

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)**

**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**

(State or other jurisdiction of incorporation or organization)

**33-0885775**

(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**

(Address of principal executive offices)

**434000**

(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 |
|---|---|
| <b>Common Stock, \$0.0001 par value</b> | <b>The Nasdaq Capital Market</b>          |

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

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

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark 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.

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   
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

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. Such 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.

70%  
Shenyang  
Jinbei  
Henglong  
Automotive  
Steering  
System  
Co., Ltd

**"Hubei  
Henglong"<sup>1</sup>**

**"Shenyang"<sup>2</sup>**

100%      100%      83.34%      77.33%      85%  
Jingzhou      Shashi      Universal      Wuhu      Wuhan  
Henglong      Jiulong      Sensor      Henglong      Jielong  
Automotive      Power      Application      Automotive      Electric  
Parts      Steering      ,Inc.      Steering      Power  
Co., Ltd.      Gears           System Co.,      Steering Co.,  
Co., Ltd.      Co., Ltd.           Ltd.      Ltd.

70%      95.84%      100%      60%  
Chongqing      CAAS      Hubei      Jingzhou  
Henglong      Brazil's      Henglong      Qingyan  
Hongyan      Imports And      Group      Intelligent  
Automotive      Trade In      Shanghai      Automotive  
System Co.,      Automotive      Automotive      Technology  
Ltd.      Parts Ltd.,      Electronics      Research  
           Research and      Institute  
                Development Co., Ltd.  
                Ltd.,

**"Henglong"<sup>3</sup> "Jiulong"<sup>4</sup> "USAI"<sup>5</sup> "Wuhu"<sup>6</sup> "Jielong"<sup>7</sup>**

**"Chongqing" "Brazil      "Shanghai      "Jingzhou  
Henglong"<sup>8</sup> Henglong"<sup>9</sup> Henglong"<sup>12</sup> Qingyan"<sup>13</sup>**

100%  
Jingzhou  
Henglong  
Automotive  
Technology  
(Testing)  
Center

85%  
Wuhan  
Chuguanjie  
Automotive  
Science  
and Technology  
Ltd.,

**"Testing  
Center"<sup>10</sup>**

**"Wuhan  
Chuguanjie"<sup>11</sup>**

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.

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 TUV Rheinland 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.

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## **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               |      | Long-term assets  |      |       |     |
|-------------------------|-------------------------|------|-------------------|------|-------|-----|
|                         | Year Ended December 31, |      | As of December 31 |      |       |     |
|                         | 2017                    | 2016 | 2017              | 2016 |       |     |
| Geographic region:      |                         |      |                   |      |       |     |
| China                   | 76.8                    | %    | 86.5              | %    | 99.2  | %   |
| 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 | %   |

## **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](http://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 Automobile 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 Automobile 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.

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***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<br>(sq.m.) | Building Area<br>(sq.m.) | Original Cost of<br>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 <sup>(1)</sup> | Electric Power Steering  | -                     | -                        | \$ 4,813                      | Wuhan City, Hubei Province       |
| Wuhan<br>Chuguanjie    | Electric Power Steering  | 53,675                | -                        | \$ -                          | Wuhan City, Hubei Province       |
| USAI <sup>(1)</sup>    | 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 MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS  
5. 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.

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**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.

| Name of Entity     | Aggregate Net Interest |   |                   |   |
|--------------------|------------------------|---|-------------------|---|
|                    | 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, |           | Increase/(Decrease) | Percentage |   |
|--|-------------------------|-----------|---------------------|------------|---|
|  | 2017                    | 2016      |                     |            |   |
| 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,

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|   | 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 <sup>(1)</sup>                         | 1,566     | 1,768     | (202)               | -11.4      | % |
| Others expenses   | 348       | 365       | (17)                | -4.7       | % |
| Total   | \$ 19,543 | \$ 16,841 | \$ 2,702            | 16.0       | % |

Listing expenses consisted of the costs associated with legal, accounting and auditing fees for operating a public (1) 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 trial-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<br>(4) | Amount Used <sup>(2)</sup> | Assessed Mortgage Value <sup>(3)</sup> |
|------------------------------------|---|----------|-------------------------|----------------------------|--|
| 1. Comprehensive credit facilities | Hubei Bank                                      | Nov 2019 | 27,547                  | 10,829                     | 57,752                                 |
| 2. Comprehensive credit facilities | Shanghai Pudong Development Bank <sup>(1)</sup> | Jan 2019 | 19,895                  | 7,148                      | 17,905                                 |
| 3. Comprehensive credit facilities | China CITIC Bank <sup>(1)</sup>                 | 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                                  |

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|                                    |                                       |          |            |            |            |
|------------------------------------|---------------------------------------|----------|------------|------------|------------|
| 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) <sup>(5)</sup> | Feb 2018 | 610        | 596        | 918        |
| 7. Comprehensive credit facilities | Bank of China <sup>(1)</sup>          | Apr 2018 | 22,956     | 12,094     | -          |
| 8. Comprehensive credit facilities | China Merchants Bank <sup>(1)</sup>   | 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 |

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 (1) 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.

"Amount used" represents the credit facilities used by the Company for the purpose of bank loans or notes payable during the facility contract period. The loans or notes payable under the credit facilities will remain outstanding regardless of the expiration of the relevant credit facilities until the separate loans or notes payable expire. The (2) amount used includes bank loans of \$ 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.

In order to obtain lines of credit, the Company needs to pledge certain assets to banks. As of December 31, 2017, (3) 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.

