28	\$ 0.17
Net income per share attributable to parent company's common shareholders – Diluted	\$ 0.28	\$ 0.17

The calculation of basic and diluted income per share attributable to the parent company for the six months ended June 30, 2017 and 2016, was (figures are in thousands of USD, except share and per share amounts):

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Numerator:		
Net income attributable to the parent company's common shareholders – Basic and Diluted	\$ 14,635	\$ 11,073
Denominator:		
Weighted average shares outstanding	31,644,004	32,103,420
Dilutive effects of stock options	5,611	2,191
Denominator for dilutive income per share – Diluted	31,649,615	32,105,611
Net income per share attributable to parent company's common shareholders – Basic	\$ 0.46	\$ 0.34
Net income per share attributable to parent company's common shareholders – Diluted	\$ 0.46	\$ 0.34

As of June 30, 2017 and 2016, the exercise prices for 82,500 shares and 82,500 shares, respectively, of outstanding stock options were above the weighted average market price of the Company's common stock during the six months ended June 30, 2017 and 2016, respectively, and these stock options were excluded from the calculation of the diluted income per share for the corresponding periods presented.

## **27. Significant concentrations**

A significant portion of the Company's business is conducted in China where the currency is the RMB. Regulations in China permit foreign owned entities to freely convert the RMB into foreign currency for transactions that fall under the "current account," which includes trade related receipts and payments, interest and dividends. Accordingly, the Company's Chinese subsidiaries may use RMB to purchase foreign exchange for settlement of such "current account" transactions without pre-approval. However, pursuant to applicable regulations, foreign-invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with the PRC law. In calculating accumulated profits, foreign investment enterprises in China are required to allocate at least 10% of their annual net income each year, if any, to fund certain reserve funds, including mandated employee benefits funds, unless these reserves have reached 50% of the registered capital of the enterprises.

Transactions other than those that fall under the "current account" and that involve conversion of RMB into foreign currency are classified as "capital account" transactions; examples of "capital account" transactions include repatriations of investment by or loans to foreign owners, or direct equity investments in a foreign entity by a China domiciled entity. "Capital account" transactions require prior approval from China's State Administration of Foreign Exchange, or SAFE, or its provincial branch to convert a remittance into a foreign currency, such as USD, and transmit the foreign currency outside of China.

This system could be changed at any time and any such change may affect the ability of the Company or its subsidiaries in China to repatriate capital or profits, if any, outside China. Furthermore, SAFE has a significant degree of administrative discretion in implementing the laws and has used this discretion to limit convertibility of current account payments out of China. Whether as a result of a deterioration in the Chinese balance of payments, a shift in the Chinese macroeconomic prospects or any number of other reasons, China could impose additional restrictions on capital remittances abroad. As a result of these and other restrictions under the laws and regulations of the PRC, the Company's PRC subsidiaries are restricted in their ability to transfer a portion of their net assets to the parent. The Company has no assurance that the relevant Chinese governmental authorities in the future will not limit further or eliminate the ability of the Company's PRC subsidiaries to purchase foreign currencies and transfer such funds to the Company to meet its liquidity or other business needs. Any inability to access funds in China, if and when needed for use by the Company outside of China, could have a material and adverse effect on the Company's liquidity and its business.

The Company grants credit to its customers including Xiamen Joylon, Xiamen Automotive Parts, Shanghai Fenglong and Jingzhou Yude, which are related parties of the Company. The Company's customers are mostly located in the PRC.



During the six months ended June 30, 2017, the Company's ten largest customers accounted for 56.7% of its consolidated net product sales, with one customer individually accounting for more than 10% of consolidated net sales i.e., 13.2%. As of June 30, 2017, approximately 4.3% of accounts receivable were from trade transactions with the aforementioned customer and there was no individual customer with a receivables balance of more than 10% of total accounts receivable.

During the six months ended June 30, 2016, the Company's ten largest customers accounted for 69.4% of its consolidated net product sales, with two customers individually accounting for more than 10% of consolidated net sales, i.e., 12.9% and 10.1%. As of June 30, 2016, approximately 3.3% and 2.7% of accounts receivable were from trade transactions with the aforementioned two customers and there was no individual customer with a receivables balance of more than 10% of total accounts receivable.

## 28. Related party transactions and balances

Related party transactions are as follows (figures are in thousands of USD):

### Related sales

	<b>Three Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Merchandise sold to related parties	\$ 8,583	\$ 10,054
Rental income obtained from related parties	32	38
Materials and others sold to related parties	510	457
Total	\$ 9,125	\$ 10,549

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Merchandise sold to related parties	\$ 18,120	\$ 18,639
Rental income obtained from related parties	46	69
Materials and others sold to related parties	811	680
Total	\$ 18,977	\$ 19,388

### Related purchases

	<b>Three Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Materials purchased from related parties	\$ 6,283	\$ 6,168
Technology purchased from related parties	-	227
Equipment purchased from related parties	1,412	1,015
Others purchased from related parties	93	110
Total	\$ 7,788	\$ 7,520

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Materials purchased from related parties	\$ 13,645	\$ 13,043
Technology purchased from related parties	-	227
Equipment purchased from related parties	4,424	3,530
Others purchased from related parties	216	375
Total	\$ 18,285	\$ 17,175

Loan transaction to a related party

	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Related party loan	\$ 29,182	\$ -

Related receivables

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Accounts and notes receivable from related parties	\$ 18,459	\$ 20,984

Related advances and loan balance

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Advance payments for property, plant and equipment to related parties	\$ 3,361	\$ 5,005
Advance payments and others to related parties	30,558	624
Total	\$ 33,919	\$ 5,629

Related payables

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
Accounts and notes payable	\$ 4,814	\$ 6,803

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

As of August 10, 2017, Hanlin Chen, the Company's Chairman, owns 56.4% of the common stock of the Company and has the effective power to control the vote on substantially all significant matters without the approval of other stockholders.

**29. Commitments and contingencies***Legal proceedings*

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

*Other commitments and contingencies*

In addition to the bank loans, notes payables and the related interest, the following table summarizes the Company's major commitments and contingencies as of June 30, 2017 (figures are in thousands of USD):

	<b>Payment obligations by period</b>					
	<b>2017 <sup>(1)</sup></b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>Thereafter</b>	<b>Total</b>
Obligations for investment contracts <sup>(1)(2)</sup>	6,790	\$5,314	\$-	\$ -	\$ -	\$12,104
Obligations for purchasing and service agreements	14,816	7,737	602	-	-	23,155
Total	\$21,606	\$13,051	\$602	\$ -	\$ -	\$35,259

On September 22, 2014, Hubei Henglong entered into an agreement with other parties to establish the Suzhou Venture Fund, under which Hubei Henglong has committed to make investments of RMB 50.0 million, equivalent to approximately \$7.6 million, into the Suzhou Venture Fund in three installments. As of June 30, 2017, Hubei (1)Henglong has completed a capital contribution of RMB 40.0 million, equivalent to approximately \$5.9 million, representing 11.8% of the Suzhou Venture Fund's shares. According to the agreement, the remaining capital commitment of RMB 10.0 million, equivalent to approximately \$1.5 million, will be paid upon capital calls received from the Suzhou Venture Fund.

In May 2016, Hubei Henglong entered into an agreement with other parties to establish a venture capital fund, the "Chongqing Venture Fund". Hubei Henglong has committed to make investments of RMB 120.0 million, equivalent to approximately \$18.0 million, in the Chongqing Venture Fund in three installments. As of June 30, 2017, Hubei (2)Henglong has completed a capital contribution of RMB 48.0 million, equivalent to approximately \$7.1 million, representing 23.5% of the Chongqing Venture Fund's shares. According to the agreement, the remaining capital commitment of RMB 72.0 million, equivalent to approximately \$10.6 million, will be paid upon capital calls received from the Chongqing Venture Fund.

### **30. Off-balance sheet arrangements**

As of June 30, 2017 and December 31, 2016, the Company did not have any significant transactions, obligations or relationships that could be considered off-balance sheet arrangements.

### **31. Segment reporting**

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

As of June 30, 2017, the Company had 11 product sectors, five of which were principal profit makers and were reported as separate sectors and engaged in the production and sales of power steering (Henglong, Jiulong, Shenyang, Wuhu and Hubei Henglong), and one holding company (Genesis). The other six sectors were engaged in the production and sale of sensor modular (USAI), automobile steering columns (Jielong), provision of after sales and R&D services (HLUSA), production and sale of power steering (Chongqing Henglong), trade (Brazil Henglong), and manufacture and sales of automobile electronic systems and parts (Wuhan Chuguanjie). Since the revenues, net income and net assets of these six sectors collectively are less than 10% of consolidated revenues, net income and net assets, respectively, in the condensed unaudited consolidated financial statements, the Company incorporated these six sectors into “Other Sectors.”

