CHINA AUTOMOTIVE SYSTEMS INC
Form 10-K
March 29, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2017

Or

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

For the transition period from ____________ to ____________

Commission File Number: **000-33123**

CHINA AUTOMOTIVE SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**33-0885775**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

No. 1 Henglong Road, Yu Qiao Development Zone Shashi District, Jing Zhou City Hubei Province The People's Republic of China	**434000**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code – **(86) 716-412-7901**

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

Title of each Class	Name of each exchange on which registered
Common Stock, $0.0001 par value	**The Nasdaq Capital Market**

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

Title of Class
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes ¨ No x

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

Yes x No ¨

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 x No ¨

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

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

Large Accelerated Filer ¨ Accelerated Filer ¨

Non-Accelerated Filer ¨ Smaller Reporting Company x
Emerging Growth Company ¨

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2017, based upon the price of $4.84 that was the closing price of the common stock as reported on the NASDAQ Stock Market under the symbol “CAAS” on such date, was approximately $40.9 million.

The Company has 31,644,004 shares of Common Stock outstanding as of March 29, 2018.

DOCUMENTS INCORPORATED BY REFERENCE

None.

CHINA AUTOMOTIVE SYSTEMS, INC.

FORM 10-K

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Cautionary Statement

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

PART I

ITEM 1. BUSINESS.

COMPANY HISTORY

China Automotive Systems, Inc., “China Automotive” or the “Company,” was incorporated in the State of Delaware on June 29, 1999. Through its subsidiary, Great Genesis Holdings Limited, “Genesis,” a corporation organized under the laws of the Hong Kong Special Administrative Region, China, it owns interests in eight Sino-joint ventures and five wholly-owned subsidiaries in the People’s Republic of China, “China” or the “PRC,” which manufacture power steering systems and/or related products for different segments of the automobile industry. Genesis also owns interests in a Brazil-based trading company, which engages mainly in the import and sales of automotive parts in Brazil.

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

Unless the context indicates otherwise, the Company uses the terms “the Company,” “we,” “our” and “us” to refer to China Automotive collectively on a consolidated basis.

BUSINESS OVERVIEW

The Company is a holding company and has no significant business operations or assets other than its interest in Genesis and HLUSA. Genesis mainly engages in the manufacture and sale of automotive systems and components through its controlled subsidiaries and the joint ventures, as described below.

Set forth below is an organizational chart as at December 31, 2017.

China Automotive Systems, Inc. [NASDAQ:CAAS]

100% 100%

Great Genesis Holdings Limited

Henglong USA Corporation

100%
Hubei Henglong Automotive System Group Co., Ltd.
"Hubei Henglong"[1]

70%
Shenyang Jinbei Henglong Automotive Steering System Co., Ltd
"Shenyang"[2]

100%	100%	83.34%	77.33%	85%	70%	95.84%	100%	60%
Jingzhou Henglong Automotive Parts Co., Ltd.	Shashi Jiulong Power Steering Gears Co., Ltd.	Universal Sensor Application ,Inc.	Wuhu Henglong Automotive Steering System Co., Ltd.	Wuhan Jielong Electric Power Steering Co., Ltd.	Chongqing Henglong Hongyan Automotive System Co., Ltd.	CAAS Brazil's Imports And Trade In Automotive Parts Ltd.,	Hubei Henglong Group Shanghai Automotive Electronics Research and Development Ltd.,	Jingzhou Qingyan Intelligent Automotive Technology Research Institute Co., Ltd.
"Henglong"[3]	**"Jiulong"[4]**	**"USAI"[5]**	**"Wuhu"[6]**	**"Jielong"[7]**	**"Chongqing Henglong"[8]**	**"Brazil Henglong"[9]**	**"Shanghai Henglong[12]**	**"Jingzhou Qingyan[13]**

100%
Jingzhou Henglong Automotive Technology (Testing) Center
"Testing Center"[10]

85%
Wuhan Chuguanjie Automotive Science and Technology Ltd.,
"Wuhan Chuguanjie"[11]

1. 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.

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

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

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

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

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

7. Jielong was established in 2006 and mainly engages in the production and sales of automobile steering columns.

8. 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.

9. 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 sale 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.

10. Testing Center was established in 2009 and mainly engages in the research and development of new products.

11. In May 2014, 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.

12.

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 sale of automotive electronics.

13. In November 2017, Hubei Henglong formed Jingzhou Qingyan Intelligent Automotive Technology Research Institute Co., Ltd., “Jingzhou Qingyan”, which mainly engages in the research and development of intelligent automotive technology.

The Company has business relationships with more than sixty vehicle manufacturers, including FAW Group and Dongfeng Auto Group Co., Ltd., two of 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, and 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 Fiat Chrysler North America are all key customers of the Company. Starting in 2008, the Company has supplied power steering gears to the Sino-foreign joint ventures established by GM, Citroen and Volkswagen in China. The Company has supplied power steering gear to Fiat Chrysler North America since 2009.

INTELLECTUAL PROPERTY RIGHTS

Intellectual Property rights, “IP,” are important in helping the Company maintain its competitive position. Currently, the Company owns IP rights, including two trademarks covering automobile parts, “HL” and “JL,” and more than eighty-five patents registered in China covering power steering technology. The Company is in the process of integrating new advanced technologies such as electronic chips in power steering systems into its current production line and is pursuing aggressive strategies in technology to maintain a competitive edge within the automobile industry. In December 2009, the Company, through Henglong, formed Testing Center and cooperated with Nanyang Ind. Co. Ltd. and Tsinghua University to engage in the research and development of new products, such as EPS, integral rack and pinion power steering and high pressure power steering, to optimize current products design and to develop new, cost-saving manufacturing processes. In January 2015, Hubei Henglong formed Shanghai Henglong, which mainly engages in the design and sale of automotive electronics, to capture the market opportunities for EPS, which were included in traditional hydraulic power steering products by many automobile makers. In November 2017, Hubei Henglong formed Jingzhou Qingyan Intelligent Automotive Technology Research Institute Co., Ltd., which mainly engages in the research and development of intelligent automotive technology.

STRATEGIC PLAN

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

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

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

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

Research and Development. The Company established Testing Center for the research and development of products and, by partnering with Nanyang Ind. Co. Ltd. and Tsinghua University for the development of advanced steering systems, the Company’s objective is to gain increased market share in China.

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

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

- companies that can be easily integrated into product manufacturing and corporate management;

- companies that have strong joint venture partners that would become major customers; and

- companies involved with power steering systems.

CUSTOMERS

The Company’s five largest customers represented 36.8% of the Company’s total sales for the year ended December 31, 2017. The following table sets forth information regarding the Company’s five largest customers.

Name of Major Customers	Percentage of Total Revenue in 2017	
Fiat Chrysler North America	14.3	%
Beiqi Foton	6.3	%
Dongfeng Auto Group Co., Ltd.	6.1	%
SAIC Motor	5.1	%
Zhejiang Geely Holding Group	5.0	%
Total	36.8	%

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

SALES AND MARKETING

The Company’s sales and marketing team has 121 sales persons, which are divided into an OEM team, a sales service team and a working group dedicated to international business. These sales and marketing teams provide a constant interface with the Company’s key customers. They are located in all major vehicle producing regions to represent more effectively the Company’s customers’ interests within the Company’s organization, to promote their programs and to coordinate their strategies with the goal of enhancing overall service and satisfaction. The Company’s ability to support its customers is further enhanced by its broad presence in terms of sales offices, manufacturing facilities, engineering technology centers and joint ventures.

The Company’s sales and marketing organization and activities are designed to create overall awareness and consideration of, and therefore to increase sales of the Company’s modular systems and components. To achieve that objective, the Company organized delegations to visit the United States, Korea, India and Japan and has supplied power steering gear to Fiat Chrysler North America. Through these activities, the Company has generated potential

business interest as a strong base for future development.

DISTRIBUTION

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

EMPLOYEES AND FACILITIES

As of December 31, 2017, the Company employed approximately 5,319 persons, including approximately:

- 2,081 by Henglong (including Testing Center formed by Henglong) ;
- 913 by Jiulong;
- 353 by Shenyang;
- 32 by USAI;
- 178 by Wuhu;
- 228 by Jielong;
- 52 by Wuhan Chuguanjie;
- 1,239 by Hubei Henglong;
- 17 by HLUSA;
- 150 by Chongqing Henglong;
- 27 by Brazil Henglong; and
- 49 by Shanghai Henglong.

As of December 31, 2017, Henglong, Jiulong, Shenyang, Chongqing, Wuhan Chuguanjie, Hubei Henglong and Wuhu had a manufacturing and administration area of 111,211 square meters, 39,478 square meters, 35,354 square meters, 57,849 square meters, 53,675 square meters, 177,747 square meters and 83,705 square meters, respectively.

Hubei Province, which is home to Dongfeng, one of the largest automakers in China, provides an ample supply of inexpensive but skilled labor to automotive-related industries. The annual production of one of the Company’s main products, power steering gears, was approximately 6.1 million units and 5.6 million units in 2017 and 2016,

respectively. Although the production process continues to rely heavily on manual labor, the Company has invested substantially in high-level production machinery to improve capacity and production quality. Approximately $108.4 million was spent over the last three years to purchase professional-grade equipment and extend workshops.

RAW MATERIALS

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

The Company's purchases from its ten largest suppliers represented in the aggregate 20.3% of all components and raw materials it purchased for the year ended December 31, 2017, and none of them provided more than 10% of total purchases.

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

RESEARCH AND DEVELOPMENT

The Company owns the Testing Center, a Hubei Provincial-Level technical center, which has been approved by the Hubei Economic Commission. The center has a staff of about 318, including 40 senior engineers and 89 engineers, primarily focusing on steering system R&D, tests, production process improvement and new material and production methodology application.