The "amount available" is used for the drawdown of bank loans and issuance of bank notes. For the drawdown of (4) bank loans, this amount represents the amount that the Company can borrow immediately; for issuance of bank notes, the Company needs to pledge additional collateral in order to utilize these bank facilities.

(5) The 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.

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<br>( in thousands of USD) |                     |           |           |                      |
|--|---|---------------------|-----------|-----------|----------------------|
|  | Total                                       | Less than 1<br>year | 1-3 years | 3-5 years | More than 5<br>Years |
| Short-term and long-term loans including interest payable                      | \$73,899                                    | \$73,565            | \$334     | \$-       | \$-                  |
| Notes payable <sup>(1)</sup>   | 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 <sup>(2)</sup>                              | 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.

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.

(2)

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

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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  | Purpose         | Borrowing Date | Borrowing Term (Months) | Annual Interest Rate | Date of Interest Payment | Due Date      | Amount Payable on Due Date |
|---|-----------------|----------------|-------------------------|----------------------|--------------------------|---------------|----------------------------|
| Government                                    |                 |                |                         |                      |                          |               |                            |
| 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                      |

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

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) | Amount Payable on |           |
|--------------------------------|--------------|-------------------|-----------|
|                                |              | Due Date          | Due Date  |
| Working Capital <sup>(1)</sup> | 6            | Jan, 2018         | \$ 13,286 |
| Working Capital <sup>(1)</sup> | 6            | Feb, 2018         | 11,523    |
| Working Capital <sup>(1)</sup> | 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:

| Balance Sheet Caption   | Critical Estimate Item                         | Nature of Estimates Required  | Assumptions/Approaches Used  | Key Factors  |
|---|--|---|--|--|
| Accrued liabilities and other long-term liabilities                         | Warranty obligations                           | Estimating warranty requires the Company to forecast the resolution of existing claims and expected future claims on products sold. OEMs are increasingly seeking to hold suppliers responsible for product warranties, which may impact the Company's exposure to these costs. | The Company bases its estimate on historical trends of units sold and payment amounts, combined with its current understanding of the status of existing claims and discussions with its customers.                            | ·OEM sourcing<br>·OEM policy decisions regarding warranty claims                             |
| Property, plant and equipment, intangible assets and other long-term assets | Valuation of long-lived assets and investments | The Company is required from time-to-time to review the recoverability of certain of its assets based on projections of anticipated future cash flows, including future profitability assessments of various product lines.   | The Company estimates cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments.   | ·Future production estimates<br>·Customer preferences and decisions                          |
| Inventory   | Provision for inventory impairment             | The Company is required from time to time to review the turnover of inventory based on projections of anticipated future cash flows, including provision of inventory impairment for over market price and undesirable inventories.   | The Company estimates cash flows using internal budgets based on recent sales data, independent automotive production volume estimates and customer commitments..  | ·Future production estimates<br>·Customer preferences and decisions                          |
| Deferred income taxes   | Recoverability of deferred tax assets          | The Company is required to estimate whether recoverability of its deferred tax assets is more likely than not based on forecasts of taxable earnings in the related tax jurisdiction.   | The Company uses historical and projected future operating results, based upon approved business plans, including a review of the eligible carry forward period, tax planning opportunities and other relevant considerations. | ·Tax law changes<br>·Variances in future projected profitability, including by taxing entity |
| Convertible notes payable,  | Warrant liabilities and                        | The Company is required to estimate the fair value of warrant   | The Company uses Black-Scholes option pricing  | ·Expected volatility   |

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|  |                                 |   |  |   |
|--|---------------------------------|---|--|---|
| warrant liabilities, compound derivative liabilities | compound derivative liabilities | liabilities and compound derivative liabilities at conception and completion of each reporting period.  | model to determine fair value of warrant; uses Monte Carlo simulation (“MCS”) valuation techniques to determine fair value of compound derivative liabilities.   | <ul style="list-style-type: none"> <li>·Risk-free rate</li> <li>·Interest market risk</li> <li>·Credit risk</li> <li>·Redemption activities before maturity</li> <li>·An allocation or a shift of income between jurisdictions</li> </ul>                   |
| Uncertain tax  | Uncertain tax positions         | The Company is required to determine and assess all material positions, including all significant uncertain positions in all tax years that are still subject to assessment or challenge under relevant tax statutes. | The Company applies a more likely than not threshold and a two-step approach for tax position measurement and financial statement recognition. For the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement. | <ul style="list-style-type: none"> <li>·The characterization of income or a decision to exclude reporting taxable income in a tax return</li> <li>·A decision to classify a transaction, entity, or other position in a tax return as tax exempt</li> </ul> |

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

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.**

The Company is exposed to market risk from changes in interest rates and foreign currency exchange rates. For purposes of specific risk analysis, the Company uses sensitivity analysis to determine the effects that market risk exposures may have.

### **FOREIGN CURRENCY RISK**

The Company's reporting currency is the U.S. dollar and the majority of its revenues will be settled in RMB and U.S. dollars. The Company's currency exchange rate risks come primarily from the sales of products to international customers. Most of the Company's assets are denominated in RMB except for part of cash and accounts receivable. As a result, the Company is exposed to foreign exchange risk as its revenues and results of operations may be affected by fluctuations in the exchange rate between the U.S. dollar and the RMB.

The value of the RMB fluctuates and is affected by, among other things, changes in China's political and economic conditions. In addition, the RMB is not readily convertible into U.S. dollars or other foreign currencies. All foreign exchange transactions continue to take place either through the Bank of China or other banks authorized to buy and sell foreign currencies at the exchange rate quoted by the People's Bank of China. The conversion of RMB into foreign currencies such as the U.S. dollar has been generally based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates on the world financial markets. On December 31, 2017 and 2016, the exchange rates of RMB against U.S. dollar were RMB1.00 to \$0.1513 and RMB1.00 to \$0.1439, respectively. Any significant future appreciation of the RMB is likely to decrease the amount of export products, thus decreasing the Company's income generated from overseas.