As of June 30, 2016, the Company had 11 product sectors, five of which were principal profit makers and were reported as separate sectors and engaged in the production and sales of power steering (Henglong, Jiulong, Shenyang, Wuhu and Hubei Henglong), and one holding company (Genesis). The other six sectors were engaged in the production and sale of sensor modular (USAI), automobile steering columns (Jielong), provision of after sales and R&D services (HLUSA), production and sale of power steering (Chongqing Henglong), trade (Brazil Henglong), commercial vehicle repacking and sales (Fujian Qiaolong), and manufacture and sales of automobile electronic systems and parts (Wuhan Chuguanjie). Since the revenues, net income and net assets of these seven sectors collectively are less than 10% of consolidated revenues, net income and net assets, respectively, in the condensed unaudited consolidated financial statements, the Company incorporated these seven sectors into “Other Sectors.”

The Company’s product sector information for the three months and six months ended June 30, 2017 and 2016, is as follows (figures are in thousands of USD):

	<b>Net Product Sales</b>		<b>Net Income (Loss)</b>	
	<b>Three Months Ended</b>		<b>Three Months Ended</b>	
	<b>June 30</b>		<b>June 30</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Henglong	\$64,478	\$62,517	\$ 2,295	\$ 3,903
Jiulong	27,161	20,449	2,186	1,110
Shenyang	10,665	9,438	323	485
Wuhu	5,644	5,429	167	147
Hubei Henglong	23,896	14,525	2,249	1,581
Other Sectors	13,150	6,814	(43 )	(23 )
Total Segments	144,994	119,172	7,177	7,203
Corporate	-	-	3,211	(1,684 )
Eliminations	(27,334 )	(18,155 )	(1,507 )	(4 )
Total	\$ 117,660	\$ 101,017	\$ 8,881	\$ 5,515

	<b>Net Product Sales</b>		<b>Net Income (Loss)</b>	
	<b>Six Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30</b>		<b>June 30</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Henglong	\$135,312	\$138,411	\$5,614	\$9,618
Jiulong	49,447	37,189	3,576	1,136
Shenyang	18,669	16,659	785	538
Wuhu	11,752	10,808	97	75
Hubei Henglong	42,029	28,902	2,487	1,551
Other Sectors	25,861	17,969	599	430
Total Segments	283,070	249,938	13,158	13,348
Corporate	-	-	3,043	(2,125 )
Eliminations	(46,102 )	(32,067 )	(1,382 )	(163 )
Total	\$236,968	\$217,871	\$14,819	\$11,060

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

The following discussion and analysis should be read in conjunction with the Company's condensed unaudited consolidated financial statements and the related notes thereto and the other financial information contained elsewhere in this Report.

### General Overview

China Automotive Systems, Inc. is a leading power steering systems supplier for the China automobile industry. The Company has business relations with more than sixty vehicle manufacturers, including JAC Motors, Changan Automobile Group, BAIC Group, SAIC Group and Dongfeng Auto Group, the five largest automobile manufacturers in China; Shenyang Brilliance Jinbei Co., Ltd., the largest light vehicle manufacturer in China; Chery Automobile Co., Ltd., the largest state owned car manufacturer in China; BYD Auto Co., Ltd. and Zhejiang Geely Automobile Co., Ltd., the largest privately owned car manufacturers in China. The PRC-based joint ventures of General Motors (GM), Volkswagen, Citroen and Chrysler North America are all key customers. Starting in 2008, the Company has supplied power steering pumps and power steering gear to the Sino-foreign joint ventures established by GM, Citroen and Volkswagen in China. The Company has supplied power steering gears to Chrysler North America since 2009.



Most of the Company's production and research and development institutes are located in China. The Company has approximately 3,000 employees dedicated to design, development, manufacture and sales of its products. By leveraging its extensive experience, innovative technology and geographic strengths, the Company aims to grow leading positions in automotive power steering systems and to further improve overall margins, long-term operating profitability and cash flows. To achieve these goals and to respond to industry factors and trends, the Company is continuing work to improve its operations and business structure and achieve profitable growth.

## **Corporate Structure**

The Company, through its subsidiaries, engages in the manufacture and sales of automotive systems and components. Great Genesis Holdings Limited, a company incorporated in Hong Kong on January 3, 2003 under the Companies Ordinance of Hong Kong as a limited liability company, "Genesis," is a wholly-owned subsidiary of the Company and the holding company of the Company's joint ventures in the PRC. 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. CAAS Brazil's Imports And Trade In Automotive Parts Ltd., "Brazil Henglong," was established by Hubei Henglong Automotive System Group Co., Ltd., formerly known as Jingzhou Hengsheng Automotive System Co., Ltd., "Hubei Henglong," as a Sino-foreign joint venture company with two Brazilian citizens in Brazil in August 2012. Fujian Qiaolong was acquired by the Company in the second quarter of 2014, as a joint venture company that mainly manufactures and distributes drainage and rescue vehicles with mass flow, drainage vehicles with vertical downhole operation, crawler-type mobile pump stations, high-altitude water supply and discharge drainage vehicles, long-range control crawler-type mobile pump stations and other vehicles, which was disposed of by the Company in the second quarter of 2016.

## **Critical Accounting Estimates**

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

The Company considers an accounting estimate to be critical if:

It requires the Company to make assumptions about matters that were uncertain at the time it was making the estimate, and

Changes in the estimate or different estimates that the Company could have selected would have had a material impact on the Company's financial condition or results of operations.

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

<b>Balance Sheet Caption</b>	<b>Critical Estimate Item</b>	<b>Nature of Estimates Required</b>	<b>Assumptions/Approaches Used</b>	<b>Key Factors</b>
Accrued liabilities and other long-term liabilities	Warranty obligations	Estimating warranty requires the Company to forecast the resolution of existing claims and expected future claims on products sold. OEMs (Original Equipment Manufacturers) are increasingly seeking to hold suppliers responsible for product warranties, which may impact the Company's exposure to these costs.	The Company bases its estimate on historical trends of units sold and payment amounts, combined with its current understanding of the status of existing claims and discussions with its customers.	·OEM sourcing ·OEM policy decisions regarding warranty claims
Property, plant and equipment, intangible assets and other long-term assets	Valuation of long-lived assets and investments	The Company is required from time to time to review the recoverability of certain of its assets based on projections of anticipated future cash flows, including future profitability assessments of various product lines.	The Company estimates cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments.	·Future production estimates ·Customer preferences and decisions
Inventory	Write-down of inventory	The Company is required from time to time to review the cashability of inventory based on projections of anticipated future cash flows, including write-down of inventory for prices that are higher than market price and undesirable inventories.	The Company estimates cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments.	·Future production estimates ·Customer preferences and decisions



Deferred income taxes	Recoverability of deferred tax assets	The Company is required to estimate whether recoverability of its deferred tax assets is more likely than not based on forecasts of taxable earnings in the related tax jurisdiction.	The Company uses historical and projected future operating results, based upon approved business plans, including a review of the eligible carry forward period, tax planning opportunities and other relevant considerations.	<ul style="list-style-type: none"> <li>·Tax law changes</li> <li>·Variances in future projected profitability, including by taxing entity</li> </ul>
Tax payable and deferred tax assets/liabilities	Uncertain tax positions	The Company is required to determine and assess all material positions, including all significant uncertain positions in all tax years that are still subject to assessment or challenge under relevant tax statutes.	The Company applies a more likely than not threshold and a two-step approach for tax position measurement and financial statement recognition. For the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement.	<ul style="list-style-type: none"> <li>·An allocation or a shift of income between jurisdictions</li> <li>·The characterization of income or a decision to exclude reporting taxable income in a tax return</li> <li>·A decision to classify a transaction, entity, or other position in a tax return as tax exempt</li> </ul>

In addition, there are other items within the Company's financial statements that require estimation, but are not as critical as those discussed above, including provision of accounts and notes receivable. Although not significant in recent years, changes in estimates used in these and other items could have a significant effect on the Company's consolidated financial statements.

## Recent Accounting Pronouncements

Please see Note 2 to the consolidated financial statements under Item 1 of Part I of this Report.