In addition, the Company has formed Shanghai Henglong to engage in the design and sale of automotive electronics, including key parts of EPS.

The Company believes that its engineering and technical expertise, together with its emphasis on continuing research and development, allow it to use the latest technologies, materials and processes to solve problems for its customers and to bring new, innovative products to market. The Company believes that continued research and development activities, including engineering, are critical to maintaining its pipeline of technologically advanced products. The Company has aggressively managed costs in other portions of its business in order to increase its total expenditures for research and development activities, including engineering, at approximately $33.5 million and $27.7 million for the years ended December 31, 2017 and 2016, respectively. In 2017 and 2016, the sales of such newly developed products accounted for about 22.0% and 18.1%, respectively, of total sales.

COMPETITION

The automotive components industry is extremely competitive. The Company's customers consider criteria including quality, price/cost competitiveness, system and product performance, reliability and timeliness of delivery, new product and technology development capability, excellence and flexibility in operations, degree of global and local presence, effectiveness of customer service and overall management capability. The power steering system market is

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

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

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

CHINESE AUTOMOBILE INDUSTRY

The Company is a supplier of automotive parts and most of its operations are located in China. An increase or decrease in the output and sales of Chinese vehicles could result in an increase or decrease of the Company's results of operations. According to the latest statistics from the China Association of Automobile Manufacturers, "CAAM", the output and sales volume of passenger vehicles in 2017 was 24.8 million and 24.7 million units, respectively, an increase of 1.6% and 1.4% compared to 2016. The output and sales volume of commercial vehicles in 2017 was 4.2 million and 4.2 million units, respectively, an increase of 13.8% and 14.0% compared to 2016. In 2017, the Company's sales of steering gears for passenger vehicles and commercial vehicles increased by 6.2% and 15.4%, respectively, compared to 2016.

CAAM expects that sales volume of vehicles in China will grow by 3% in 2018.

ENVIRONMENTAL COMPLIANCE

The Company is subject to the requirements of U.S. federal, state, local and non-U.S., including China's, environmental and occupational safety and health laws and regulations. These include laws regulating air emissions, water discharge and waste management. The Company has an environmental management structure designed to facilitate and support its compliance with these requirements globally. Although the Company intends to comply with all such requirements and regulations, it cannot provide assurance that it is at all times in compliance. The Company has made and will continue to make capital and other expenditures to comply with environmental requirements, although such expenditures were not material during the past two years. Environmental requirements are complex, change frequently and have tended to become more stringent over time. Accordingly, the Company cannot assure that environmental requirements will not change or become more stringent over time or that its eventual environmental

cleanup costs and liabilities will not be material.

During the years ended December 31, 2017 and 2016, the Company did not make any material capital expenditures relating to environmental compliance.

FINANCIAL INFORMATION AND GEOGRAPHIC AREAS

Financial information about sales and long-term assets by major geographic region can be found in Note 34, "Segment Reporting" to the consolidated financial statements in this Report. The following table summarizes the percentage of sales and total assets by major geographic regions:

	Net Sales Year Ended December 31,				Long-term assets As of December 31			
	2017		2016		2017		2016	
Geographic region:								
China	76.8	%	86.5	%	99.2	%	99.1	%
United States	16.9		12.0		0.5		0.5	
Other foreign countries	6.3		1.5		0.3		0.4	
Total consolidated	100.0	%	100.0	%	100.0	%	100.0	%

WEBSITE ACCESS TO SEC FILINGS

The Company files electronically with, or furnishes to, the SEC its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports pursuant to Section 13(a) of the Securities Exchange Act of 1934. The Company makes available free of charge on its web site (www.caasauto.com) all such reports as soon as reasonably practicable after they are filed.

The SEC maintains an Internet site that contains reports, proxy information and information statements, and other information regarding issuers that file electronically with the SEC. The address of that website is http://www.sec.gov. The materials are also available at the SEC's Public Reference Room, located at 100 F Street N.E., Washington, D.C. 20549. The public may obtain information through the public reference room by calling the SEC at 1-800-SEC-0330.

ITEM 1A. RISK FACTORS.

Any investment in the Company's securities involves a high degree of risk. You should carefully consider the risks described below, together with the information contained elsewhere in this Annual Report, before you make a decision to invest in the Company. The Company's business, financial conditions and results of operations could be materially and adversely affected by many risk factors. Because of these risk factors, actual results might differ significantly from those projected in any forward-looking statements. Factors that might cause such differences include, among others, the following:

RISKS RELATED TO THE COMPANY'S BUSINESS AND INDUSTRY

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

The Company's business relies on automotive vehicle production and sales by its customers, which are highly cyclical and depend on general economic conditions and other factors, including consumer spending and preferences and the price and availability of gasoline. They also can be affected by labor relations issues, regulatory requirements and other factors. In the last two years, the price of automobiles in China has generally declined. Additionally, the volume of automotive production in China has fluctuated from year to year, which gives rise to fluctuations in the demand for the Company's products. Therefore, any significant economic decline could result in a reduction in automotive production and sales by the Company's customers and could have a material adverse effect on the Company's results of operations. Moreover, if the prices of automobiles keep declining, the selling price of automotive parts also would

decrease, which would result in lower revenues and profitability.

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

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

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

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

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

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

The automobile parts industry is a highly competitive business. The Company's customers consider criteria including:

- quality;
- price/cost competitiveness;
- system and product performance;
- reliability and timeliness of delivery;
- new product and technology development capability;
- excellence and flexibility in operations;
- degree of global and local presence;
- effectiveness of customer service; and
- overall management capability.

The Company's competitors include independent suppliers of parts, as well as suppliers formed by spin-offs from the Company's customers, who are becoming more aggressive in selling parts to other vehicle manufacturers. Depending on the particular product, the number of the Company's competitors varies significantly. Many of the Company's

competitors have substantially greater revenues and financial resources than it does, as well as stronger brand names, consumer recognition, business relationships with vehicle manufacturers, and geographic presence than it has. The Company may not be able to compete favorably and increased competition may substantially harm its business, business prospects and results of operations.

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

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

Recently, pricing pressure from automobile manufacturers has been prevalent in the automotive parts industry in China. Virtually all vehicle manufacturers seek price reductions each year. Although the Company has tried to reduce costs and resist price reductions, these reductions have impacted the Company's sales and profit margins. If the Company cannot offset continued price reductions through improved operating efficiencies and reduced expenditures, price reductions will have a material adverse effect on the Company's results of operations.

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

For the year ended December 31, 2017, approximately 14.3%, 6.3%, 6.1% and 5.1% of the Company's sales were to Fiat Chrysler North America, Beiqi Foton, Dongfeng Auto Group Co., Ltd., and SAIC Motor, the Company's four largest customers in 2017, respectively. In total, these four largest customers accounted for 31.8% of total sales in 2017. For the year ended December 31, 2016, approximately 11.5%, 9.1%, 7.3% and 7.0% of the Company's sales were to Fiat Chrysler North America, JAC, Dongfeng Auto Group Co., Ltd., and SAIC Motor, the Company's four largest customers in 2016, respectively. In total, these four largest customers accounted for 34.9% of total sales in 2016. The loss of, or significant reduction in purchases by, one or more of these major customers could adversely affect the Company's business.

The Company may not be able to collect receivables incurred by customers.

The Company currently sells its products on credit and its ability to receive payment for its products depends on the continued creditworthiness of its customers. Although the Company has long term relationships with its major customers, the customer base may change if its sales increase because of the Company's expanded capacity. If the Company is not able to collect its receivables, its profitability will be adversely affected.

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

The Company may be exposed to product liability and warranty claims if its products actually or allegedly fail to perform as expected or the use of its products results, or is alleged to result, in bodily injury and/or property damage.

The Company started to pay some of its customers' increased after-sales service expenses due to consumer rights protection policies of "recall" issued by the Chinese government in 2004, such as the recalling flawed vehicles policy. Beginning in 2004, automobile manufacturers unilaterally required their suppliers to pay a "3-R Guarantees" service charge for repair, replacement and refund in an amount of about 2%–6% of the total amount of parts supplied. Accordingly, the Company has experienced and will continue to experience higher after sales service expenses. Product liability, warranty and recall costs may have a material adverse effect on the Company's financial condition.

On January 3, 2017, Chongqing Changan Automobile Co., Ltd. registered a recall plan with The General Administration of Quality Supervision, Inspection and Quarantine pursuant to the "Regulation on the Administration of Recall of Defective Auto Products". The recall plan relates to the recall of 108,642 Eulove vehicles manufactured between November 7, 2012 and November 13, 2015. The recall commenced on March 1, 2017. According to the supplier, the torque sensor on the upper steering shaft subassembly in the recalled vehicles is subject to abnormal wear after long-term usage, posing a safety risk in extreme situations. Chongqing Changan Automotive Co., Ltd. is implementing the recall to replace the upper steering shaft subassembly in the recalled vehicles free of charge to mitigate the safety risk.

On January 22, 2017, Jiangxi Changhe Suzuki Automobile Co., Ltd. registered a recall plan with The General Administration of Quality Supervision, Inspection and Quarantine pursuant to the "Regulation on the Administration of Recall of Defective Auto Products". The recall plan relates to the recall of 44,169 Liana A6 vehicles manufactured between September 7, 2013 and April 28, 2015. The recall commenced on February 24, 2017. According to the supplier, the electronic-assist ECU may malfunction under certain circumstances, which may lead the steering assist to enter safety protection status, posing a safety risk in extreme situations. Jiangxi Changhe Suzuki Automotive Co., Ltd. is implementing the recall to conduct a technical upgrade of the ECU in the recalled vehicles free of charge to mitigate the safety risk.