In order to mitigate the currency exchange rate risk, the Company has inserted a currency exchange rate fluctuation compensation provision in its sales contracts with its international customers to the effect that both parties will bear 50% of such loss when the fluctuation is over 8% within that contract year.



## **CREDIT RISK**

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable. The Company does not require collateral or other security to support client receivables since most of its customers are large, well-established companies. The Company's credit risk is also mitigated because its customers are all selected enterprises supported by the local government. One customer, Fiat Chrysler North America, accounted for more than 10% (14.3%) of the Company's consolidated revenues in 2017. The Company maintains an allowance for doubtful accounts for any potential credit losses related to its trade receivables. The Company does not use foreign exchange contracts to hedge the risk in receivables denominated in foreign currencies and the Company does not hold or issue derivative financial instruments for trading or speculative purposes.

## **INTEREST RATE RISK**

The Company's exposure to changes in interest rates results primarily from its credit facility borrowings. As of December 31, 2017, the Company had \$73.0 million of outstanding indebtedness, which is subject to interest rate fluctuations. Based on the amount of such borrowings as of December 31, 2017, it is expected that a hypothetical 100 basis point increase in the then current LIBOR rate would increase the Company's interest expense by \$0.21 million on an annual basis.

The Company's level of outstanding indebtedness fluctuates from time to time and may result in additional payable.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

- (a) The financial statements required by this item begin on page 70.
- (b) Selected quarterly financial data for the past two years are summarized in the following table (figures are in thousands of USD, except those for items headed "Basic" and "Diluted"):

|   | Quarterly Results of Operations |           |           |           |           |          |           |           |
|---|---------------------------------|-----------|-----------|-----------|-----------|----------|-----------|-----------|
|   | First                           |           | Second    |           | Third     |          | Fourth    |           |
|   | 2017                            | 2016      | 2017      | 2016      | 2017      | 2016     | 2017      | 2016      |
| Net sales   | \$119,308                       | \$116,854 | \$117,660 | \$101,017 | \$118,365 | \$94,626 | \$143,730 | \$149,553 |
| Gross profit  | 21,629                          | 21,012    | 24,061    | 18,148    | 22,487    | 19,985   | 16,457    | 21,774    |
| Income/(loss) from operations   | 7,230                           | 7,054     | 11,071    | 5,276     | 4,919     | 5,703    | (3,950 )  | 4,983     |
| Net income  | 5,938                           | 5,545     | 8,881     | 5,515     | 5,228     | 5,859    | (38,686 ) | 6,058     |
| Net income/(loss) attributable to non-controlling interest                        | 224                             | (164 )    | (40 )     | 151       | 169       | 177      | 354       | 302       |
| Net income/(loss) attributable to parent company's common shareholders            | 5,714                           | 5,709     | 8,921     | 5,364     | 5,059     | 5,682    | (39,040 ) | 5,756     |
| Net income/(loss) attributable to parent company's common shareholders per share- |                                 |           |           |           |           |          |           |           |
| Basic   | \$0.18                          | \$0.18    | \$0.28    | \$0.17    | \$0.16    | \$0.18   | \$(1.23 ) | \$0.18    |
| Diluted   | \$0.18                          | \$0.18    | \$0.28    | \$0.17    | \$0.16    | \$0.18   | \$(1.23 ) | \$0.18    |

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**ITEM 9A. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures**

The Company's management, under the supervision and with the participation of its chief executive officer and chief financial officer, Messrs. Wu Qizhou and Li Jie, respectively, evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2017, the end of the period covered by this Report. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports, such as this Form 10-K, that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the

Exchange Act is accumulated and communicated to the company's management, including its chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. Based on that evaluation, Messrs. Wu and Li concluded that the Company's disclosure controls and procedures were effective as of December 31, 2017.

## Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting.

Internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act, is a process designed by, or under the supervision of, the chief executive officer and chief financial officer and effected by the board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements for external reporting purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that:

- a. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets;
- b. provide reasonable assurance that transactions are recorded as necessary to permit preparation of the consolidated financial statements in accordance with generally accepted accounting principles, and that the Company's receipts and expenditures are being made only in accordance with appropriate authorization of the Company's management and board of directors; and
- c. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the consolidated financial statements.

In making its assessment of internal control over financial reporting, management, under the supervision and with the participation of the chief executive officer and chief financial officer, used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control—Integrated Framework (2013)."

Management has assessed the effectiveness of internal control over financial reporting as of December 31, 2017 and determined that internal control over financial reporting was effective as of December 31, 2017.

This report does not include an auditors' report on the effectiveness of internal control over financial reporting due to SEC rules that exempt smaller reporting companies such as CAAS from providing such a report.

#### **Inherent Limitations on Effectiveness of Controls**

A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

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

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### **ITEM 9B. OTHER INFORMATION.**

None.