**Results of Operations****Results of Operations—Three Months Ended June 30, 2017 and 2016**

	Net Product Sales (in thousands of USD, except percentages)				Cost of Products Sold (in thousands of USD, except percentages)			
	2017	2016	Change		2017	2016	Change	
Henglong	\$64,478	\$62,517	1,961	3.1 %	\$55,668	\$53,689	\$1,979	3.7 %
Jiulong	27,161	20,449	6,712	32.8	23,129	17,579	5,550	31.6
Shenyang	10,665	9,438	1,227	13.0	9,652	8,221	1,431	17.4
Wuhu	5,644	5,429	215	4.0	5,279	4,904	375	7.6
Hubei Henglong	23,896	14,525	9,371	64.5	16,035	11,033	5,002	45.3
Other Sectors	13,150	6,814	6,336	93.0	11,062	5,594	5,468	97.7
Total Segments	144,994	119,172	25,822	21.7	120,825	101,020	19,805	19.6
Elimination	(27,334 )	(18,155 )	(9,179 )	50.6	(27,226 )	(18,151 )	(9,075 )	50.0
Total	\$117,660	\$101,017	\$16,643	16.5 %	\$93,599	\$82,869	\$10,730	12.9 %

*Net Product Sales*

Net product sales were \$117.7 million for the three months ended June 30, 2017, compared to \$101.0 million for the same period in 2016, representing an increase of \$16.7 million, or 16.5%.

The Company's net product sales were affected by the change in the product mix. Net sales of traditional steering products were \$91.1 million for the three months ended June 30, 2017, compared to \$73.0 million for the same period in 2016, representing an increase of \$18.1 million, or 24.8%. Net sales of EPS were \$26.6 million for the three months ended June 30, 2017, compared to \$28.0 million for the same period in 2016, representing a decrease of \$1.4 million, or 5.0%. As a percentage of net sales, sales of EPS were 22.6 % for the three months ended June 30, 2017, compared to 29.0% for the same period in 2016. The increase in net product sales was mainly due to increased sales and the changes in the product mix in the three months ended June 30, 2017.

The depreciation of China's currency, the RMB, against the U.S. dollar in the second quarter of 2017 as compared to the second quarter of 2016 had a negative impact on net sales as more than 80% of the Company's business is conducted in China.

In summary, the Company had an increase in sales volume leading to a sales increase of \$36.9 million, a decrease in average selling price of steering gears leading to a sales decrease of \$13.2 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a sales decrease of \$7.0 million.

Further analysis by segment (before elimination) is as follows:

Net product sales for Henglong were \$64.5 million for the three months ended June 30, 2017, compared with \$62.5 million for the three months ended June 30, 2016, representing an increase of \$2.0 million, or 3.2%. An increase in sales volume led to a sales increase of \$12.4 million, a decrease in average selling price led to a sales decrease of \$7.3 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$3.1 million.

Net product sales for Jiulong were \$27.2 million for the three months ended June 30, 2017, compared with \$20.4 million for the three months ended June 30, 2016, representing an increase of \$6.8 million, or 33.3%. Jiulong is gradually shifting its strategy from focusing on sales volume to focusing on high gross margin products and developing new markets such as exports. An increase in sales volume led to a sales increase of \$10.1 million, a decrease in average selling price led to a sales decrease of \$2.1 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$1.2 million.

Net product sales for Shenyang were \$10.7 million for the three months ended June 30, 2017, compared to \$9.4 million for the same period in 2016, representing an increase of \$1.3 million, or 13.8%. Shenyang's products are mainly sold to Shenyang Brilliance Jinbei Co., Ltd., "Brilliance Jinbei", one of China's largest commercial car manufacturers. The sales of Shenyang are mainly impacted by the demand of Brilliance Jinbei. An increase in sales volumes led to a sales increase of \$1.8 million, a decrease in average selling price led to a sales decrease of \$0.1 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$0.4 million.

Net product sales for Wuhu were \$5.6 million for the three months ended June 30, 2017, compared to \$5.4 million for the same period in 2016, representing an increase of \$0.2 million, or 3.7%. An increase in sales volumes led to a sales increase of \$1.2 million, a decrease in average selling price led to a sales decrease of \$0.7 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$0.3 million.

Net product sales for Hubei Henglong were \$23.9 million for the three months ended June 30, 2017, compared to \$14.5 million for the same period in 2016, representing an increase of \$9.4 million, or 64.8%. Hubei Henglong's products are mainly sold to Chrysler and Ford. The significant increase in the sales of Hubei Henglong was mainly due to the new products developed for Chrysler and Ford that began mass production at the end of 2016. An increase in sales volumes led to a sales increase of \$12.2 million, a decrease in average selling price led to a sales decrease of \$1.7 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$1.1 million.

Net product sales for Other Sectors were \$13.2 million for the three months ended June 30, 2017, compared to \$6.8 million for the same period in 2016, representing an increase of \$6.4 million, or 94.0%, primarily due to an increase in the sales volume of Jielong, which manufactures automobile steering columns for both HPS and EPS.





*Cost of Products Sold*

For the three months ended June 30, 2017, the cost of products sold was \$93.6 million, compared to \$82.9 million for the same period of 2016, representing an increase of \$10.7 million, or 12.9%. The increase in the cost of products sold was mainly due to the net effect of a net increase in sales volumes which led to a cost of products sold increase of \$28.7 million, a decrease in unit cost which led to a cost of products sold decrease of \$12.2 million, and the effect of foreign currency translation of the RMB against the U.S. dollar which led to a cost of products sold decrease of \$5.8 million. Further analysis is as follows:

Cost of products sold for Henglong was \$55.7 million for the three months ended June 30, 2017, compared to \$53.7 million for the same period of 2016, representing an increase of \$2.0 million, or 3.7%. An increase in sales volumes led to a cost of products sold increase of \$9.2 million, a decrease in unit cost led to a cost of products sold decrease of \$4.6 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a cost of products sold decrease of \$2.6 million.

Cost of products sold for Jiulong was \$23.1 million for the three months ended June 30, 2017, compared to \$17.6 million for the same period of 2016, representing an increase of \$5.5 million, or 31.3%. An increase in sales volumes led to a cost of products sold increase of \$9.3 million, a decrease in unit cost led to a cost of products sold decrease of \$2.3 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a cost of products sold decrease of \$1.5 million.

Cost of products sold for Shenyang was \$9.7 million for the three months ended June 30, 2017, compared to \$8.2 million for the same period of 2016, representing an increase of \$1.5 million, or 18.3%. The increase in cost of products sold was mainly due to an increase in sales volumes, which led to a cost of products sold increase of \$1.8 million, an increase in unit cost, which led to a cost of products sold increase of \$0.1 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of \$0.4 million.

Cost of products sold for Wuhu was \$5.3 million for the three months ended June 30, 2017, compared to \$4.9 million for the same period of 2016, representing an increase of \$0.4 million, or 8.2%. The increase in cost of products sold was mainly due to an increase in sales volumes, which led to a cost of products sold increase of \$1.1 million, a decrease in unit cost, which led to a cost of products sold decrease of \$0.5 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of \$0.2 million.

Cost of products sold for Hubei Henglong was \$16.0 million for the three months ended June 30, 2017, compared to \$11.0 million for the same period of 2016, representing an increase of \$5.0 million, or 45.5%. The increase in cost of products sold was mainly due to an increase in sales volumes, which led to a cost of products sold increase of \$9.3 million, a decrease in unit cost, which led to a cost of products sold decrease of \$3.6 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of \$0.7 million.

Cost of products sold for Other Sectors was \$11.1 million for the three months ended June 30, 2017, compared to \$5.6 million for the same period of 2016, representing an increase of \$5.5 million, or 97.8%, primarily due to the increase in sales volumes of Jielong.

Gross margin was 20.4% for the three months ended June 30, 2017, compared to 18.0% for the same period of 2016, representing an increase of 2.4%, mainly due to increased sales and the changes in the product mix for the three months ended June 30, 2017.

#### *Gain on Other Sales*

Gain on other sales mainly consisted of net amount retained from sales of materials, property, plant and equipment, land use rights, and scraps. For the three months ended June 30, 2017, gain on other sales amounted to \$4.6 million, as compared to \$1.2 million for the three months ended June 30, 2016, representing an increase of \$3.4 million. The increase was mainly due to the gain on disposal of a building of \$2.2 million and increased sales volume of materials.

#### *Selling Expenses*

Selling expenses were \$4.6 million for the three months ended June 30, 2017, as compared to \$4.1 million for the same period of 2016, representing an increase of \$0.5 million, or 12.2%, which was mainly due to the increased logistics fees related to the increase in revenue.

#### *General and Administrative Expenses*

General and administrative expenses were \$5.3 million for the three months ended June 30, 2017, as compared to \$3.9 million for the same period of 2016, representing an increase of \$1.4 million, or 35.9%, which was mainly due to the allowance for doubtful accounts of \$1.1 million and higher payroll expenses.

#### *Research and Development Expenses*

Research and development expenses were \$7.7 million for the three months ended June 30, 2017, as compared to \$6.0 million for the three months ended June 30, 2016, representing an increase of \$1.7 million, or 28.3%, which was mainly due to increased expenditures on R&D activities for EPS products. The Company's research and development expenses were mainly used for the development and trial production of EPS and other new products. The Company's research and development expenditures have continued to be significant in the past several years.