Management has concluded that the defect that led to each of the recalls arose due to the erosion of the contact sensor after long-term use only in vehicles equipped with first-generation EPS. The Company has taken technical measures to reduce the contact sensor erosion in first-generation EPS. The contact sensors in current EPS products have been largely replaced by non-contact sensors.

The Company has recorded a warranty expense of $5.0 million relating to the recall plans in 2016 described above, which represents the Company's best estimate of the related costs, in the consolidated financial statements included in this Report (See Note 2).

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

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

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

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

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

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

The Company's management controls approximately 62.2% ***of its outstanding common stock and may have conflicts of interest with the Company's minority stockholders.***

As of December 31, 2017, members of the Company's management beneficially own approximately 62.2% of the outstanding shares of the Company's common stock. As a result, except for the related party transactions that require approval of the audit committee of the board of directors of the Company, these majority stockholders have control over decisions to enter into any corporate transaction, which could result in the approval of transactions that might not maximize overall stockholders' value. Additionally, these stockholders control the election of members of the Company's board, have the ability to appoint new members to the Company's management team and control the outcome of matters submitted to a vote of the holders of the Company's common stock. The interests of these majority stockholders may at times conflict with the interests of the Company's other stockholders. The Company regularly engages in transactions with entities controlled by one or more of its officers and directors, including those controlled by Mr. Hanlin Chen, the chairman of the board of directors of the Company and its controlling stockholder.

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

There is a limited public float of the Company's common stock. As of December 31, 2017, approximately 37.8% of the Company's outstanding common stock is considered part of the public float. The term "public float" refers to shares freely and actively tradable on the NASDAQ Capital Market and not owned by officers, directors or affiliates, as such term is defined under the Securities Act. As a result of the limited public float and the limited trading volume on some days, the market price of the Company's common stock can be volatile, and relatively small changes in the demand for or supply of the Company's common stock can have a disproportionate effect on the market price for its common stock. This stock price volatility could prevent a security holder seeking to sell the Company's common stock or derivative securities from being able to sell them at or above the price at which the stock or derivative securities were bought, or at a price which a fully liquid market would report.

The Company is subject to penny stock regulations and restrictions.

The SEC has adopted regulations which generally define so-called "penny stock" as an equity security that has a market price less than $5.00 per share or an exercise price of less than $5.00 per share, subject to certain exemptions. As of December 31, 2017, the closing price for the Company's common stock was $4.80. If the Company's stock is a "penny stock", it may become subject to Rule 15g-9 under the Securities Exchange Act of 1934, the "Penny Stock Rule." This rule imposes additional sales practice requirements on broker-dealers that sell such securities to persons other than established customers and "accredited investors," generally, individuals with a net worth in excess of $1.0 million or annual incomes exceeding $0.2 million, or $0.3 million together with their spouses. For transactions covered by Rule 15g-9, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to sale. As a result, this rule may affect the ability of broker-dealers to sell the Company's securities and may affect the ability of purchasers to sell any of the Company's securities in the secondary market.

For any transaction involving a penny stock, unless exempt, the rules require delivery, prior to any transaction in a penny stock, of a disclosure schedule prepared by the SEC relating to the penny stock market. Disclosure also is required to be made about sales commissions payable to both the broker-dealer and the registered representative and current quotations for the securities. Finally, monthly statements are required to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stock.

There can be no assurance that the Company's common stock will qualify for exemption from the Penny Stock Rule. In any event, even if the Company's common stock were exempt from the Penny Stock Rule, the Company would remain subject to Section 15(b)(6) of the Exchange Act, which gives the SEC the authority to restrict any person from

participating in a distribution of penny stock if the SEC finds that such a restriction would be in the public interest.

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

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

Failure to maintain effective internal control over financial reporting could have a material adverse effect on the Company's business, results of operations and the trading price of its shares.

The Company is subject to reporting obligations under the U.S. securities laws. The Securities and Exchange Commission, the "SEC," as required by Section 404 of the Sarbanes-Oxley Act of 2002, has adopted rules requiring public companies to include a report of management in its annual report that contains an assessment by management of the effectiveness of such company's internal control over financial reporting.

If the Company fails to maintain the adequacy of its internal controls in the future, it will not be able to ensure that it can conclude on an ongoing basis that it has effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal controls are necessary for the Company to produce reliable financial reports and are important to help prevent fraud. Any failure to maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of the Company's financial statements, which in turn could harm its business and negatively impact the trading price of its common stock. Furthermore, the Company may need to incur additional costs and use additional management and other resources in an effort to comply with Section 404 of the Sarbanes-Oxley Act and other requirements going forward.

The Company generally does not pay cash dividends on its common stock.

Although the Company announced a special cash dividend of $0.18 per common share to the Company's shareholders of record as of the close of business on June 26, 2014, it does not anticipate paying any other cash dividends in the foreseeable future. The Company currently intends to retain future earnings, if any, to finance operations and the expansion of its business. Any future determination to pay cash dividends will be at the discretion of the Company's board of directors and will be based upon the Company's financial condition, operating results, capital requirements, plans for expansion, restrictions imposed by any financing arrangements and any other factors that the Company's board of directors deems relevant.

Techniques employed by short sellers may drive down the market price of the Company’s common stock.

Short selling is the practice of selling securities that the seller does not own but rather has borrowed from a third party with the intention of buying identical securities back at a later date to return to the lender. The short seller hopes to profit from a decline in the value of the securities between the sale of the borrowed securities and the purchase of the replacement shares, as the short seller expects to pay less in that purchase than it received in the sale. As it is in the short seller’s best interests for the price of the stock to decline, many short sellers publish, or arrange for the publication of, negative opinions regarding the relevant issuer and its business prospects in order to create negative market momentum and generate profits for themselves after selling a stock short. These short attacks have, in the past, led to selling of shares in the market.

In the recent past, public companies that have substantially all of their operations in China have been the subject of short selling. Much of the scrutiny and negative publicity has centered around allegations of a lack of effective internal control over financial reporting resulting in financial and accounting irregularities and mistakes, inadequate corporate governance policies or a lack of adherence thereto and, in many cases, allegations of fraud. As a result, many of these companies are now conducting internal and external investigations into the allegations and, in the interim, are subject to shareholder lawsuits and/or SEC enforcement actions.

It is not clear what effect such negative publicity would have on the Company, if any. If the Company were to become the subject of any unfavorable allegations, whether such allegations are proven to be true or untrue, the Company could have to expend a significant amount of resources to investigate such allegations and/or defend itself. While the Company would strongly defend against any such short seller attacks, the Company may be constrained in the manner in which it can proceed against the relevant short seller by principles of freedom of speech, applicable state law or issues of commercial confidentiality. Such a situation could be costly and time-consuming, and could distract the Company's management from growing the Company. Even if such allegations are ultimately proven to be groundless, allegations against the Company could severely impact its business operations and stockholders equity, and any investment in the Company's stock could be greatly reduced or rendered worthless.

The Company's secured credit facilities contain certain financial covenants that it may not satisfy, which, if not satisfied, could result in the acceleration of the amounts due under the Company's secured credit facilities and the limitation of the Company's ability to borrow additional funds in the future.

The agreements governing the Company's secured credit facilities subject it to various financial and other restrictive covenants with which the Company must comply on an ongoing or periodic basis. These covenants include, but are not limited to, restrictions on the utilization of the funds and the maintenance of certain financial ratios. If the Company violate any of these covenants, the Company's outstanding debt under the Company's secured credit facilities could become immediately due and payable, the Company's lenders could proceed against any collateral securing such indebtedness and the Company's ability to borrow additional funds in the future may be limited. Alternatively, the Company could be forced to refinance or renegotiate the terms and conditions of the Company's secured credit facilities, including the interest rates, financial and restrictive covenants and security requirements of the secured credit facilities, on terms that may be significantly less favorable to the Company.

RISKS RELATED TO DOING BUSINESS IN CHINA AND OTHER COUNTRIES BESIDES THE UNITED STATES

The Company may face a severe operating environment during times of economic recession.

The sales volume of the Company's core products is largely influenced by the demand for its customers' end products which are mostly sold in the Chinese markets. Future economic crises, either within China or without, may lead to a drastic drop in demand for the Company's products.

Inflation in China could negatively affect the Company's profitability and growth.

China's economy has experienced rapid growth, much of it due to the issuance of debt over the last few years. This debt-fueled economic growth has led to growth in the money supply, causing rising inflation. If prices for the Company's products rise at a rate that is insufficient to compensate for the rise in the cost of production, it may harm the Company's profitability. In order to control inflation, the Chinese government has imposed controls on bank credit, limits on loans and other restrictions on economic activities. Such policies have led to a slowing of economic growth. Additional measures could further slow economic activity in China, which could, in turn, materially increase the Company's costs while also reducing demand for the Company's products.

The Chinese government's macroeconomic policies could have a negative effect on the Company's business and results of operations.

The Chinese government has implemented various measures from time to time to control the rate of economic growth in the PRC. Some of these measures may have a negative effect on the Company over the short or long term. Recently, to cope with high inflation and economic imbalances, the Chinese government has tightened monetary policy and implemented floating exchange rate policy. In addition, in order to alleviate some of the effects of unbalanced growth and social discontent, the Chinese government has enacted a series of social programs and anti-inflationary measures. These, in turn, have increased the costs on the financial and manufacturing sectors, without having alleviated the effects of high inflation and economic imbalances. The Chinese government's macroeconomic policies, even if effected properly, may significantly slow down China's economy or cause great social unrest, all of which would have a negative effect on the Company's business and results of operations.

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

Most of the Company’s business, assets and operations are located in China. The economy of China differs from the economies of most developed countries in many respects, including government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. The economy of China has been transitioning from a planned economy to a more market-oriented economy. Although the Chinese government has implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the Chinese government.

In addition, the Chinese government continues to play a significant role in regulating industry by imposing industrial policies. It also exercises significant control over China’s economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Therefore, the Chinese government’s involvement in the economy could adversely affect the Company’s business operations, results of operations and/or financial condition.