**PART III****ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The following table and text set forth the names and ages of all directors and executive officers of the Company as of December 31, 2017. The Board of Directors is comprised of only one class. All of the directors will serve until the next annual meeting of stockholders and until their successors are elected and qualified, or until their earlier death, retirement, resignation or removal. Also provided herein are brief descriptions of the business experience of each director and executive officer during the past five years and an indication of directorships held by each director in other companies subject to the reporting requirements under the federal securities laws.

| <b>Name</b> | <b>Age</b> | <b>Position(s)</b>                   |
|-------------|------------|--------------------------------------|
| Hanlin Chen | 60         | Chairman of the Board                |
| Robert Tung | 61         | Director                             |
| Guangxun Xu | 67         | Director                             |
| Arthur Wong | 58         | Director                             |
| Qizhou Wu   | 53         | Chief Executive Officer and Director |
| Jie Li      | 48         | Chief Financial Officer              |
| Andy Tse    | 47         | Senior Vice President                |
| Yijun Xia   | 55         | Vice President                       |
| Haimian Cai | 54         | Vice President                       |

## BIOGRAPHIES OF DIRECTORS AND EXECUTIVE OFFICERS

### *Directors*

**Hanlin Chen** has served as the chairman of the board of directors and an executive officer since March 2003. Since January 2013, Mr. Chen has been a standing committee member of the Chinese People's Political Consultative Conference and vice president of Foreign Investors Association of Hubei Province. From 1993 to 1997, Mr. Chen was the general manager of Shashi Jiulong Power Steering Gears Co., Ltd. Since 1997, he has been the chairman of the Board of Henglong Automotive Parts, Ltd. Mr. Hanlin Chen is the brother-in-law of the Company's senior vice president, Mr. Andy Tse.

**Qizhou Wu** has served as a director since March 2003 and as the chief executive officer of the Company since September 2007. He served as chief operating officer from 2003 to 2007. He was the executive general manager of Shashi Jiulong Power Steering Gears Co., Ltd. from 1993 to 1999 and the general manager of Henglong Automotive Parts Co., Ltd. from 1999 to 2002. Mr. Wu graduated from Tsinghua University in Beijing with a Master's degree in automobile engineering.

**Arthur Wong** has been an independent director of the Company since May 2012 and is the chairman of the audit committee and a member of the compensation and nominating committees of the Board of Directors. Mr. Wong is currently the chief financial officer of Beijing Radio Cultural Transmission Company Limited, a music production and music data management service company, and an independent director and chairman of the audit committee of Daqo New Energy Corp. (NYSE: DQ) and China Maple Leaf Educational Systems Limited (HKSE: 1317). Mr. Wong was formerly the chief financial officer of GreenTree Inns Hotel Management Group, Nobao Renewable Energy, and Asia New-Energy. Prior to that, he worked at Deloitte Touche Tohmatsu from 1982 to 2008, in that firm's San Jose, Hong Kong and Beijing offices, and most recently as a partner in the Beijing office. Mr. Wong received a Bachelor of Science in Applied Economics degree from the University of San Francisco and was awarded a Higher Diploma of Accountancy from Hong Kong Polytechnic. His professional affiliations include being a member of the American Institute of Certified Public Accountants, the Hong Kong Institute of Certified Public Accountants and the Chartered Association of Certified Accountants.

**Robert Tung** has been an independent director of the Company since September 2003. He is a member of the audit and nominating committees, and the chairman of the compensation committee of the Board of Directors. Mr. Tung has been engaging in the real and commodity trading and consultation in the energy sector in the past fifteen years. Mr. Tung was granted the Grand China sales representative position from TRI Products, Inc., a well-known North American scrap metals, scrap plastics, and spent battery supplier. Mr. Tung is currently the managing director of North-South Resource International Ltd. which consults on the trading of crude oil, fuel oil, diesel and jet fuels. In addition, Mr. Tung is currently developing the produce distribution channel for selling "green" food in Northern



Taiwan.

**Guangxun Xu** has served as an independent director of the Company since December 2009. He is a member of the audit and compensation committees, and the chairman of the nominating committee of the Board of Directors. Mr. Xu has been the Chief Representative of NASDAQ in China and a managing director of the NASDAQ Stock Market International, Asia for over 10 years. With a professional career in the finance field spanning over 25 years, Mr. Xu's practice focuses on providing package services on U.S. and U.K. listings, advising on and arranging for private placements, PIPEs, IPOs, pre-IPO restructuring, M&A, corporate and project finance, corporate governance, post-IPOIR compliance, and risk control.

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### *Executive Officers*

**Jie Li** has served as the chief financial officer since September 2007. Prior to that position he served as the corporate secretary from December 2004. Prior to joining the Company in September 2003, Mr. Li was the assistant president of Jingzhou Jiulong Industrial Inc. from 1999 to 2003 and the general manager of Jingzhou Tianxin Investment Management Co. Ltd. from 2002 to 2003. Mr. Li has a Bachelor's degree from the University of Science and Technology of China. He also completed his graduate studies in economics and business management at the Hubei Administration Institute.

**Andy Tse** has served as a senior vice president of the Company since March 2003. He has also served as chairman of the board of Shenyang. He was the vice GM of Jiulong from 1993 to 1997 and the vice GM of Henglong. Mr. Tse has over 10 years of experience in automotive parts sales and strategic development. Mr. Tse has an MBA from the China People University. He is brother in-law to Hanlin Chen.

**Yijun Xia** has served as a vice president of the Company since December 2009. He also served as the general manager of Henglong from April 2005 to December 2011. Prior to that position he served as the Vice-G.M. of Henglong from December 2002. Mr. Xia graduated from Wuhan University of Water Transportation Engineering with a bachelor degree in Metal Material and Heat Treatment.