The global automotive parts industry is highly competitive; winning and maintaining new business requires suppliers to rapidly produce innovative products on a cost-competitive basis. In the past several years, the Company has continued to purchase advanced manufacturing equipment for newly developed products, hiring senior technicians and actively seeking external technical support.

*Income from Operations*

Income from operations was \$11.1 million for the three months ended June 30, 2017, compared to \$5.3 million for the three months ended June 30, 2016, representing an increase of \$5.8 million, including an increase of \$5.9 million in gross profit, an increase of \$3.4 million in gain on other sales and an increase of \$3.5 million in operating expenses.

*Other Income, Net*

Other income, net was \$0.2 million for the three months ended June 30, 2017, compared to other income, net of \$1.2 million for the three months ended June 30, 2016, representing a decrease of \$1.0 million, or 83.3%, primarily as a result of the gain on disposal of a subsidiary amounting to \$0.7 million in 2016, whereas there was no such gain in the current quarter.

*Interest Expense*

Interest expense was \$0.6 million for the three months ended June 30, 2017, compared to interest expense of \$0.1 million for the three months ended June 30, 2016, representing an increase of \$0.5 million, or 500%, primarily due to the new bank loans borrowed in the first quarter of 2017.

*Financial Income, Net*

Financial income, net, was \$0.6 million for the three months ended June 30, 2017, compared to financial income of \$0.1 million for the three months ended June 30, 2016, representing an increase of \$0.5 million, or 500%, which was mainly due to the interest income of \$0.4 million generated from the loan to Henglong Real Estate, one of the Company's related parties (See Note 5).

*Income Before Income Tax Expenses and Equity in Earnings of Affiliated Companies*

Income before income tax expenses and equity in earnings of affiliated companies was \$11.1 million for the three months ended June 30, 2017, compared to \$6.5 million for the three months ended June 30, 2016, representing an increase of \$4.6 million, or 70.8%, which was mainly due to an increase in operating income of \$5.8 million and a decrease in other income of \$1.0 million.

### *Income Taxes*

Income tax expense was \$2.2 million for the three months ended June 30, 2017, compared to \$1.2 million of income tax expense for the three months ended June 30, 2016, representing an increase of \$1.0 million, or 83.3%. The income before income tax increased to \$11.1 million for the three months ended June 30, 2017 from \$6.5 million for the same period in 2016 and the effective tax rate increased to 19.6% from 18.4% for the same period in 2016.

### *Net Income*

Net income was \$8.9 million for the three months ended June 30, 2017, compared to net income of \$5.5 million for the three months ended June 30, 2016, representing an increase of \$3.4 million, or 61.8%, which was mainly due to an increase in income before income tax expenses and equity in earnings of affiliated companies of \$4.6 million, an increase in income tax of \$1.0 million and a decrease in equity in earnings of affiliated companies of \$0.2 million.

### *Net (Loss)/Income Attributable to Non-controlling Interests*

Net loss attributable to non-controlling interests amounted to \$0.1 million for the three months ended June 30, 2017, while net income attributable to non-controlling interests amounted to \$0.2 million for the three months ended June 30, 2016.

The Company owns equity interests in nine non-wholly owned subsidiaries established in the PRC and Brazil, through which it conducts its operations. Except for Beijing Henglong and Chongqing Jinghua, which are accounted for under the equity method, all of the operating results of these non-wholly owned subsidiaries were consolidated in the Company's financial statements as of June 30, 2017 and 2016.

### *Net Income Attributable to Parent Company's Common Shareholders*

Net income attributable to parent company's common shareholders was \$8.9 million for the three months ended June 30, 2017, compared to net income attributable to parent company's common shareholders of \$5.4 million for the three months ended June 30, 2016, representing an increase of \$3.5 million, which was mainly due to an increase in net income of \$3.4 million and an increase in net loss attributable to non-controlling interests of \$0.3 million.





**Results of Operations—Six Months Ended June 30, 2017 and 2016**

	<b>Net Product Sales (in thousands of USD, except percentages)</b>				<b>Cost of Products Sold (in thousands of USD, except percentages)</b>			
	<b>2017</b>	<b>2016</b>	<b>Change</b>		<b>2017</b>	<b>2016</b>	<b>Change</b>	
Henglong	\$135,312	\$138,411	(3,099 )	-2.2 %	\$117,133	\$117,805	\$(672 )	-0.6 %
Jiulong	49,447	37,189	12,258	33.0	42,227	32,649	9,578	29.3
Shenyang	18,669	16,659	2,010	12.1	16,358	14,640	1,718	11.7
Wuhu	11,752	10,808	944	8.7	10,965	9,763	1,202	12.3
Hubei Henglong	42,030	28,902	13,128	45.4	28,903	21,148	7,755	36.7
Other Sectors	25,860	17,969	7,891	43.9	21,809	14,610	7,199	49.3
Total Segments	283,070	249,938	33,132	13.3	237,395	210,615	26,780	12.7
Elimination	(46,102 )	(32,067 )	(14,035)	43.8	(46,117 )	(31,904 )	(14,213)	44.5
Total	\$236,968	\$217,871	\$19,097	8.8 %	\$191,278	\$178,711	\$12,567	7.0 %

*Net Product Sales*

Net product sales were \$237.0 million for the six months ended June 30, 2017, compared to \$217.9 million for the same period in 2016, representing an increase of \$19.1 million, or 8.8%.

The Company's net product sales were affected by the change in the product mix. Net sales of traditional steering products were \$177.6 million for the six months ended June 30, 2017, compared to \$157.7 million for the same period in 2016, representing an increase of \$19.9 million, or 12.6%. Net sales of EPS were \$59.4 million for the six months ended June 30, 2017, compared to \$60.2 million for the same period in 2016, representing an increase of \$0.8 million, or 1.3%. As a percentage of net sales, sales of EPS were 22.6 % for the six months ended June 30, 2017, compared to 27.6% for the same period in 2016. The increase in net product sales was mainly due to increased sales and the changes in the product mix for the six months ended June 30, 2017.

The depreciation of China's currency, the RMB, against the U.S. dollar in the first six months of 2017 as compared to the first six months of 2016 had a negative impact on net sales as more than 80% of the Company's business is conducted in China.

In summary, the Company had an increase in sales volume leading to a sales increase of \$52.8 million, a decrease in average selling price of steering gears leading to a sales decrease of \$19.9 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a sales decrease of \$13.8 million.

Further analysis by segment (before elimination) is as follows:

Net product sales for Henglong were \$135.3 million for the six months ended June 30, 2017, compared with \$138.4 million for the six months ended June 30, 2016, representing a decrease of \$3.1 million, or 2.6%. An increase in sales volume led to a sales increase of \$23.8 million, a decrease in average selling price led to a sales decrease of \$19.8 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$7.1 million.

Net product sales for Jiulong were \$49.4 million for the six months ended June 30, 2017, compared with \$37.2 million for the six months ended June 30, 2016, representing an increase of \$12.2 million, or 32.8%. Jiulong is gradually shifting its strategy from focusing on sales volume to focusing on high gross margin products and developing new markets such as exports. An increase in sales volume led to a sales increase of \$11.4 million, an increase in average selling price led to a sales increase of \$3.1 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$2.3 million.

Net product sales for Shenyang were \$18.7 million for the six months ended June 30, 2017, compared to \$16.7 million for the same period in 2016, representing an increase of \$2.0 million, or 12.0%. Shenyang's products are mainly sold to Shenyang Brilliance Jinbei Co., Ltd., "Brilliance Jinbei", one of China's largest commercial car manufacturers. The sales of Shenyang are mainly impacted by the demand of Brilliance Jinbei. An increase in sales volumes led to a sales increase of \$4.0 million, a decrease in average selling price led to a sales decrease of \$1.1 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$0.9 million.

Net product sales for Wuhu were \$11.8 million for the six months ended June 30, 2017, compared to \$10.8 million for the same period in 2016, representing an increase of \$1.0 million, or 9.3%. An increase in sales volumes led to a sales increase of \$2.2 million, a decrease in average selling price led to a sales decrease of \$0.7 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$0.5 million.

Net product sales for Hubei Henglong were \$42.0 million for the six months ended June 30, 2017, compared to \$28.9 million for the same period in 2016, representing an increase of \$13.1 million, or 45.3%. Hubei Henglong's products are mainly sold to Chrysler and Ford. The significant increase in the sales of Hubei Henglong was mainly due to the new products developed for Chrysler and Ford that began mass production at the end of 2016. An increase in sales volumes led to a sales increase of \$17.4 million, a decrease in average selling price led to a sales decrease of \$2.3 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales decrease of \$2.0 million.