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

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

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

The Company's long-term business strategy relies on the expansion of its international sales outside China by targeting markets, such as the United States and Brazil. The Company's net sales outside of China increased from $62.5 million in 2016 to $87.7 million in 2017. Risks affecting the Company's international expansion include challenges caused by distance, language and cultural differences, conflicting and changing laws and regulations, foreign laws, international import and export legislation, trading and investment policies, foreign currency fluctuations, the burdens of complying with a wide variety of laws and regulations, protectionist laws and business practices that favor local businesses in some countries, foreign tax consequences, higher costs associated with doing business internationally, restrictions on the export or import of technology, difficulties in staffing and managing international operations, trade and tariff restrictions, and variations in tariffs, quotas, taxes and other market barriers. These risks could harm the Company's international expansion efforts, which could in turn materially and adversely affect its business, operating results and financial condition.

On September 17, 2012, the United States filed a trade case with the World Trade Organization, "WTO," against the PRC with respect to the PRC government's purported provision of subsidies to the automobile and automobile-parts enterprises in the PRC. If the WTO rules against China in this trade case, the cost of sales of the Company could increase due to the imposition of any tariff and/or the Company's ability to export products to the United States could be limited, which could affect the Company's business and operating results.

In addition, under Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC has adopted additional disclosure requirements related to the source of certain "conflict minerals" for issuers for which such "conflict minerals" are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by that issuer. The metals covered by the rules include tin, tantalum, tungsten and gold, commonly referred to as "3TG." If these materials are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, the rules require a reasonable country of origin inquiry be conducted to determine if an issuer knows, or has reason to believe, that any of the minerals used in the production process may have originated from the Democratic Republic of the Congo or an adjoining country. In such a case, if an issuer were not able to

determine that the minerals did not originate from a covered country or conclude that there is no reason to believe that the minerals used in the production process may have originated in a covered country, that issuer could be required to perform supply chain due diligence on members of its supply chain. Global supply chains can have multiple layers, thus the costs of complying with these new requirements could be substantial. These new requirements may also reduce the number of suppliers that provide conflict-free metals, and may affect a company’s ability to obtain products in sufficient quantities or at competitive prices. If the Company was to source such 3TG minerals that are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, compliance costs with these rules and/or the unavailability of raw materials could have a material adverse effect on the Company’s results of operations.

The Company faces risks associated with currency exchange rate fluctuations; any adverse fluctuation may adversely affect its operating margins.

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

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

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

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

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

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

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

The Chinese government controls its foreign currency reserves through restrictions on imports and conversion of RMB into foreign currency. In July 2005, the Chinese government has adjusted its exchange rate policy from "Fixed Rate" to "Floating Rate". Between July 2005 to December 2017, the exchange rate between the RMB and the U.S. dollar appreciated from RMB1.00 to $0.1205 to RMB1.00 to $0.1513. Any significant appreciation of the RMB is likely to decrease the income of export products and the cash flow of the Company.

Because the Chinese legal system is not fully developed, the Company and its security holders' legal protections may be limited.

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

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

Most of the Company's assets are located in China and twelve of its directors and officers are non-residents of the United States, and all or substantial portions of the assets of such non-residents are located outside the United States. As a result, it may not be possible to effect service of process within the United States upon such persons to originate an action in the United States. Moreover, there is uncertainty that the courts of China would enforce judgments of U.S.

courts against the Company, its directors or officers based on the civil liability provisions of the securities laws of the United States or any state, or an original action brought in China based upon the securities laws of the United States or any state.

The Company may be subject to fines and legal sanctions imposed by State Administration of Foreign Exchange, "SAFE", or other Chinese government authorities if it or its Chinese directors or employees fail to comply with recent Chinese regulations relating to employee share options or shares granted by offshore listed companies to Chinese domestic individuals.

On December 25, 2006, the People's Bank of China, or PBOC, issued the Administration Measures on Individual Foreign Exchange Control, and the corresponding Implementation Rules were issued by SAFE on January 5, 2007. Both of these regulations became effective on February 1, 2007. According to these regulations, all foreign exchange matters relating to employee stock holding plans, share option plans or similar plans with Chinese domestic individuals' participation require approval from the SAFE or its authorized branch. On March 28, 2007, the SAFE issued the Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas-Listed Company, or the Stock Option Rule. Under the Stock Option Rule, Chinese domestic individuals who are granted share options or shares by an offshore listed company are required, through a Chinese agent or Chinese subsidiary of the offshore listed company, to register with the SAFE and complete certain other procedures. As the Company is an offshore listed company, its Chinese domestic directors and employees who may be granted share options or shares shall become subject to the Stock Option Rule. Under the Stock Option Rule, employees stock holding plans, share option plans or similar plans of offshore listed companies with Chinese domestic individuals' participation must be filed with the SAFE. After the Chinese domestic directors or employees exercise their options, they must apply for the amendment to the registration with the SAFE. As of December 31, 2017, the Company has completed such SAFE registration and other related procedures according to PRC law. If the Company or its Chinese domestic directors or employees fail to comply with these regulations in the future, the Company or its Chinese domestic directors or employees may be subject to fines or other legal sanctions imposed by the SAFE or other Chinese government authorities.

Capital outflow policies in China may hamper the Company's ability to declare and pay dividends to its stockholders.

China has adopted currency and capital transfer regulations. These regulations may require the Company to comply with complex regulations for the movement of capital. Although the Company's management believes that it will be in compliance with these regulations, should these regulations or the interpretation of them by courts or regulatory agencies change, the Company may not be able to pay dividends to its stockholders outside of China. In addition, under current Chinese law, the Company's joint-ventures and wholly-owned enterprise in China must retain a reserve equal to 10% of its net income after taxes, not to exceed 50% of its registered capital. Accordingly, this reserve will not be available to be distributed as dividends to the Company's stockholders. The Company presently does not intend to pay dividends for the foreseeable future. The Company's board of directors intends to follow a policy of retaining all of its earnings to finance the development and execution of its strategy and the expansion of its business.

Registered public accounting firms in China, including the Company's independent registered public accounting firm, are not inspected by the U.S. Public Company Accounting Oversight Board, which deprives the Company and

its investors of the benefits of such inspection.

Auditors of companies whose shares are registered with the U.S. Securities and Exchange Commission and traded publicly in the United States, including the Company's independent registered public accounting firm, must be registered with the U.S. Public Company Accounting Oversight Board, the "PCAOB," and are required by the laws of the United States to undergo regular inspections by the PCAOB to assess their compliance with the laws of the United States and professional standards applicable to auditors. The Company's independent registered public accounting firm is located in, and organized under the laws of, the PRC, which is a jurisdiction where the PCAOB, notwithstanding the requirements of U.S. law, is currently unable to conduct inspections without the approval of the Chinese authorities, which approval has not been granted for auditors such as the Company's independent registered public accounting firm. This lack of PCAOB inspections in China prevents the PCAOB from fully evaluating audits and quality control procedures of the Company's independent registered public accounting firm. As a result, the Company and investors in its common stock are deprived of the benefits of such PCAOB inspections.

The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of the Company's independent registered public accounting firm's audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections, which could cause investors and potential investors in the Company's stock to lose confidence in its audit procedures and reported financial information and the quality of its financial statements.

If additional remedial measures are imposed on the Big Four PRC-based accounting firms, including our independent registered public accounting firm, in administrative proceedings brought by the SEC alleging the firms' failure to meet specific criteria set by the SEC, we could be unable to timely file future financial statements in compliance with the requirements of the Securities Exchange Act of 1934.

In December 2012, the SEC instituted administrative proceedings against the Big Four PRC-based accounting firms, including our independent registered public accounting firm, alleging that these firms had violated U.S. securities laws and the SEC's rules and regulations thereunder by failing to provide to the SEC the firms' audit work papers with respect to certain PRC-based companies that are publicly traded in the United States. On January 22, 2014, the administrative law judge (ALJ) presiding over the matter rendered an initial decision that each of the firms had violated the SEC's rules of practice by failing to produce audit work papers to the SEC. The initial decision censured each of the firms and barred them from practicing before the SEC for a period of six months. The Big Four PRC-based accounting firms appealed the ALJ's initial decision to the SEC. The ALJ's decision does not take effect unless and until it is endorsed by the SEC. In February 2015, the four China-based accounting firms each agreed to a censure and to pay a fine to the SEC to settle the dispute and avoid suspension of their ability to practice before the SEC and audit U.S.-listed companies. The settlement required the firms to follow detailed procedures and to provide the SEC with access to Chinese firms' audit documents via the China Securities Regulatory Commission, or the CSRC. If future document productions fail to meet specified criteria, the SEC retains authority to impose a variety of additional remedial measures on the firms depending on the nature of the failure. While we cannot predict whether the SEC will further review the four China-based accounting firms' compliance with specified criteria or if the results of such a review would result in the SEC imposing penalties such as suspensions or restarting the administrative proceedings, if the accounting firms are subject to additional remedial measures, our ability to file our financial statements in compliance with SEC requirements could be impacted. A determination that we have not timely filed financial statements in compliance with SEC requirements could ultimately lead to the delisting of our common stock from NASDAQ or the termination of the registration of our common stock under the Securities Exchange Act of 1934, or both, which would substantially reduce or effectively terminate the trading of our common stock in the United States.

The non-U.S. activities of our non-U.S. subsidiaries may be subject to U.S. taxation.