**Haimian Cai** was an independent director of the Company from September 2003 to December 2009, and also a member of the Company's Audit, Compensation and Nominating Committees. Dr. Cai is a technical specialist in the automotive industry. Prior to that, Dr. Cai was a staff engineer in ITT Automotive Inc. Dr. Cai has written more than fifteen technical papers and co-authored a technical book regarding the Powder Metallurgy industry for automotive application. Dr. Cai has more than ten patents including pending patents. Dr. Cai holds a B.S. Degree in Automotive Engineering from Tsinghua University and a M.S. and Ph. D. in manufacturing engineering from Worcester Polytechnic Institute. Since December 2009, Mr. Cai has not served as independent director and a member of the Company's Audit Committee, Compensation and Nominating Committees, because he was nominated as vice president of the Company.

## **BOARD COMPOSITION AND COMMITTEES**

### *Audit Committee and Independent Directors*

The Company has a standing Audit Committee of the Board of Directors established in accordance with Section 3(a)(58)(A) of the Exchange Act, as amended. The Audit Committee is operated under a written charter. The Audit Committee consists of the following individuals, all of whom the Company considers to be independent, as defined under the SEC's rules and regulations and the Nasdaq's definition of independence: Mr. Robert Tung, Mr. Guangxun Xu and Mr. Arthur Wong. Mr. Arthur Wong is the Chairman of the Audit Committee. The Board has determined that Mr. Arthur Wong is the audit committee financial expert, as defined in Item 407(d)(5) of Regulation S-K, serving on the Company's Audit Committee.

### *Compensation Committee*

The Company has a standing Compensation Committee of the Board of Directors. The Compensation Committee is responsible for determining compensation for the Company's executive officers. Three of the Company's independent directors, as defined under the SEC's rules and regulations and the Nasdaq's definition of independence, Mr. Robert Tung, Mr. Guangxun Xu and Mr. Arthur Wong serve on the Compensation Committee. Since July 8, 2010, Mr. Robert Tung has been the Chairman of the Compensation Committee. The Board has determined that all members of the Compensation Committee are independent directors under the rules of the Nasdaq Stock Market, as applicable. The Compensation Committee administers the Company's benefit plans, reviews and administers all compensation arrangements for executive officers, and establishes and reviews general policies relating to the compensation and benefits of the Company's officers and employees. The Compensation Committee operates under a written charter that is made available on the Company's website, [www.caasauto.com](http://www.caasauto.com).

The Company's Compensation Committee is empowered to review and approve the annual compensation and compensation procedures for the executive officers of the Company. The primary goals of the Compensation Committee of the Company's Board of Directors with respect to executive compensation are to attract and retain the most talented and dedicated executives possible and to align executives' incentives with stockholder value creation. The Compensation Committee evaluates individual executive performance with a goal of setting compensation at levels the committee believes are comparable with executives in other companies of similar size and stage of development operating in similar industry while taking into account the Company's relative performance and its strategic goals.

The Company has not retained a compensation consultant to review its policies and procedures with respect to executive compensation. The Company conducts an annual review of the aggregate level of its executive compensation, as well as the mix of elements used to compensate its executive officers. The Company compares compensation levels with amounts currently being paid to executives in its industry and most importantly with local practices in China. The Company is satisfied that its compensation levels are competitive with local conditions.

### *Nominating Committee*

The Company has a standing Nominating Committee of the Board of Directors. Director candidates are nominated by the Nominating Committee. The Nominating Committee will consider candidates based upon their business and financial experience, personal characteristics, and expertise that are complementary to the background and experience of other Board members, willingness to devote the required amount of time to carry out the duties and responsibilities of Board membership, willingness to objectively appraise management performance, and any such other qualifications the Nominating Committee deems necessary to ascertain the candidates' ability to serve on the Board. The Nominating Committee will not consider nominee recommendations from security holders, other than the recommendations

received from a security holder or group of security holders that beneficially owned more than five (5) percent of the Company's outstanding common stock for at least one year as of the date the recommendation is made. Three of the Company's independent directors, as defined under the SEC's rules and regulations and the Nasdaq's definition of independence, Mr. Robert Tung, Mr. Guangxun Xu and Mr. Arthur Wong, serve on the Nominating Committee. Since December 17, 2009, Mr. Guangxun Xu has been the Chairman of the Nominating Committee.

### ***Stockholder Communications***

Stockholders interested in communicating directly with the Board of Directors, or individual directors, may email the Company's independent director Mr. Arthur Wong at arthurltwong@yahoo.com. Mr. Wong will review all such correspondence and will regularly forward to the board of directors of the Company copies of all such correspondence that deals with the functions of the Board or committees thereof or that he otherwise determines requires their attention. Directors may at any time review all of the correspondence received that is addressed to members of the board of directors of the Company and request copies of such correspondence. Concerns relating to accounting, internal controls or auditing matters will immediately be brought to the attention of the Audit Committee and handled in accordance with procedures established by the Audit Committee with respect to such matters.

### ***Family Relationships***

Mr. Hanlin Chen and Mr. Andy Tse are brothers-in-law.

### ***Code of Ethics and Conduct***

The Board of Directors has adopted a Code of Ethics and Conduct which is applicable to all officers, directors and employees. The Code of Ethics and Conduct was filed as an exhibit to the Form 10-K for the year ended December 31, 2009, which was filed with the Securities and Exchange Commission on March 25, 2010.

### ***Section 16(a) Beneficial Ownership Compliance***

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's executive officers and directors and persons who own more than 10% of a registered class of the Company's equity securities to file with the Securities and Exchange Commission initial statements of beneficial ownership, reports of changes in ownership and annual reports concerning their ownership of common stock and other of the Company's equity securities, on Forms 3, 4 and 5 respectively. Executive officers, directors and greater than 10% stockholders are required by Commission regulations to furnish the Company with copies of all Section 16(a) reports they file. To the best of the Company's knowledge, based solely upon a review of the Form 3, 4 and 5 filed, no officer, director or 10% beneficial shareholder failed to file on a timely basis any reports required by Section 16(a) of the Securities Exchange Act of 1934, as amended.