Net product sales for Other Sectors were \$25.9 million for the six months ended June 30, 2017, compared to \$18.0 million for the same period in 2016, representing an increase of \$7.9 million, or 43.9%, primarily due to an increase in the sales of Jielong, which manufactures automobile steering columns for both HPS and EPS.

### *Cost of Products Sold*

For the six months ended June 30, 2017, the cost of products sold was \$191.3 million, compared to \$178.7 million for the same period of 2016, representing an increase of \$12.6 million, or 7.1%. The increase in the cost of products sold was mainly due to the net effect of a net increase in sales volumes which led to a cost of products sold increase of \$41.1 million, a decrease in unit cost which led to a cost of products sold decrease of \$17.1 million, and the effect of foreign currency translation of the RMB against the U.S. dollar which led to a cost of products sold decrease of \$11.4 million. Further analysis is as follows:

Cost of products sold for Henglong was \$117.1 million for the six months ended June 30, 2017, compared to \$117.8 million for the same period of 2016, representing a decrease of \$0.7 million, or 0.6%. An increase in sales volumes led to a cost of products sold increase of \$19.4 million, a decrease in unit cost led to a cost of products sold decrease of \$14.1 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a cost of products sold decrease of \$6.0 million.



Cost of products sold for Jiulong was \$42.2 million for the six months ended June 30, 2017, compared to \$32.6 million for the same period of 2016, representing an increase of \$9.6 million, or 29.3%. An increase in sales volume led to a cost of products sold increase of \$10.0 million, an increase in unit cost led to a cost of products sold increase of \$1.7 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a cost of products sold decrease of \$2.1 million.

Cost of products sold for Shenyang was \$16.4 million for the six months ended June 30, 2017, compared to \$14.6 million for the same period of 2016, representing an increase of \$1.8 million, or 12.3%. The increase in cost of products sold was mainly due to an increase in sales volumes, which led to a cost of products sold increase of \$3.9 million, a decrease in unit cost, which led to a cost of products sold decrease of \$1.3 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of \$0.8 million.

Cost of products sold for Wuhu was \$11.0 million for the six months ended June 30, 2017, compared to \$9.8 million for the same period of 2016, representing an increase of \$1.2 million, or 12.3%. The increase in cost of products sold was mainly due to an increase in sales volumes, which led to a cost of products sold increase of \$2.1 million, a decrease in unit cost, which led to a cost of products sold decrease of \$0.3 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of \$0.6 million.

Cost of products sold for Hubei Henglong was \$28.9 million for the six months ended June 30, 2017, compared to \$21.1 million for the same period of 2016, representing an increase of \$7.8 million, or 37.0%. The increase in cost of products sold was mainly due to an increase in sales volumes, which led to a cost of products sold increase of \$12.9 million, a decrease in unit cost, which led to a cost of products sold decrease of \$4.0 million, and the effect of foreign currency translation of the RMB against the U.S. dollar, which led to a cost of products sold decrease of \$1.1 million.

Cost of products sold for Other Sectors was \$21.8 million for the six months ended June 30, 2017, compared to \$14.6 million for the same period of 2016, representing an increase of \$7.2 million, or 49.3%, primarily due to the increase in sales volumes of Jielong.

Gross margin was 19.3% for the six months ended June 30, 2017, compared to 18.0% for the same period of 2016, representing an increase of 1.3%, mainly due to increased sales and the changes in the product mix in the six months ended June 30, 2017.

#### *Gain on Other Sales*

Gain on other sales mainly consisted of net amount retained from sales of materials, property, plant and equipment, land use rights, and scraps. For the six months ended June 30, 2017, gain on other sales amounted to \$5.3 million, as compared to \$2.0 million for the six months ended June 30, 2016, representing an increase of \$3.3 million, or 165.0%. The increase was mainly due to the gain on disposal of a building of \$2.2 million and increased sales volume of

materials.

### *Selling Expenses*

Selling expenses were \$8.6 million for the six months ended June 30, 2017, as compared to \$8.4 million for the same period of 2016, representing an increase of \$0.2 million, or 0.2%, which was mainly due to the increased logistics fees related to the increase in revenue.

### *General and Administrative Expenses*

General and administrative expenses were \$9.6 million for the six months ended June 30, 2017, as compared to \$8.3 million for the same period of 2016, representing an increase of \$1.3 million, or 15.7%, which was mainly due to the allowance for doubtful accounts of \$1.1 million and higher payroll expenses.

### *Research and Development Expenses*

Research and development expenses were \$14.5 million for the six months ended June 30, 2017, as compared to \$12.1 million for the six months ended June 30, 2016, representing an increase of \$2.4 million, or 19.8%, which was mainly due to increased expenditures on R&D activities for EPS products. The Company's research and development expenses were mainly used for the development and trial production of EPS and other new products. The Company's research and development expenditures have continued to be significant in the past several years.

The global automotive parts industry is highly competitive; winning and maintaining new business requires suppliers to rapidly produce innovative products on a cost-competitive basis. In the past several years, the Company has continued to purchase advanced manufacturing equipment for newly developed products, hiring senior technicians and actively seeking external technical support.

### *Income from Operations*

Income from operations was \$18.3 million for the six months ended June 30, 2017, compared to \$12.3 million for the six months ended June 30, 2016, representing an increase of \$6.0 million, or 48.8%, including an increase of \$6.5 million in gross profit, an increase of \$3.4 million in gain on other sales and an increase of \$3.9 million in operating expenses.





*Other (Expense)/ Income, Net*

Other expense, net was \$0.1 million for the six months ended June 30, 2017, compared to other income, net of \$0.6 million for the six months ended June 30, 2016, representing a decrease of \$0.7 million, primarily as a result of the gain on disposal of a subsidiary amounting to \$0.7 million in 2016 whereas there was no such gain in the current period.

*Interest Expense*

Interest expense was \$0.9 million for the six months ended June 30, 2017, compared to interest expense of \$0.3 million for the six months ended June 30, 2016, representing an increase of \$0.6 million, primarily due to the new bank loans borrowed in the first quarter of 2017.

*Financial Income, Net*

Financial income, net, was \$0.9 million for the six months ended June 30, 2017, compared to financial income, net of \$0.5 million for the six months ended June 30, 2016, representing an increase of \$0.4 million, or 80.0%, which was mainly due to the interest income of \$0.5 million generated from the loan to Henglong Real Estate, one of the Company's related parties (See Note 5).

*Income Before Income Tax Expenses and Equity in Earnings of Affiliated Companies*

Income before income tax expenses and equity in earnings of affiliated companies was \$18.2 million for the six months ended June 30, 2017, compared to \$13.1 million for the six months ended June 30, 2016, representing an increase of \$5.1 million, or 38.9%, which was mainly due to an increase in operating income of \$6.0 million, an increase in other expense of \$0.7 million, an increase in interest expense of \$0.6 million and an increase in financial income of \$0.4 million.

*Income Taxes*

Income tax expense was \$3.4 million for the six months ended June 30, 2017, compared to \$2.2 million of income tax expense for the six months ended June 30, 2016, representing an increase of \$1.2 million, or 54.5%. The income before income tax increased to \$18.2 million for the six months ended June 30, 2017 from \$13.1 million for the same period in 2016 and the effective tax rate increased to 18.5% from 17.2%.

### *Net Income*

Net income was \$14.8 million for the six months ended June 30, 2017, compared to net income of \$11.1 million for the six months ended June 30, 2016, representing an increase of \$3.7 million, or 33.3%, which was mainly due to an increase in income before income tax expenses and equity in earnings of affiliated companies of \$5.1 million, an increase in income tax of \$1.2 million and a decrease in equity in earnings of affiliated companies of \$0.3 million.

### *Net Income / (Loss) Attributable to Non-controlling Interests*

Net income attributable to non-controlling interests amounted to \$0.2 million for the six months ended June 30, 2017, while net loss attributable to non-controlling interests amounted to \$0.1 million for the six months ended June 30, 2016.

The Company owns equity interests in nine non-wholly owned subsidiaries established in the PRC and Brazil, through which it conducts its operations. Except for Beijing Henglong and Chongqing Jinghua, which are accounted for under the equity method, all the operating results of these non-wholly owned subsidiaries were consolidated in the Company's financial statements as of June 30, 2017 and 2016.

### *Net Income Attributable to Parent Company's Common Shareholders*

Net income attributable to parent company's common shareholders was \$14.6 million for the six months ended June 30, 2017, compared to net income attributable to parent company's common shareholders of \$11.1 million for the six months ended June 30, 2016, representing an increase of \$3.5 million, or 31.5%, which was mainly due to an increase in net income of \$3.7 million and an increase in net income attributable to non-controlling interests of \$0.2 million.