The majority of our subsidiaries are based in China and are subject to income taxes in the PRC. These China-based subsidiaries conduct substantially all of our operations, and generate most of our income in China. The Company is a Delaware corporation and is subject to income tax in the United States. New U.S. federal tax legislation, commonly referred to as the Tax Cuts and Jobs Act (the "U.S. Tax Reform"), was signed into law on December 22, 2017. The U.S. Tax Reform significantly modified the U.S. Internal Revenue Code by, among other things, reducing the statutory U.S. federal corporate income tax rate from 35% to 21% for taxable years beginning after December 31, 2017; limiting and/or eliminating many business deductions; migrating the U.S. to a territorial tax system with a one-time transition tax on a mandatory deemed repatriation of previously deferred foreign earnings of certain foreign subsidiaries; subject to certain limitations, generally eliminating U.S. corporate income tax on dividends from foreign subsidiaries; and providing for new taxes on certain foreign earnings. Taxpayers may elect to pay the one-time transition tax over eight years, or in a single lump-sum payment.

Certain activities conducted in the PRC or other jurisdictions outside of the U.S. may give rise to U.S. corporate income tax. These taxes would be imposed on the Company when its subsidiaries that are controlled foreign corporations ("CFCs") generate income that is subject to Subpart F of the U.S. Internal Revenue Code, or "Subpart F". Passive income, such as rents, royalties, interest, dividends, and gain from disposal of our investments, is among the types of income subject to taxation under Subpart F. Any income taxable under Subpart F is taxable in the U.S. at federal corporate income tax rates of up to 21% for taxable years beginning after December 31, 2017. Subpart F income is taxable to the Company, even if it is not distributed to the Company.

The U.S. Tax Reform also includes provisions for a new tax on global intangible low-taxed income ("GILTI") effective for tax years of non-U.S. corporations beginning after December 31, 2017. The GILTI provisions impose a tax on foreign income in excess of a deemed return on tangible assets of CFCs, subject to the possible use of foreign tax credits and a deduction equal to 50 percent to offset the income tax liability, subject to some limitations.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not Applicable.

ITEM 2. PROPERTIES.

The Company's headquarters are located at No. 1 Henglong Road, Yu Qiao Development Zone, Shashi District, Jing Zhou City Hubei Province, the PRC. Set forth below are the manufacturing facilities operated by each joint venture. The Company has forty-five to fifty years long-term rights to use the lands and buildings (in thousands of USD, except for references to area in square meters).

Name of Entity	Product	Total Area (sq.m.)	Building Area (sq.m.)	Original Cost of Equipment	Site
Henglong	Automotive Parts	97,818	20,226	$ 55,438	Jingzhou City, Hubei Province
		13,393	13,707	$ -	Wuhan City, Hubei Province
Jiulong	Power Steering Gear	39,478	23,728	$ 35,690	Jingzhou City, Hubei Province
Shenyang	Automotive Steering Gear	35,354	10,425	$ 6,169	Shenyang City, Liaoning Province
Chongqing	Power Steering Gear	57,849	10,413	$ 2,431	Chongqing City
Jielong(1)	Electric Power Steering	-	-	$ 4,813	Wuhan City, Hubei Province
Wuhan Chuguanjie	Electric Power Steering	53,675	-	$ -	Wuhan City, Hubei Province
USAI(1)	Sensor Modular	-	-	$ 1,021	Wuhan City, Hubei Province
Hubei Henglong	Automotive Steering Gear	177,747	65,749	$ 17,438	Jingzhou City, Hubei Province
Wuhu	Automotive Steering Gear	83,705	27,288	$ 4,610	Wuhu City, Anhui Province
Total		559,019	171,536	$ 127,610	

(1) Jielong and USAI do not own land use rights or buildings by themselves. They rent buildings from Jiulong and Henglong, respectively.

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

ITEM 3. LEGAL PROCEEDINGS.

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

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

PART II

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

MARKET PRICES OF COMMON STOCK

The Company's common stock has been traded on the NASDAQ Capital Market under the symbol "**CAAS**". The high and low bid intra-day prices of the common stock in 2017 and 2016 were reported on NASDAQ for the time periods indicated on the table below. Accordingly, the table below contains the high and low bid closing prices of the common stock as reported on the NASDAQ for the time periods indicated.

	Price Range			
	2017		2016	
	High	Low	High	Low
First Quarter	$5.90	$4.38	$5.24	$3.52
Second Quarter	$5.17	$4.41	$4.60	$3.15
Third Quarter	$5.85	$4.71	$4.34	$3.18
Fourth Quarter	$5.35	$4.76	$7.78	$3.76

ISSUER PURCHASES OF EQUITY SECURITIES

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 markets prices or in privately negotiated transactional 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. During the year ended December 31, 2017, there were no share repurchases.

STOCKHOLDERS

The Company's common shares are issued in registered form. Securities Transfer Corporation in Frisco, Texas is the registrar and transfer agent for the Company's common stock. As of December 31, 2017, there were 31,644,004 shares of the Company's common stock (excluding 694,298 shares of the Company's treasury stock) issued and outstanding and the Company had approximately 58 stockholders of record.

DIVIDENDS

On May 27, 2014, the Company announced the payment of a special cash dividend of $0.18 per common share to the Company's shareholders of record as of the close of business on June 26, 2014. This special dividend was treated as a return of capital. The Company does not anticipate paying any other cash dividends in the foreseeable future. The Company currently intends to retain future earnings, if any, to finance operations and the expansion of its business. Any future determination to pay cash dividends will be at the discretion of the Company's board of directors and will be based upon the Company's financial condition, operating results, capital requirements, plans for expansion, restrictions imposed by any financing arrangements and any other factors that the Company's board of directors deems relevant.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The securities authorized for issuance under equity compensation plans at December 31, 2017 are as follows:

Plan category	Number of securities to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of securities remaining available for future issuance
Equity compensation plans approved by security holders	2,200,000	$ 7.57	1,608,650

The stock option plan was approved at the Annual Meeting of Stockholders held on June 28, 2005 and extended for ten years at the Annual Meeting of Stockholders held on September 16, 2014. The maximum common shares for issuance under the plan are 2,200,000. The term of the plan was extended to June 27, 2025.

ITEM 6. SELECTED FINANCIAL DATA.

Not Applicable.

ITEM 7. 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 consolidated financial statements and the related notes thereto and other financial information contained elsewhere in this report.

GENERAL OVERVIEW

China Automotive Systems, Inc., including, when the context so requires, its subsidiaries and the subsidiaries' interests in the Sino-foreign joint ventures described below, is referred to herein as the "Company." The Company, through its Sino-foreign joint ventures, engages in the manufacture and sales of automotive systems and components in the People's Republic of China, the "PRC," or "China." Genesis, a company incorporated on January 3, 2003 under the Companies Ordinance of Hong Kong as a limited liability company, is a wholly-owned subsidiary of the Company. Henglong USA Corporation, "HLUSA," which was incorporated on January 8, 2007 in Troy, Michigan, is a wholly-owned subsidiary of the Company, and mainly engages in marketing of automotive parts in North America, and provides after sales service and research and development support accordingly. Furthermore, the Company owns the following aggregate net interests in the subsidiaries incorporated in the PRC and Brazil as of December 31, 2017 and 2016.

	Aggregate Net Interest			
Name of Entity	December 31, 2017		December 31, 2016	
Henglong	100.00	%	100.00	%
Jiulong	100.00	%	100.00	%
Shenyang	70.00	%	70.00	%
USAI	83.34	%	83.34	%
Wuhu	77.33	%	77.33	%
Jielong	85.00	%	85.00	%
Hubei Henglong	100.00	%	100.00	%
Testing Center	100.00	%	100.00	%
Chongqing Henglong	70.00	%	70.00	%
Brazil Henglong	95.84	%	80.00	%
Wuhan Chuguanjie	85.00	%	85.00	%
Shanghai Henglong	100.00	%	100.00	%
Jingzhou Qingyan	60.00	%	-	

RESULTS OF OPERATIONS

2017 Versus 2016 Comparative

Net Sales and Cost of Sales

For the years ended December 31, 2017 and 2016, net sales and cost of sales are summarized as follows (figures are in thousands of USD):

	Net Sales				Cost of sales			
	2017	2016	Change		2017	2016	Change	
Henglong	$279,706	$301,367	$(21,661)	-7.2 %	$250,507	$263,105	$(12,598)	-4.8 %
Jiulong	100,776	76,968	23,808	30.9	87,652	66,944	20,708	30.9
Shenyang	40,182	35,191	4,991	14.2	34,829	30,092	4,737	15.7
Wuhu	25,599	23,968	1,631	6.8	23,636	21,951	1,685	7.7
Hubei Henglong	92,293	57,311	34,982	61.0	66,390	39,975	26,415	66.1
Other Sectors	59,075	46,928	12,147	25.9	49,871	38,446	11,425	29.7
Eliminations	(98,568)	(79,683)	(18,885)	23.7	(98,456)	(79,382)	(19,074)	24.0
Total	$499,063	$462,050	$37,013	8.0 %	$414,429	$381,131	$33,298	8.7 %

Net Sales

Net product sales were $499.1 million for the year ended December 31, 2017, as compared to $462.1 million for the year ended December 31, 2016, representing an increase of $37.0 million, or 8.0%.

The product mix change also caused an increase in the Company’s net product sales. Net sales of traditional steering products were $378.4 million for the year ended December 31, 2017, compared to $329.7 million for 2016, representing an increase of $48.7 million, or 14.8%. Net sales of EPS were $120.7 million for the year ended December 31, 2017, compared to $129.2 million for 2016, representing a decrease of $8.5 million, or 6.6%. As a percentage of net sales, the sales of EPS was 24.2% for the year ended December 31, 2017, compared to 28.0% for 2016.

The appreciation of the RMB against the U.S. dollar in 2017 also caused an increase in net sales, as more than 80.0% of the Company's business is conducted in China.

In summary, an increase in sales volume led to a sales increase of $35.3 million, a decrease in average selling price of steering gears led to a sales decrease of $6.2 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales increase of $7.9 million.