## ITEM 11. EXECUTIVE COMPENSATION.

### COMPENSATION DISCUSSION AND ANALYSIS

In 2003, the Board of Directors established a Compensation Committee consisting only of independent Board members, which is responsible for setting the Company's policies regarding compensation and benefits and administering the Company's benefit plans. At the end of fiscal year 2016, the Compensation Committee consisted of Mr. Robert Tung, Mr. Guangxun Xu and Mr. Arthur Wong. The members of the Compensation Committee approved the amount and form of compensation paid to executive officers of the Company and set the Company's compensation policies and procedures during these periods.

The primary goals of the Company's compensation committee with respect to executive compensation are to attract and retain highly talented and dedicated executives and to align executives' incentives with stockholder value creation.

The Compensation Committee will conduct an annual review of the aggregate level of the Company's executive compensation, as well as the mix of elements used to compensate the Company's executive officers. The Company compares compensation levels with amounts currently being paid to executives at similar companies in the same area and the same industry. Most importantly, the Company compares compensation levels with local practices in China. The Company believes that its compensation levels are competitive with local conditions.

#### *Elements of Compensation*

The Company's executive compensation consists of the following elements:

#### Base Salary

Base salaries for the Company's executives are established to be amounts of compensation that are similar to those paid by other companies to executives in similar positions and with similar responsibilities. Base salaries are adjusted from time to time to realign salaries with market levels after taking into account individual responsibilities, performance and experience. The Compensation Committee established a salary structure to determine base salaries and is responsible for initially setting executive officer compensation in employment arrangements with each individual. The base salary amounts are intended to reflect the Company's philosophy that the base salary should



attract experienced individuals who will contribute to the success of the Company's business goals and represent cash compensation that is commensurate with the compensation of individuals at similarly situated companies.

The Company's Board of Directors and Compensation Committee have approved the current salaries for executives: RMB2.5 million (equivalent to approximately \$0.38 million) for the Chairman, RMB1.6 million (equivalent to approximately \$0.25 million) for the CEO, and RMB1.0 million (equivalent to approximately \$0.15 million) individually for other officers in 2016.

#### Performance Bonus

a. Grantees: Mr. Hanlin Chen, Mr. Qizhou Wu, Mr. Andy Tse, Mr. Jie Li, and Mr. Yijun Xia.

b. Conditions: based on the Company's consolidated financial statements, (i) the year over year growth rate of sales for 2017 must be 5% or higher; or (ii) the year over year growth rate of sales for 2017 must be 10% or higher;

Bonus: If condition (i) is satisfied, 25% of each officer's annual salary in 2017.

c.

If condition (ii) is satisfied, 50% of each officer's annual salary in 2017.

The Company accrued 25% of the annual salary as performance bonus for each Named Executive Officer in 2017 as the Company reached the above condition (i).

#### Stock Option Awards

The stock options plan proposed by management, which aims to incentivize and retain core employees, to meet employees' benefits, the Company's long term operating goals and stockholder benefits, 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 available for issuance under the plan is 2,200,000. The term of the plan was extended to June 27, 2025.

There were no stock options granted to management in 2017.

#### Other Compensation

Other than the base salary for the Company's Named Executive Officers, the performance bonus and the stock option awards referred to above, the Company does not have any other benefits and perquisites for its Named Executive Officers. However, the Compensation Committee in its discretion may provide benefits and perquisites to these

executive officers if it deems advisable to do so.

### *Compensation Tables*

#### Executive Officers

The compensation that Named Executive Officers received for their services for fiscal years ended 2017 and 2016 were as follows (figures are in thousands of USD):

| Name and principal position  | Year | Salary<br>(1) | Bonus<br>(2) | Option Awards<br>(3) | Total  |
|------------------------------|------|---------------|--------------|----------------------|--------|
| Hanlin Chen (Chairman)       | 2017 | \$ 246        | \$ 62        | \$ -                 | \$ 308 |
|                              | 2016 | \$ 246        | \$ -         | \$ -                 | \$ 246 |
| Qizhou Wu (CEO)              | 2017 | \$ 164        | \$ 41        | \$ -                 | \$ 205 |
|                              | 2016 | \$ 164        | \$ -         | \$ -                 | \$ 164 |
| Jie Li (CFO)                 | 2017 | \$ 98         | \$ 25        | \$ -                 | \$ 123 |
|                              | 2016 | \$ 98         | \$ -         | \$ -                 | \$ 98  |
| Haimian Cai (Vice President) | 2017 | \$ 150        | \$ -         | \$ -                 | \$ 150 |
|                              | 2016 | \$ 150        | \$ -         | \$ -                 | \$ 150 |

(1) Salary – Please refer to Base Salary disclosed under “Elements of compensation” section above for further details.

(2) Bonus – Please refer to Performance Bonus disclosed under “Elements of compensation” section above for further details.

(3) Option Awards – Please refer to Stock Option Awards disclosed under “Elements of compensation” section above for further details.

For detailed information on option exercises and stock vested, please see Note 19 to the consolidated financial statements in this report.