## **Privatization Proposal**

On August 2, 2017, the Company issued a press release announcing the appointment by the special committee (the "Special Committee") of the Company's board of directors (the "Board") of Houlihan Lokey Capital, Inc. as its financial advisor and Kirkland & Ellis as its U.S. legal counsel in connection with its review and evaluation of the previously announced preliminary non-binding proposal letter that the Board received on May 14, 2017 from Mr.

Hanlin Chen, the Chairman of the Board of the Company, relating to a possible “going private” transaction, as well as in connection with its review and evaluation of any other sale, merger, business combination or other corporate transaction, with Mr. Chen or any other party, and any other strategic alternatives.

As previously announced, Mr. Chen has submitted a preliminary non-binding proposal to the Board to acquire all of the outstanding shares of common stock of the Company not already beneficially owned by Mr. Chen for US\$5.45 per share of common stock in cash. Mr. Chen and his affiliates currently beneficially own approximately 56.4% of the issued and outstanding shares of common stock of the Company on a fully diluted and as-converted basis. The proposal is expressly conditioned on approval by a special committee of the Board comprised of independent directors and is subject to a non-waivable condition requiring approval by a majority vote of the Company's unaffiliated stockholders. The Special Committee, consisting of Mr. Arthur Wong, Mr. Robert Tung and Mr. Guangxun Xu, is empowered to, and will be responsible for, among other things, investigating, evaluating, negotiating and making a recommendation to the Board with respect to the proposal. The Special Committee is also empowered to retain its own independent advisors to assist in the evaluation of the proposal and any alternative proposals.

The Board cautions the Company's shareholders, and others considering trading in its securities, that it has only received a proposal. No decision has been made with respect to the Company's response to the proposal. There can be no assurance that any definitive offer will be made, that any agreement will be executed or that a transaction with Mr. Chen or any other transaction will be approved or consummated. The Company is not obligated to make, and does not at this time anticipate making, any further public statements about this matter or the activities of the special committee unless and until either the Company enters into a definitive agreement for a transaction or the special committee determines that no such transaction will be effected.

## **Liquidity and Capital Resources**

### *Capital Resources and Use of Cash*

The Company has historically financed its liquidity requirements from a variety of sources, including short-term borrowings under bank credit agreements, bankers' acceptances, issuances of capital stock and notes and internally generated cash. As of June 30, 2017, the Company had cash and cash equivalents and time deposits included in short-term investments of \$63.7 million, compared to \$61.6 million as of December 31, 2016, representing an increase of \$2.1 million, or 3.4%. Short-term investments included pledged short-term investments of \$6.5 million and \$5.7 million as of June 30, 2017 and December 31, 2016, respectively.

The Company had working capital (total current assets less total current liabilities) of \$170.6 million as of June 30, 2017, compared to \$161.0 million as of December 31, 2016, representing an increase of \$9.6 million, or 6.0%.

The Company intends to indefinitely reinvest the funds in subsidiaries established in the PRC.



The Company believes that, in view of its current cash position, the cash expected to be generated from the operations and funds available from bank borrowings as detailed in subsequent paragraphs will be sufficient to meet its working capital and capital expenditure requirements, including the repayment of bank loans, for at least twelve months commencing from the date of this report.

### Capital Source

The Company's capital source is multifaceted, such as bank loans and banker's acceptance facilities. In financing activities and operating activities, the Company's banks require the Company to sign line of credit agreements and repay all existing borrowings under such facilities within one year. On the condition that the Company can provide adequate mortgage security and has not violated the terms of the line of credit agreement, such one year facilities can be extended for another year.

The Company had short-term loans of \$67.4 million (See Note 13) and bankers' acceptances of \$83.4 million (See Note 14) as of June 30, 2017.

The Company currently expects to be able to obtain similar bank loans, i.e., RMB loans, and bankers' acceptance facilities in the future if it can provide adequate mortgage security following the termination of the above-mentioned agreements, see the table under "Bank Arrangements" below for more information. If the Company is not able to do so, it will have to refinance such debt as it becomes due or repay that debt to the extent it has cash available from operations or from the proceeds of additional issuances of capital stock. Owing to depreciation, the value of the mortgages securing the above-mentioned bank loans and banker's acceptances will be reduced by approximately \$12.0 million over the next 12 months. If the Company wishes to obtain the same amount of bank loans and banker's acceptances, it will have to provide additional mortgages of \$12.0 million as of the maturity date of such line of credit agreements, see the table under "Bank Arrangements" below for more information. The Company can still obtain a reduced line of credit with a reduction of \$8.7 million, which is 72.3%, the mortgage rate, of \$12.0 million, if it cannot provide additional mortgages. The Company expects that the reduction in bank loans will not have a material adverse effect on its liquidity.

	Bank	Due Date	Amount Available (4)	Amount Used	Assessed Mortgage Value <sup>(5)</sup>
1. Comprehensive credit facilities	Hubei Bank	Sep-2017	\$26,571	\$11,270	\$55,053
2. Comprehensive credit facilities	China Construction Bank	Dec-2017	4,428	639	10,389
3. Comprehensive credit facilities	Shanghai Pudong Development Bank <sup>(1)</sup>	Oct-2017	19,190	13,675	15,243
4. Comprehensive credit facilities	China CITIC Bank <sup>(1)</sup>	Sep-2017	59,046	49,414	9,068
	China CITIC Bank <sup>(1)</sup>	Jul-2019	3,188	2,214	5,614
5. Comprehensive credit facilities	Hua Xia Bank <sup>(1)</sup>	Jul-2017	29,523	1,748	-
6. Comprehensive credit facilities	China Everbright Bank	Oct-2017	4,428	3,940	7,559
7. Comprehensive credit facilities	ICBC Macau	May-2018	23,360	20,000	23,404
8. Comprehensive credit facilities	HSBC (China) Company Limited	Jul-2017	5,000	5,000	5,314
9. Comprehensive credit facilities	HSBC (Brazil) Company Limited	Oct-2017	70	20	74
10. Comprehensive credit facilities	Bank of China (Brazil)	Feb-2018	627	599	886
11. Comprehensive credit facilities	Bank of China <sup>(1)</sup>	Apr-2018	22,142	564	-
12. Comprehensive credit facilities	China Merchants Bank <sup>(1)</sup>	Apr-2018	14,761	1,096	-
13. Comprehensive credit facilities	Taishin International Bank	Apr-2018	10,000	9,858	12,253
Total			\$222,334	\$120,037 <sup>(2)</sup>	\$144,857 <sup>(3)</sup>



## Bank Arrangements

As of June 30, 2017, the principal outstanding under the Company's credit facilities and lines of credit was as follows (figures are in thousands of USD):

Each of Hubei Henglong's comprehensive credit facilities with Shanghai Pudong Development Bank is required to be guaranteed by Jielong and Hubei Henglong in addition to the above pledged assets. Each of Hubei Henglong, Henglong, Jiulong, Jielong, Chuguanjie and USAI's comprehensive credit facilities with China CITIC Bank is required to be guaranteed by Henglong and Hubei Henglong, in addition to the above pledged assets and

(1) Henglong's comprehensive credit facilities with Hua Xia Bank are required to be guaranteed by Hubei Henglong. Each of Hubei Henglong, Henglong, Jiulong, Jielong's comprehensive credit facilities with Bank of China is required to be guaranteed by Hubei Henglong and Henglong, and Henglong's comprehensive credit facilities with China Merchants Bank are required to be guaranteed by Hubei Henglong.

Amount used represents the credit facilities used by the Company for the purpose of bank loans or notes payable during the facility contract period. The loans or notes payable under the credit facilities will remain outstanding regardless of the expiration of the relevant credit facilities until the separate loans or notes payable expire. The

(2) amount used includes bank loans of \$ 65.9 million and notes payable of \$52.8 million as of June 30, 2017. The remainder of \$1.5 million of government loan and \$34.2 million of notes payable was secured by bank notes or time deposits without utilization of credit lines.

In order to obtain lines of credit, the Company needs to pledge certain assets to banks. As of June 30, 2017, the

(3) pledged assets included \$35.1 million accounts and notes receivable, \$6.9 million of time deposits and other pledged assets with assessed value of \$102.9 million.

The amount available is used for the drawdown of bank loans and issuance of bank notes. For the drawdown of

(4) bank loans, this amount represents the amount that the Company can borrow immediately; for issuance of bank notes, the Company needs to pledge additional collateral in order to utilize these bank facilities.

(5) The pledged cash deposits were not included in the assessed mortgage value.

The Company may request the banks to issue notes payable or bank loans within its credit line using a 365-day revolving line.