Further analysis is as follows:

Net sales for Henglong were $279.7 million for the year ended December 31, 2017, compared with $301.4 million for the year ended December 31, 2016, representing a decrease of $21.7 million, or 7.2%, which was mainly due to a decrease in sales of EPS, partially offset by the increase in sales of hydraulic power steering gears. A decrease in sales volume led to a sales decrease of $17.9 million, a decrease in selling price led to a sales decrease of $4.9 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales increase of $1.1 million.

Net sales for Jiulong were $100.8 million for the year ended December 31, 2017, compared with $77.0 million for the year ended December 31, 2016, representing an increase of $23.8 million, or 30.9%. An increase in sales volume led to a sales increase of $22.9 million, a decrease in selling price led to a sales decrease of $0.5 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales increase of $1.4 million.

Net sales for Shenyang were $40.2 million for the year ended December 31, 2017, compared with $35.2 million for the year ended December 31, 2016, representing an increase of $5.0 million, or 14.2%. The products of Shenyang are mainly sold to Shenyang Brilliance Jinbei Automobile Co., LTD., "Jinbei". An increase in sales volumes led to a sales increase of $4.5 million, a decrease in 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 increase of $0.6 million.

Net sales for Wuhu were $25.6 million for the year ended December 31, 2017, compared with $24.0 million for the year ended December 31, 2016, representing an increase of $1.6 million, or 6.7%. The products of Wuhu are mainly sold to Chery Automobile Co., Ltd., "Chery". An increase in sales volumes led to a sales increase of $4.6 million, a decrease in selling prices led to a sales decrease of $3.3 million and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales increase of $0.3 million.

Net sales for Hubei Henglong were $92.3 million for the year ended December 31, 2017, compared with $57.3 million for the year ended December 31, 2016, representing an increase of $35.0 million, or 61.1%. 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 $34.8 million, a decrease in selling price led to a sales decrease of $0.9 million, and the effect of foreign currency translation of the RMB against the U.S. dollar led to a sales increase of $1.1 million.

Net sales for Other Sectors were $59.1 million for the year ended December 31, 2017, compared with $46.9 million for the year ended December 31, 2016, representing an increase of $12.2 million, or 26.0%, primarily due to an increase in sales volumes of Jielong, which manufactures automobile steering columns for both HPS and EPS.

Cost of Sales

For the year ended December 31, 2017, the cost of sales was $414.4 million, compared with $381.1 million for the year ended December 31, 2016, representing an increase of $33.3 million, or 8.7%. The increase in cost of sales was mainly due to an increase in sales volumes with a cost of sales increase of $24.1 million, an increase in unit cost with a cost of sales increase of $2.6 million and the appreciation of the RMB against the U.S. dollar with a cost of sales increase of $6.6 million. The increase in the unit cost of sales was primarily due to an increase in the costs of raw materials, such as steel. Further analysis is as follows:

Cost of sales for Henglong was $250.5 million for the year ended December 31, 2017, compared with $263.1 million for the year ended December 31, 2016, representing a decrease of $12.6 million, or 4.8%. A decrease in sales volumes resulted in a cost of sales decrease of $14.8 million, an increase in unit material and subcomponents costs led to a cost of sales increase of $1.1 million and the effect of foreign currency translation of the RMB against the U.S. dollar led to a cost of sales increase of $1.1 million.

Cost of sales for Jiulong was $87.7 million for the year ended December 31, 2017, compared with $66.9 million for the year ended December 31, 2016, representing an increase of $20.8 million, or 31.1%. The increase in cost of sales was mainly due to an increase in sales volumes resulting in a cost of sales increase of $18.8 million, an increase in unit cost resulting in a cost of sales increase of $1.0 million, and the effect of foreign currency translation of the RMB against the U.S. dollar resulting in a cost of sales increase of $1.0 million.

Cost of sales for Shenyang was $34.8 million for the year ended December 31, 2017, compared with $30.1 million for the year ended December 31, 2016, representing an increase of $4.7 million, or 15.6%. The increase in cost of sales was mainly due to an increase in sales volumes resulting in a cost of sales increase of $3.9 million, an increase in unit cost resulting in a cost of sales increase of $0.3 million and the effect of foreign currency translation of the RMB against the U.S. dollar resulting in a cost of sales increase of $0.5 million.

Cost of sales for Wuhu was $23.6 million for the year ended December 31, 2017, compared with $22.0 million for the year ended December 31, 2016, representing an increase of $1.6 million, or 7.3%. The increase in cost of sales was mainly due to an increase in sales volumes resulting in a cost of sales increase of $1.1 million, an increase in unit cost resulting in a cost of sales increase of $0.3 million and the effect of foreign currency translation of the RMB against the U.S. dollar resulting in a cost of sales increase of $0.2 million.

Cost of sales for Hubei Henglong was $66.4 million for the year ended December 31, 2017, compared with $40.0 million for the year ended December 31, 2016, representing an increase of $26.4 million, or 66.0%. The net increase in cost of sales was mainly due to an increase in sales volumes resulting in a cost of sales increase of $25.2 million, an increase in unit cost resulting in a cost of sales increase of $0.6 million and the appreciation of the RMB against U.S. dollar resulting in a cost of sales increase of $0.6 million

Cost of sales for Other Sectors was $49.9 million for the year ended December 31, 2017, compared with $38.4 million for the year ended December 31, 2016, representing an increase of $11.5 million, or 29.9%. The increase in cost of sales for Other Sectors was mainly due to the increase in cost of sales of Jielong.

Gross margin was 17.0% for the year ended December 31, 2017, representing a 0.5% decrease from 17.5% for the year ended December 31, 2016, which was primarily due to the product mix change in 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 year ended December 31, 2017, gain on other sales amounted to $7.6 million, as compared to $3.8 million for the year ended December 31, 2016, representing an increase of $3.8 million, which was due to the gain on disposal of a building of $2.2 million and increased sales volumes of materials.

Selling Expenses

For the years ended December 31, 2017 and 2016, selling expenses are summarized as follows (figures are in thousands of USD):

	Year Ended December 31,			
	2017	2016	Increase/(Decrease)	Percentage
Transportation expense	$ 7,356	$ 6,136	$ 1,220	19.9 %
Salaries and wages	4,492	4,406	86	2.0 %
Marketing and office expense	5,130	3,764	1,366	36.3 %
Warehouse rent and inventory handling expenses	2,628	2,523	105	4.2 %
Other expense	306	330	(24)	-7.3 %
Total	$ 19,912	$ 17,159	$ 2,753	16.0 %

Selling expenses were $19.9 million for the year ended December 31, 2017. As compared to $17.2 million for the year ended December 31, 2016, there was an increase of $2.7 million, or 15.7%, which was mainly due to the Company’s increased transportation expense and increases in marketing and office expenses that were related to the increase in revenue.

General and Administrative Expenses

For the years ended December 31, 2017 and 2016, general and administrative expenses are summarized as follows (figures are in thousands of USD):

Year Ended December 31,

	2017	2016	Increase/(Decrease)	Percentage
Salaries and wages	$ 7,323	$ 5,637	$ 1,686	29.9 %
Labor insurance expenses	2,552	2,305	247	10.7 %
Maintenance and repair expenses	931	1,312	(381)	-29.0 %
Property and other taxes	1,599	1,731	(132)	-7.6 %
Provision/(reversal) of allowance for doubtful accounts	1,372	(16)	1,388	-8675.0 %
Office expense	2,889	2,519	370	14.7 %
Depreciation and amortization expense	963	1,220	(257)	-21.1 %
Listing expenses[1]	1,566	1,768	(202)	-11.4 %
Others expenses	348	365	(17)	-4.7 %
Total	$ 19,543	$ 16,841	$ 2,702	16.0 %

(1) Listing expenses consisted of the costs associated with legal, accounting and auditing fees for operating a public company. The expenses also included share-based compensation expense for options granted to independent directors.

General and administrative expenses were $19.5 million for the year ended December 31, 2017. As compared to $16.8 million for the year ended December 31, 2016, there was an increase of $2.7 million, or 16.1%, which was mainly due to the allowance for doubtful accounts of $1.4 million and the increase in salaries and wages by $1.7 million.

Research and Development Expenses

Research and development expenses, “R&D” expenses, were $33.5 million for the year ended December 31, 2017 as compared to $27.7 million for the year ended December 31, 2016, representing an increase of $5.8 million, or 20.9%, which was mainly due to increased expenditures on R&D activities for EPS products.

The global automotive parts industry is highly competitive; winning and maintaining new business requires suppliers to rapidly produce new and innovative products on a cost-competitive basis. In 2017, remaining foreign OEMs significantly increased their demand for EPS, but the related technology in China was still in the research, development and testing stage. In order to expand into the market for EPS, the Company continued its investment in the research and development of EPS in 2017, including assigning the Company’s senior technicians and advanced manufacturing equipment to EPS, establishing the EPS trail-production department, hiring technologists and purchasing advanced technology and testing equipment.

Income from Operations

Income from operations was $19.3 million for the year ended December 31, 2017 as compared to $23.0 million for the year ended December 31, 2016, representing a decrease of $3.7 million, or 16.1%, which was mainly due to an increase of $3.7 million in gross profit and an increase of $3.8 million in gain on other sales, offset by an increase in operating expenses of $11.3 million.

Other Income, Net

Other income, net was $0.7 million for the year ended December 31, 2017 as compared to $ 1.1 million for the year ended December 31, 2016, representing a decrease of $0.4 million, or 36.4%, primarily due to a decrease in government subsidies in 2017.

Interest Expense

Interest expense was $1.8 million for the year ended December 31, 2017 as compared to interest expense of $0.7 million for the year ended December 31, 2016, representing an increase of $1.1 million, primarily due to the new bank and government loan borrowed in 2017 and higher interest rates.