Compensation for Directors

Based on the number of the board of directors' service years, workload and performance, the Company decides on their pay. The management believes that the pay for the members of the Board of Directors was appropriate as of December 31, 2017. The compensation that directors received for serving on the Board of Directors for fiscal year 2017 was as follows (figures are in thousands of USD):

| Name        | Fees earned or paid in cash | Option awards <sup>(1)</sup> | Total |
|-------------|-----------------------------|------------------------------|-------|
| Robert Tung | \$ 140                      | \$ 33                        | \$173 |
| Guangxun Xu | \$ 134                      | \$ 33                        | \$167 |
| Arthur Wong | \$ 140                      | \$ 33                        | \$173 |

Other than the cash payment based on the number of a director's service years, workload and performance, the Company grants 7,500 option awards to each director every year. In accordance with *ASC Topic 718*, the cost of (1) the above mentioned stock options issued to directors was measured on the grant date based on their fair value. The fair value is determined using the Black-Scholes option pricing model and certain assumptions. Please see Note 19 to the consolidated financial statements in this Report.

The cost of the above-mentioned compensation paid to directors was measured based on investment, operating, technology, and consulting services they provided. All other directors did not receive compensation for their service on the Board of Directors.

**ITEM SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND  
12. RELATED STOCKHOLDER MATTERS.**

As used in this section, the term beneficial ownership with respect to a security is defined by Rule 13d-3 under the Securities Exchange Act of 1934, as amended, as consisting of sole or shared voting power, including the power to vote or direct the vote, and/or sole or shared investment power, including the power to dispose of or direct the disposition of, with respect to the security through any contract, arrangement, understanding, relationship or otherwise, subject to community property laws where applicable. The percentage ownership is based on 31,644,004 shares of common stock outstanding at December 31, 2017 (exclusive of 694,298 shares of treasury stock).

| Name/Title   | Total Number of Shares | Percentage Ownership |
|--|------------------------|----------------------|
| Hanlin Chen, Chairman <sup>(1)</sup>                 | 17,849,014             | 56.41 %              |
| Li Ping Xie <sup>(1)</sup>                           | 17,849,014             | 56.41 %              |
| Wiselink Holdings Limited, "Wiselink" <sup>(2)</sup> | 17,849,014             | 56.41 %              |

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|  |            |       |   |
|--|------------|-------|---|
| Qizhou Wu, CEO and Director                      | 1,325,136  | 4.19  | % |
| Robert Tung, Director                            | 7,500      | 0.02  | % |
| Arthur Wong, Director                            | 3,000      | 0.01  | % |
| Haimian Cai, Director                            | -          | -     | % |
| Jie Li, CFO <sup>(2)</sup>                       | 83,403     | 0.26  | % |
| Tse Andy, Sr. VP                                 | 400,204    | 1.26  | % |
| Yijun Xia, VP                                    | 17,200     | 0.05  | % |
| All Directors and Executive Officers (8 persons) | 19,685,457 | 62.20 | % |

(1) These 17,849,014 shares of common stock include: (i) 13,322,547 shares of common stock beneficially owned by Mr. Hanlin Chen; (ii) 1,502,925 shares of common stock beneficially owned by Ms. Liping Xie, Mr. Hanlin Chen's wife; and (iii) 3,023,542 shares of common stock beneficially owned by Wiselink, a company controlled by Mr. Hanlin Chen.

(2) Includes 50,000 shares held as nominee for Jingzhou Jiulong Machinery and Electronic Manufacturing Co., Ltd. On October 13, 2014, the Company issued 4,078,000 of its common shares in a private placement to nominee holders of Jingzhou Jiulong Machinery and Electronic Manufacturing Co., Ltd. for the acquisition of the 19.0% and 20.0% equity interest in Jiulong and Henglong held by Jingzhou Jiulong Machinery and Electronic Manufacturing Co., Ltd., respectively. All of the nominee holders of Jingzhou Jiulong Machinery and Electronic Manufacturing Co., Ltd. are unrelated parties except for Mr. Jie Li (CFO).

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

For the information required by Item 13 please refer to Note 2 (Basis of Presentation and Significant Accounting Policies—Certain Relationships and Related Transactions) and Note 30 (Related Party Transactions) to the consolidated financial statements in this Report.

The Company's Audit Committee's charter provides that one of its responsibilities is to review and approve related party transactions defined as those transactions required to be disclosed under Item 404 of Regulation S-K of the rules and regulations under the Exchange Act. The Company has a formal written set of policies and procedures for the review, approval or ratification of related party transactions. Where a related party transaction is identified, the Audit Committee reviews and, where appropriate, approves the transaction based on whether it believes that the transaction is at arm's length and contains terms that are no less favorable than what the Company could have obtained from an unaffiliated third party.

#### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.**

The following table sets forth the aggregate fees for professional audit services rendered by PricewaterhouseCoopers for the audit of the Company's annual financial statements and other services provided in the fiscal years 2017 and 2016. The Audit Committee has approved all of the following fees (figures are in thousands of USD):

|            | Fiscal Year Ended |        |
|------------|-------------------|--------|
|            | 2017              | 2016   |
| Audit Fees | \$ 708            | \$ 666 |
| Other Fees | 80                | -      |
| Total Fees | \$ 788            | \$ 666 |

#### **AUDIT COMMITTEE'S PRE-APPROVAL POLICY**

During the fiscal years ended December 31, 2017 and 2016, the Audit Committee of the Board of Directors adopted policies and procedures for the pre-approval of all audit and non-audit services to be provided by the Company's independent auditor and for the prohibition of certain services from being provided by the independent auditor. The Company may not engage the Company's independent auditor to render any audit or non-audit service unless the service is approved in advance by the Audit Committee or the engagement to render the service is entered into pursuant to the Audit Committee's pre-approval policies and procedures. On an annual basis, the Audit Committee may pre-approve services that are expected to be provided to the Company by the independent auditor during the fiscal year. At the time such pre-approval is granted, the Audit Committee specifies the pre-approved services and establishes a monetary limit with respect to each particular pre-approved service, which limit may not be exceeded without obtaining further pre-approval under the policy. For any pre-approval, the Audit Committee considers whether such services are consistent with the rules of the Securities and Exchange Commission on auditor independence.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.**