The Company's loan terms range from eleven months to eighteen months. Pursuant to the comprehensive credit line arrangement, the Company pledged and guaranteed:

1. Equipment with an assessed value of approximately \$55.1 million as security for its revolving comprehensive credit facility with Hubei Bank.
2. Land use rights, buildings and equipment with an assessed value of approximately \$10.4 million as security for its revolving comprehensive credit facility with China Construction Bank.
3. Land use rights and buildings with an assessed value of approximately \$15.2 million as security for its revolving comprehensive credit facility with Shanghai Pudong Development Bank.
4. Land use rights and buildings with an assessed value of approximately \$9.1 million as security for its comprehensive credit facility with China CITIC Bank Wuhan branch.
5. Land use rights and buildings with an assessed value of approximately \$5.6 million as security for its comprehensive credit facility with China CITIC Bank Shenyang branch.
6. Land use rights and buildings with an assessed value of approximately \$7.6 million as security for its comprehensive credit facility with China Everbright Bank.

On April 20, 2017, the Company entered into a Credit Agreement with ICBC Macau to obtain the Credit Facility. The interest rate of the Credit Facility is calculated based on a three-month LIBOR plus 1.30% per annum, subject to the availability of funds and fluctuation at ICBC Macau's discretion. Interest is calculated daily based on a 360-day year and it is fixed one day before the first day of each interest period. The interest period is defined as three months from the date of drawdown.

As security for the Credit Facility, the Company was required to provide ICBC Macau with the Henglong Standby Letter of Credit for a total amount of not less than \$23.4 million if the Credit Facility is fully drawn.

On May 5, 2017, the Company drew down the full amount of \$20.0 million under the Credit Facility and provided the Henglong Standby Letter of Credit for an amount of \$23.4 million in favor of ICBC Macau. The Henglong Standby Letter of Credit issued by ICBC Jingzhou is collateralized by Henglong's notes receivable of RMB 158.5 million, equivalent to approximately \$23.4 million. The Company also paid an arrangement fee of \$0.04 million to ICBC Jingzhou. The maturity date of the Credit Facility is May 12, 2018.

8. On July 16, 2014, Great Genesis entered into a credit facility agreement with HSBC HK to obtain a non-revolving credit facility in the amount of \$5.0 million, the “HSBC Credit Facility”. The HSBC Credit Facility would have expired on July 1, 2015 and had an annual interest rate of 1.7%. Interest was paid on the twentieth day of each month and the principal repayment is at maturity. As security for the HSBC Credit Facility, the Company’s subsidiary Hubei Henglong was required to provide HSBC HK with the Standby Letter of Credit for a total amount of not less than \$5.4 million if the HSBC Credit Facility was fully drawn.

On July 22, 2014, Great Genesis drew down a loan amounting to \$5.0 million provided by HSBC HK and Hubei Henglong provided a Standby Letter of Credit for an amount of \$5.4 million in favor of HSBC HK. Hubei Henglong’s Standby Letter of Credit was issued by HSBC Bank (China) Company Limited Wuhan branch and was collateralized by short-term investments of Hubei Henglong of RMB 33.0 million, equivalent to approximately \$4.9 million.

On July 7, 2016, HSBC HK agreed to extend the maturity date of the HSBC Credit Facility to July 1, 2017. The interest rate of the HSBC Credit Facility under the extended term was revised as three-month LIBOR plus 0.8% per annum, i.e. 2.0% per annum, and additional short-term investments of Hubei Henglong were pledged of RMB 3.0 million, equivalent to approximately \$0.4 million. Except for the above, all other terms and conditions as stipulated in the HSBC Credit Agreement remained unchanged.

On April 1, 2016, Brazil Henglong entered into a credit facility agreement with HSBC Brazil to obtain a credit facility in the amount of \$0.1 million, the “HSBC Brazil Credit Facility”. The HSBC Brazil Credit Facility will expire 9. on October 27, 2017. As security for the HSBC Credit Facility, the Company’s subsidiary Hubei Henglong is required to provide HSBC Brazil with the Standby Letter of Credit for a total amount of \$0.1 million if the HSBC Brazil Credit Facility is fully drawn.

On May 6, 2016, Brazil Henglong drew down a loan amounting to \$0.1 million provided by HSBC Brazil. The loan will mature on October 9, 2017 and has an annual interest rate of 8.2%. The principal and interest are paid each month. Hubei Henglong provided a Standby Letter of Credit for an amount of \$0.1 million in favor of HSBC Brazil. Hubei Henglong’s Standby Letter of Credit was issued by China CITIC Bank Wuhan branch and is collateralized by short-term investments of Hubei Henglong of RMB 0.5 million, equivalent to approximately \$0.1 million.

On August 26, 2016, Brazil Henglong entered into a credit facility agreement with Bank of China (Brazil) to obtain a credit facility in the amount of \$0.6 million, the “Bank of China Credit Facility”. The Bank of China Credit 10. Facility will expire on January 15, 2018. As security for the Bank of China Credit Facility, the Company’s subsidiary Hubei Henglong is required to provide Bank of China (Brazil) with a Standby Letter of Credit for a total amount of \$0.9 million if the Bank of China Credit Facility is fully drawn.

On August 26, 2016, Brazil Henglong drew down a loan amounting to \$0.6 million provided by Bank of China (Brazil). The loan will mature on January 15, 2018 and has an annual interest rate of 3.9%. Interest is paid semiannually and the principal repayment is at maturity. Hubei Henglong provided a Standby Letter of Credit for an amount of \$0.9 million in favor of Bank of China (Brazil). Hubei Henglong’s Standby Letter of Credit was issued by Bank of China Jingzhou branch and is collateralized by long-term time deposits of Hubei Henglong of RMB 6.0 million, equivalent to approximately \$0.9 million.

On April 25, 2017, Great Genesis entered into a credit facility agreement with Taishin Bank to obtain a non-revolving credit facility in the amount of \$10.0 million, the “Taishin Bank Credit Facility”. The Taishin Bank Credit Facility will expire on April 25, 2018 and has an annual interest rate of 2.7%. Interest is paid quarterly and 11. the principal repayment is payable at maturity. As security for the Taishin Bank Credit Facility, the Company’s subsidiary Henglong is required to provide Taishin Bank with the Standby Letter of Credit for a total amount of not less than \$10.0 million if the Taishin Bank Credit Facility is fully drawn.

On April 28, 2017, Great Genesis drew down a loan amounting to \$9.9 million provided by Taishin Bank and Henglong provided a Standby Letter of Credit for an amount of \$10.0 million in favor of Taishin Bank. Henglong’s Standby Letter of Credit was issued by China CITIC Bank Wuchang branch and is collateralized by short-term investments of Henglong of RMB 4.0 million, equivalent to approximately \$0.6 million and notes receivable of RMB 79.0 million, equivalent to approximately \$11.7 million.

## Cash Requirements

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

	Total	Payment Due Dates			
		Less than 1 year	1-2 years	3-5 years	More than 5 Years
Short-term loan including interest payable	\$68,978	\$68,978	\$ -	\$ -	\$ -
Notes payable <sup>(1)</sup>	87,046	87,046	-	-	-
Obligation for investment contract <sup>(2)(3)</sup>	12,104	6,790	5,314	-	-
Other contractual purchase commitments, including service agreements	23,155	14,816	8,339	-	-
Total	\$191,283	\$177,630	\$13,653	\$ -	\$ -

(1) Notes payable do not bear interest.

On September 22, 2014, Hubei Henglong entered into an agreement with other parties to establish the Suzhou Venture Fund, under which Hubei Henglong has committed to make investments of RMB 50.0 million, equivalent to approximately \$7.6 million, into the Suzhou Venture Fund in three installments. As of June 30, 2017, Hubei Henglong has completed a capital contribution of RMB 40.0 million, equivalent to approximately \$5.9 million, representing 11.8% of the Suzhou Venture Fund's shares. According to the agreement, the remaining capital commitment of RMB 10.0 million, equivalent to approximately \$1.5 million, will be paid upon capital calls received from the Suzhou Venture Fund.

In May 2016, Hubei Henglong entered into an agreement with other parties to establish a venture capital fund, the "Chongqing Venture Fund". Hubei Henglong has committed to make investments of RMB 120.0 million, equivalent to approximately \$18.0 million, into the Chongqing Venture Fund in three installments. As of June 30, 2017, Hubei Henglong has completed a capital contribution of RMB 48.0 million, equivalent to approximately \$7.1 million, representing 23.5% of the Chongqing Venture Fund's shares. According to the agreement, the remaining capital commitment of RMB 72.0 million, equivalent to approximately \$10.6 million, will be paid upon capital calls received from the Chongqing Venture Fund.