Financial Income, Net

Financial income, net was $2.2 million for the year ended December 31, 2017 as compared to $1.4 million for the year ended December 31, 2016, representing an increase of $0.8 million, or 57.1%, primarily due to the interest income of $1.3 million generated from the loan to Henglong Real Estate, one of the Company’s related parties.

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 $20.4 million for the year ended December 31, 2017 compared with $24.9 million for the year ended December 31, 2016, a decrease of $4.5 million, or 18.1%, including a decrease in income from operations of $3.7 million, a decrease in other income of $0.4 million, an increase in interest expenses of $1.1 million and an increase in financial income of $0.8 million.

Income Taxes

Income tax expense was $41.6 million for the year ended December 31, 2017 compared to $2.5 million for the year ended December 31, 2016, representing an increase of $39.1 million. The increase in 2017 resulted primarily from a one-time transition tax of $35.6 million recognized in the fourth quarter of 2017 that represented management's estimate of the amount of U.S. corporate income tax based on the deemed repatriation to the United States of the Company's share of previously deferred earnings of certain non-U.S. subsidiaries of the Company mandated by the U.S. Tax Reform. The Company elected to pay the one-time transition tax over eight years commencing in April 2018. In addition, withholding tax of $4.0 million was accrued in the fourth quarter of 2017 since the Company plans to distribute dividends from its PRC subsidiaries to the Company in order to fund the payment of such one-time transition tax. Excluding the one-time transition tax and the withholding tax discussed above, income tax expense was $2.0 million, representing a decrease of $0.5 million which was mainly due to the decrease in income before income tax. The effective tax rate (excluding the impact of the one-time transition tax) was consistent from 2016 to 2017 at approximately 10%.

Net (Loss)/Income

Net loss was $18.6 million for the year ended December 31, 2017, compared with net income of $23.0 million for the year ended December 31, 2016, representing a decrease of $41.6 million, mainly due to a decrease in income before income tax expenses of $4.5 million and an increase in income tax expenses of $39.1 million, offset by an increase in equity in earnings of affiliated companies of $2.0 million.

Net Income Attributable to Non-controlling Interests

The Company recorded net income attributable to non-controlling interests of $0.7 million for the year ended December 31, 2017, consistent with $0.5 million for the year ended December 31, 2016.

The Company owns different equity interests in nine non-wholly owned subsidiaries established in the PRC and Brazil, through which it conducts its operations. All of the operating results of these non-wholly owned subsidiaries were consolidated in the Company's consolidated financial statements as of December 31, 2017 and 2016, and the share of the income attributable to the holders of the non-controlling interests was presented as net income attributable to non-controlling interest.

Net (Loss)/Income Attributable to Parent Company

Net loss attributable to parent company was $19.3 million for the year ended December 31, 2017. As compared to $22.5 million for the year ended December 31, 2016, there was a decrease of $41.8 million, mainly resulting from the decrease in net income of $41.6 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 HoulihanLokey 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 $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 December 31, 2017, the Company had cash and cash equivalents and short-term investments of $94.1 million, compared with $61.6 million as of December 31, 2016, an increase of $32.5 million, or 52.8%. Short-term investments included pledged short-term investments of $2.0 million and $5.7 million, respectively, as of December 31, 2017 and 2016.

The Company had working capital (current assets less current liabilities) of $159.1 million as of December 31, 2017, compared with $161.0 million as of December 31, 2016, representing a decrease of $0.9 million, or 0.6%.

Except for the expected distribution of dividends from the Company’s PRC subsidiaries to the Company in order to fund the payment of the one time transition tax due to the U.S. Tax Reform, 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 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 issuance of this annual report.

Capital Source

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

The Company had short-term loans of $72.7 million, long-term loans of $0.3 million (See Note 13) and bankers' acceptance notes of $83.8 million (See Note 14) as of December 31, 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. Due to a depreciation of assets, the value of the mortgages securing the above-mentioned bank loans and banker's acceptances is expected to be reduced by approximately $12.7 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 $12.7 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 $9.0 million, which is 71.0%, the mortgage ratio, of $12.7 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 Arrangements

As of December 31, 2017, the principal outstanding under the Company's credit facilities and lines of credit was as follows (figures are in thousands of USD)

	Bank	Due Date	Amount Available[4]	Amount Used[2]	Assessed Mortgage Value[3]
1. Comprehensive credit facilities	Hubei Bank	Nov 2019	27,547	10,829	57,752
2. Comprehensive credit facilities	Shanghai Pudong Development Bank[1]	Jan 2019	19,895	7,148	17,905
3. Comprehensive credit facilities	China CITIC Bank[1]	Oct 2018	78,817	48,899	15,200
	China CITIC Bank	Jul 2019	2,755	2,755	5,820
	China Everbright Bank		4,591	4,451	7,836

4. Comprehensive credit facilities		Dec 2018			
5. Comprehensive credit facilities	ICBC Macau	May 2018	24,219	20,000	24,334
6. Comprehensive credit facilities	Bank of China (Brazil)(5)	Feb 2018	610	596	918
7. Comprehensive credit facilities	Bank of China(1)	Apr 2018	22,956	12,094	-
8. Comprehensive credit facilities	China Merchants Bank(1)	Apr 2018	15,304	2,621	-
9. Comprehensive credit facilities	Taishin International Bank	Apr 2018	10,000	9,858	12,770
Total			$ 206,694	$ 119,251	$ 142,535

(1) 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. 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.

(2) "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 amount used includes bank loans of $ 69.6 million and notes payable of $48.2 million as of December 31, 2017. The remainder of $3.4 million of government loans and $35.6 million of notes payable was secured by bank notes or time deposits without utilization of credit lines.

(3) In order to obtain lines of credit, the Company needs to pledge certain assets to banks. As of December 31, 2017, the pledged assets included $36.5 million accounts and notes receivable, $1.5 million of time deposits and other pledged assets with assessed value of $115.3 million.

(4) The "amount available" is used for the drawdown of bank loans and issuance of bank notes. For the drawdown of 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 comprehensive credit facility provided by Bank of China (Brazil) expired in February 2018 and the bank loan under this facility was repaid in January 2018.

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 renewed its existing short-term bank loans and borrowed new bank loans during 2017 at annual interest rates ranging from 1.5% to 5.2%, and the Company's loan terms range from 11 months to 36 months. The large spread in interest rates was due to the different currencies (interest rates of loans in foreign currencies are normally lower than loans in RMB) and lenders (interest rates for government loans are normally lower than for commercial bank loans). Pursuant to the comprehensive credit line arrangement, the Company pledged and guaranteed:

1. Equipment with an assessed value of approximately $57.8 million as security for its revolving comprehensive credit facility with Hubei Bank.

2. Land use rights and buildings with an assessed value of approximately $10.8 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 $17.9 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 $15.2 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 $5.8 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 $7.8 million as security for its comprehensive credit facility with China Everbright Bank.

7. 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 on a 360-day basis and it is to be 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 $24.3 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 $24.3 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 159.0 million, equivalent to approximately $24.3 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 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 expired on February 18, 2018 and was not renewed. 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 were to be 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 matured on January 15, 2018 and had an annual interest rate of 4.1%. The loan was repaid on January 16, 2018, and was not renewed. Interest was paid semiannually and the principal repayment was 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.

9. 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 expires on April 25, 2018 and has an annual interest rate of 2.7%. Interest is paid quarterly and the principal repayment is 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 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 79.4 million, equivalent to approximately $12.2 million.

Cash Requirements

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

	Payment Due Dates (in thousands of USD)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 Years
Short-term and long-term loans including interest payable	$73,899	$73,565	$334	$-	$-
Notes payable[(1)]	83,848	83,848	-	-	-
Taxes payable and withholding tax liabilities due to U.S. Tax Reform (Note 27)	39,516	3,161	6,322	6,322	23,711
Obligation for investment contract[(2)]	6,428	6,428	-	-	-
Other contractual purchase commitments, including service agreements	25,317	18,253	7,064	-	-
Total	$229,008	$185,255	$13,720	$6,322	$23,711

(1) Notes payable do not bear interest.

(2) 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, representing 17.1% of Chongqing Venture Fund's shares. As of December 31, 2017, Hubei Henglong has completed a capital contribution of RMB 84.0 million, equivalent to approximately $12.7 million, representing 23.5% of Chongqing Venture Fund's shares. According to the agreement, the remaining capital commitment of RMB 36.0 million, equivalent to approximately $5.5 million, will be paid upon capital calls received from the Chongqing Venture Fund.

In November 2017, Hubei Henglong entered into an agreement with other parties to form Jingzhou Qingyan Intelligent Automotive Technology Research Institute Co., Ltd., "Jingzhou Qingyan". The capital contribution will be RMB 6.0 million, equivalent to approximately $0.9 million, representing 60.0% of Jingzhou Qingyan's shares, and will be paid in 2018.

Short-term and Long-term Loans

The following table summarizes the contract information of short-term and long-term borrowings between the banks, government and the Company as of December 31, 2017 (figures are in thousands of USD).