## Short-term Bank Loans

The following table summarizes the contract information of short-term borrowings between the banks and the Company as of June 30, 2017 (figures are in thousands of USD).

<b>Bank</b>	<b>Purpose</b>	<b>Borrowing Date</b>	<b>Borrowing Term (Months)</b>	<b>Annual Interest Rate</b>	<b>Date of Interest Payment</b>	<b>Due Date</b>
<b>Government</b>						
HSBC Bank (China) Company Limited <sup>(1)</sup>	Working Capital	Jul. 1, 2016	12	2.10 %	Pay monthly	Jun. 30, 2017
Bank of China (Brazil)	Working Capital	Aug. 26, 2016	18	3.95 %	Pay semi annually	Jan. 15, 2018
HSBC (Brazil) Company Limited	Working Capital	May 6, 2016	17	8.21 %	Pay quarterly	Oct. 9, 2017
China CITIC Bank	Working Capital	Nov. 4, 2016	12	5.22 %	Pay monthly	Nov. 4, 2017
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99 %	Pay in arrear	Feb. 5, 2018
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99 %	Pay in arrear	Feb. 6, 2018
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99 %	Pay in arrear	Feb. 7, 2018
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99 %	Pay in arrear	Feb. 8, 2018
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99 %	Pay in arrear	Feb. 2, 2018
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99 %	Pay in arrear	Feb. 9, 2018
Financial Bureau of Jingzhou Development Zone	Working Capital	Apr. 21, 2017	8	0.00 %	N/A	Dec. 8, 2017
ICBC Macau	Working Capital	May 5, 2017	12	3.95 %	Pay quarterly	May 4, 2018
Taishin International Bank	Working Capital	Apr. 28, 2017	12	2.65%	Pay quarterly	Apr. 23, 2018
<b>Total</b>						

(1) The Company repaid this bank borrowing in July 2017.

The Company must use the loans for the purpose described in the table. For the two bank loans with ICBC Macau and HSBC Bank (China) Company Limited, if the Company fails to do so, it will be charged a penalty interest at 60% to 100% of the specified loan rate listed in the table above. Except for the loan granted by ICBC Macau as disclosed in the section “Capital Source” above, the Company has to pay interest at the interest rate described in the table on the 20th of each month, quarter or semiannual period, as applicable. If the Company fails to do so, it will be charged compound interest at the specified rate in the above table. The Company has to repay the principal outstanding on the specified date in the table. If it fails to do so, it will be charged a penalty interest at 50% of the specified loan rate.

Management believes that the Company complied with such financial covenants as of June 30, 2017, and will continue to comply with them.

#### Notes Payable

The following table summarizes the contract information of issuing notes payable between the banks and the Company as of June 30, 2017 (figures are in thousands of USD):

Purpose	Term (Month)	Due Date	Amount Payable on Due Date
Working Capital (1)	6	Jul. 2017	\$ 13,300
Working Capital	6	Aug. 2017	15,763
Working Capital	6	Sep. 2017	14,800
Working Capital	6	Oct. 2017	17,112
Working Capital	6	Nov. 2017	11,782
Working Capital	12	Nov. 2017	2,244
Working Capital	6	Dec. 2017	12,045
Total (See Note 15)			\$ 87,046

(1) The notes payable were repaid in full on their respective due dates.

The Company must use notes payable for the purpose described in the table. If it fails to do so, the banks will no longer issue the notes payable, and it may have an adverse effect on the Company’s liquidity and capital resources. The Company has to deposit sufficient cash in the designated account of the bank on the due date of notes payable for payment to the suppliers. If the bank has advanced payment for the Company, it will be charged a penalty interest at 50% of the loan rate that is published by the People’s Bank of China for the same period. The Company complied with such financial covenants as of June 30, 2017, and believes it will continue to comply with them.





*Cash Flows*

***(a) Operating Activities***

Net cash provided by operating activities for the six months ended June 30, 2017 was \$19.2 million, compared with net cash used in operating activities of \$6.4 million for the same period of 2016, representing an increase of \$25.6 million, which was mainly due to the net effect of (1) the increase in net income excluding non-cash items by \$5.2 million and (2) the increase in cash inflows from movements of operating assets and liabilities by \$20.4 million. The increase in cash inflows was primarily due to the offsetting effect of (1) the increase in cash outflows due to the movement of pledged deposits by \$9.4 million and (2) the increase in cash outflows due to the movement of accounts and notes payable by \$28.8 million and (3) the increase in cash inflows due to the movement of accounts and notes receivable by \$57.5 million and (4) the increase in cash inflows due to the movement of inventories by \$8.1 million and (5) the increase in cash outflows due to the movement of tax payable by \$6.3 million.

***(b) Investing Activities***

The Company used net cash of \$39.5 million in investment activities during the six months ended June 30, 2017, compared to \$30.4 million for the same period of 2016, representing an increase of cash outflows by \$9.1 million, which was mainly due to a decrease in purchases of property, plant and equipment of \$8.3 million, a decrease in cash used in purchases of short-term investments of \$6.7 million, a decrease in cash outflows due to investment under equity method of \$2.3 million and an increase in cash received from property, plant and equipment sales of \$1.6 million, offset by the increase in cash outflows due to a loan to a related party by \$29.0 million.

***(c) Financing Activities***

Net cash provided by financing activities for the six months ended June 30, 2017 was \$25.0 million, compared to net cash provided by financing activities of \$5.9 million for the same period of 2016, representing an increase of \$19.1 million, which was mainly due to the net effect of (1) increased proceeds of \$47.5 million from bank and government loans and (2) increased repayments of \$29.0 million to banks and the government.

*Off-Balance Sheet Arrangements*

As of June 30, 2017 and December 31, 2016, the Company did not have any significant transactions, obligations or relationships that could be considered off-balance sheet arrangements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

There were no material changes to the disclosure made in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 regarding this matter.

#### **ITEM 4. CONTROLS AND PROCEDURES.**

##### *A. Disclosure Controls and Procedures*

The Company's management, under the supervision and with the participation of its chief executive officer and chief financial officer, Messrs. Wu Qizhou and Li Jie, respectively, evaluated the effectiveness of the Company's disclosure controls and procedures as of June 30, 2017, the end of the period covered by this Report. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports, such as this Form 10-Q, that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on that evaluation, Messrs. Wu and Li concluded that the Company's disclosure controls and procedures were effective as of June 30, 2017.

The Company's disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the objectives of its disclosure control system are met. Because of inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected.

##### *B. Changes in Internal Control Over Financial Reporting*

There have been no changes in the Company's internal control over financial reporting during the three months ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. — OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS.**

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

### **ITEM 1A. RISK FACTORS.**

There have been no material changes from the risk factors previously disclosed in Item 1A of the Company's 2016 Annual Report on Form 10-K.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

### **ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

### **ITEM 5. OTHER INFORMATION.**

None.

**ITEM 6. EXHIBITS.**

INDEX TO EXHIBITS

<b>Exhibit Number</b>	<b>Description</b>
3.1(i)	Certificate of Incorporation (incorporated by reference from the filing on Form 10KSB File No. 000-33123).
3.1(ii)	Bylaws (incorporated by reference from the Form 10KSB for the year ended December 31, 2002).
10.1	Joint-venture Agreement, dated March 31, 2006, as amended on May 2, 2006, between Great Genesis Holdings Limited and Wuhu Chery Technology Co., Ltd. (incorporated by reference to Exhibit 10.8 to the Company's Form 10-Q Quarterly Report on May 10, 2006).

10.2 Stock Exchange Agreement dated August 11, 2014 by and among Jingzhou City Jiulong Machinery Electricity Manufacturing Co., Ltd., China Automotive Systems, Inc. and Hubei Henglong Automotive System Group Co., Ltd. (incorporated by reference to Exhibit 10.2 to the Company's Form 10-Q Quarterly Report on August 13, 2014).

31.1 Rule 13a-14(a) Certification\*

31.2 Rule 13a-14(a) Certification\*

32.1 Section 1350 Certification\*

32.2 Section 1350 Certification\*

101\* The following materials from the China Automotive Systems, Inc. Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, were filed on August 10, 2017 formatted in Extensible Business Reporting Language (XBRL):

- (i) Condensed Unaudited Consolidated Statements of Operations and Comprehensive Income,
- (ii) Condensed Unaudited Consolidated Balance Sheets,
- (iii) Condensed Unaudited Consolidated Statements of Cash Flows, and
- (iv) related notes

\* filed herewith

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

**CHINA AUTOMOTIVE SYSTEMS,  
INC.**

(Registrant)

Date: August 10, 2017 By: /s/ *Qizhou Wu*  
Qizhou Wu  
President and Chief Executive Officer

Date: August 10, 2017 By: /s/ *Jie Li*  
Jie Li  
Chief Financial Officer