Bank Government	Purpose	Borrowing Date	Borrowing Term (Months)	Annual Interest Rate		Date of Interest Payment	Due Date	Amount Payable on Due Date
Bank of China (Brazil)	Working Capital	Aug. 26, 2016	17	Libor 6 months +2.5	%	Pay semi annually	Jan. 15, 2018	596
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99	%	Pay in arrear	Feb. 5, 2018	4,973
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99	%	Pay in arrear	Feb. 6, 2018	4,972
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99	%	Pay in arrear	Feb. 7, 2018	4,679
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99	%	Pay in arrear	Feb. 8, 2018	4,386
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99	%	Pay in arrear	Feb. 2, 2018	4,390
China CITIC Bank	Working Capital	Mar. 3, 2017	11	4.99	%	Pay in arrear	Feb. 9, 2018	5,848
China CITIC Bank	Working Capital	Nov. 1, 2017	12	5.22	%	Pay monthly	Nov. 1, 2018	2,296
Taishin International Bank	Working Capital	Apr. 28, 2017	12	2.65	%	Pay quarterly	Apr. 23, 2018	9,858
ICBC Macau	Working Capital	May 5, 2017	12	Libor 3 months +1.3	%	Pay quarterly	May 4, 2018	20,000
Financial Bureau of Jingzhou Development Zone	Working Capital	Aug. 17, 2017	12	1.50	%	Pay in arrear	Aug. 16, 2018	3,061
Bank of China (Jingzhou Shashi)	Working Capital	Sep. 28, 2017	12	4.57	%	Pay monthly	Sep. 27, 2018	7,652

Wuhu Municipal Science and Technology Bureau	Working Capital	Nov. 13, 2017	36	4.75	%	Pay quarterly	Nov. 12, 2020	306
Total								$ 73,017

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The Company must use the loans for the purpose described in the table. For the bank loan with Bank of China (Jingzhou Shashi) and the government loan with Wuhu Municipal Science and Technology Bureau, if the Company fails to do so, it will be charged a penalty interest at 50% to 100% of the specified loan rate listed in the table above or early repayment will be triggered. 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 30% to 50% of the specified loan rate.

Management believes that the Company had complied with such financial covenants as of December 31, 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 December 31, 2017 (figures are in thousands of USD):

Purpose	Term (Month)	Due Date	Amount Payable on Due Date
Working Capital[(1)]	6	Jan, 2018	$ 13,286
Working Capital[(1)]	6	Feb, 2018	11,523
Working Capital[(1)]	6	Mar, 2018	15,801
Working Capital	6	Apr, 2018	16,469
Working Capital	6	May, 2018	14,892
Working Capital	6	Jun, 2018	11,877
Total (See Note 14)			$ 83,848

(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 December 31, 2017, and believes it will continue to comply with them.

Cash flows

(a) Operating Activities

Net cash provided by operating activities for the year ended December 31, 2017 was $50.2 million, compared with net cash provided of $11.8 million for the year ended December 31, 2016, representing an increase of $38.4 million, which was mainly due to the net effect of (1) the decrease in net income excluding non-cash items by $35.2 million primarily because of the one-time transition tax of $35.6 million recognized in the fourth quarter of 2017 and (2) the increase in cash inflows from movements of operating assets and liabilities by $73.6 million. The increase in cash inflows was primarily due to the net effect of (1) the increase in cash inflows due to the movement of accounts and notes receivable by $87.2 million compared to 2016 as the Company strengthened the collection of accounts receivable, (2) the decrease in cash outflows due to the movement of advance payments and others by $1.8 million, (3) the decrease in cash outflows due to the movement of inventories by $3.3 million, (4) the increase in cash inflows due to the movement of pledged deposits by $2.1 million, (5) the increase of cash inflows due to the movement of customer deposits by $1.1 million, (6) the increase in cash inflows due to the movement of long-term taxes payable by $35.6 million, (7) the decrease in cash inflows due to the movement of accounts and notes payable by $32.9 million, (8) the increase of cash outflows due to the movement of tax payable by $11.7 million and (9) the decrease of cash inflows due to the movement of accrued expenses and other payables by $10.0 million.

(b) Investing Activities

The Company used net cash of $47.3 million in investment activities during the year ended December 31, 2017, compared to $52.2 million in 2016, representing a decrease of $4.9 million, which was mainly due to the net effect of (1) an increase in cash received from maturities of short-term investments and long-term time deposits by $15.1 million, (2) a decrease in cash paid to acquire property, plant and equipment of $12.5 million, (3) an increase in repayment of the loan to a related party by $10.6 million, (4) an increase in the loan to a related party of $29.0 million, (5) a decrease in cash received from disposal of Fujian Qiaolong by $2.0 million and (6) a decrease in cash inflows due to the movement of other receivables by $2.2 million.

(c) Financing Activities

During the year ended December 31, 2017, the Company had net cash of $28.5 million provided by financing activities, compared to net cash of $4.4 million provided by financing activities for 2016, representing an increase of $24.1 million, which was mainly due to the net effect of (1) an increase in proceeds from bank and government loans by $57.9 million, (2) a decrease in payments to repurchase common stock by $1.9 million and (3) an increase in repayments of bank and government loans by $36.2 million.

OFF-BALANCE SHEET ARRANGEMENTS

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

COMMITMENTS AND CONTINGENCIES

At December 31, 2017, the Company did not enter into any other commitments except those cash requirements disclosed in the Liquidity and Capital Resources section.

SUBSEQUENT EVENTS

None.

INFLATION AND CURRENCY MATTERS

China's economy has experienced rapid growth recently, mostly through the issuance of debt. Debt-induced economic growth can lead to growth in the money supply and rising inflation. If prices for the Company's products rise at a rate that is insufficient to compensate for the rise in the cost of supplies, it may harm the Company's profitability. In order to control inflation, the Chinese government has imposed controls on bank credit, limits on loans for fixed assets and restrictions on state bank lending. Such policies can lead to a slowing of economic growth. Rises in interest rates by the central bank would likely slow economic activity in China which could, in turn, materially increase the Company's costs and also reduce demand for the Company's products.

Foreign operations are subject to certain risks inherent in conducting business abroad, including price and currency exchange controls, and fluctuations in the relative value of currencies. During 2017, the Company mainly supplied products to North America and settled in cash in U.S. dollars. As a result, appreciation or currency fluctuation of the RMB against the U.S. dollar would increase the cost of export products, and adversely affect the Company's financial performance.

In July 2005, the Chinese government adjusted its exchange rate policy from "Fixed Rate" to "Floating Rate." During December 2016 to December 2017, the exchange rate between RMB and U.S. dollar depreciated from RMB1.00 to $0.1439 to RMB1.00 to $0.1513. The depreciation of the RMB may continue. Significant depreciation of the RMB is likely to decrease the Company's income generated from China.

RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB and the International Accounting Standards Board (IASB) jointly issued ASU No. 2014-9, Revenue from Contracts with Customers (Topic 606), which was further updated by ASU No. 2016-08 in March 2016, ASU No.2016-10 in April 2016 and ASU No.2016-11 in May 2016. The new guidance clarifies the principles for recognizing revenue and develops a common revenue standard for GAAP and International Financial Reporting Standards (IFRS). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. In July 2015, the FASB approved a deferral of the ASU effective date from annual and interim periods beginning after December 15, 2016 to annual and interim periods beginning after December 15, 2017. The Company has evaluated its material contracts, and has concluded that the impact of adopting the standard on its consolidated financial statements and related disclosures will not be material. The Company will adopt the standard on a modified retrospective basis in 2018.

In February 2016, the FASB issued ASU 2016-02, Leases. Under the new guidance, lessees will be required to recognize a lease liability and a lease asset for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The update also expands the required quantitative and qualitative disclosures surrounding leases. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with earlier application permitted. The Company is in the process of evaluating the impact of adopting this guidance.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which eliminates the probable recognition threshold for credit impairments. The new guidance broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually to include forecasted information, as well as past events and current conditions. There is no specified method for measuring expected credit losses, and an entity is allowed to apply methods that reasonably reflect its expectations of the credit loss estimate. This ASU is effective for the Company on December 15, 2019. The Company is in the process of evaluating the impact of the ASU on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 refines how companies classify certain aspects of the cash flow statement in regards to debt prepayment, settlement of debt instruments, contingent consideration payments, proceeds from insurance claims and life insurance policies, distribution from equity method investees, beneficial interests in securitization transactions and separately identifiable cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company is in the process of evaluating the impact of ASU 2016-16 on its consolidated financial statements and related disclosures.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory, to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The FASB decided that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in this Update eliminate the exception for an intra-entity transfer of an asset other than inventory. Two common examples of assets included in the scope of this Update are intellectual property and property, plant, and equipment. The Update does not change GAAP for an intra-entity transfer of inventory. The amendments in this Update do not include new disclosure requirements; however, existing disclosure requirements might be applicable when accounting for the current and deferred income taxes for an intra-entity transfer of an asset other than inventory. For public business entities, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. The amendments in this Update should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is in the process of evaluating the impact of the Update, and does not expect that the adoption will have a material impact on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230), ASU 2016-18 requires that the statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This guidance will become effective for the reporting periods beginning on or after December 15, 2017, and interim periods within those fiscal years. The Company is currently evaluating the impact of this guidance and its impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01: Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments in this Update provide a screen to determine when a set is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. If the screen is not met, the amendments in this Update (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The amendments provide a framework to assist entities in evaluating whether both an input and a substantive process are present. The framework includes two sets of criteria to consider that depend on whether a set has outputs. Although outputs are not required for a set to be a business, outputs generally are a key element of a business; therefore, the Board has developed more stringent criteria for sets without outputs. Lastly, the amendments in this Update narrow the definition of the term output so that the term is consistent with how outputs are described in Topic 606. Public business entities should apply the amendments in this Update to annual periods beginning after December 15, 2017, including interim periods within those periods. Early application of the amendments in this Update is allowed. The amendments in this Update should be applied prospectively on or after the effective date. No disclosures are required at transition. The Company is in the process of evaluating the impact of the Update, and does not expect that the adoption will have a material impact on its 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.

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, to address specific consequences of the U.S. Tax Reform. The update allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the U.S. Tax Reform. The accounting update is effective January 1, 2019, with early adoption permitted, and is to be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the U.S.Tax Reform is recognized. The Company is currently evaluating the impact of the new standard on the Company's consolidated financial statements.

SIGNIFICANT ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

The Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the 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 consolidated financial statements.

The Company considers an accounting estimate to be critical if:

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

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

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

Critical &nbs