**(a)(1) FINANCIAL STATEMENTS**

1. Report of Independent Registered Public Accounting Firm, PricewaterhouseCoopers Zhong Tian LLP
2. Consolidated Balance Sheets as of December 31, 2017 and 2016
3. Consolidated Statements of Income for the years ended December 31, 2017 and 2016
4. Consolidated Statements of Comprehensive Income for the years ended December 31, 2017 and 2016
5. Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2017 and 2016
6. Consolidated Statements of Cash Flows for the years ended December 31, 2017 and 2016
7. Notes to Consolidated Financial Statements

**(b) EXHIBITS**

The following is a list of exhibits filed as part of this Annual Report on Form 10-K. Where so indicated by footnote, exhibits that were previously filed are incorporated by reference.

**Exhibit**

**Number Description**

3.1(i) Certificate of Incorporation (incorporated by reference from the filing on Form 10KSB File No. 000-33123)

3.1(ii) Bylaws (incorporated by reference from the Form 10KSB for the year ended December 31, 2002)

10.5 Joint-venture Agreement, dated March 31, 2006, as amended on May 2, 2006, between Great Genesis Holdings Limited and Wuhu Chery Technology Co., Ltd. (incorporated by reference to the exhibit 10.8 to the Company's Form 10-Q Quarterly Report on May 10, 2006)

10.20 Translation of the Equity Transfer Agreement dated March 31, 2008 in English (incorporated by reference to exhibit 99.1 of the Company's Form 8-K filed on April 2, 2008)

10.21 English Translation of the Sino-Foreign Equity Joint Venture Contract dated January 24, 2010 between Great Genesis Holdings Limited and Beijing Hainachuan Auto Parts Co., Ltd. (incorporated by reference to the Company's Form 10-K for the year ended December 31, 2009 filed on March 25, 2010)

21 Schedule of Subsidiaries (incorporated by reference to Note 1 of the consolidated financial statements of the Company in this Annual Report on Form 10-K)

23.1 Consent of PricewaterhouseCoopers Zhong Tian LLP\*

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

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

32.1 Section 1350 Certification\*

32.2 Section 1350 Certification\*

101\* The following materials from the China Automotive Systems, Inc. Annual Report on Form 10-K for the year ended December 31, 2017, filed on March 29, 2018, formatted in Extensible Business Reporting Language (XBRL):

- (i) Consolidated Balance Sheets;
- (ii) Consolidated Statements of Income;



- (iii) Consolidated Statements of Comprehensive Income;
- (iv) Consolidated Statements of Changes in Stockholders' Equity;
- (v) Consolidated Statements of Cash Flows; and
- (vi) Related notes.

\*Filed herewith.

**ITEM 16. FORM 10-K SUMMARY**

Not Applicable.

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**SIGNATURES**

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHINA AUTOMOTIVE SYSTEMS, INC.

Dated: March 29, 2018      */s/ Qizhou Wu*

Name: Qizhou Wu

Title: Chief Executive Officer and President

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## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Qizhou Wu his attorney-in-fact and agent, with the power of substitution, for him in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorneys-in-fact, or substitutes, may do or cause to be done by virtue hereof.

In accordance with the Securities Exchange Act of 1934, this Annual Report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Dated: March 29, 2018        */s/ Hanlin Chen*  
Name: Hanlin Chen  
Title: Chairman and Director

Dated: March 29, 2018        */s/ Qizhou Wu*  
Name: Qizhou Wu  
Title: Chief Executive Officer, President and Director  
(Principal Executive Officer)

Dated: March 29, 2018        */s/ Jie Li*  
Name: Jie Li  
Title: Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)

Dated: March 29, 2018        */s/ Robert Tung*  
Name: Robert Tung  
Title: Director

Dated: March 29, 2018        */s/ Guangxun Xu*  
Name: Guangxun Xu  
Title: Director

Dated: March 29, 2018        */s/ Arthur Wong*  
Name: Arthur Wong  
Title: Director



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**TO BOARD OF DIRECTORS AND STOCKHOLDERS OF  
CHINA AUTOMOTIVE SYSTEMS, INC.**

*Opinion on the Financial Statements*

We have audited the accompanying consolidated balance sheets of China Automotive Systems, Inc. and its subsidiaries as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2017, including the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America.

*Basis for Opinion*

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits of these consolidated financial statements in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

*/s/ PricewaterhouseCoopers Zhong Tian LLP*  
PricewaterhouseCoopers Zhong Tian LLP  
Shanghai, People's Republic of China  
March 29, 2018

We have served as the Company's auditor since 2010.

**China Automotive Systems, Inc. and Subsidiaries****Consolidated Balance Sheets***(In thousands of USD, except share and per share amounts)*

|   | December 31, |           |
|---|--------------|-----------|
|   | 2017         | 2016      |
| <b>ASSETS</b>   |              |           |
| Current assets:   |              |           |
| Cash and cash equivalents   | \$64,558     | \$31,092  |
| Pledged cash  | 31,535       | 30,799    |
| Short-term investments  | 29,587       | 30,475    |
| Accounts and notes receivable, net - unrelated parties                | 274,989      | 285,731   |
| Accounts and notes receivable, net - related parties                  | 19,086       | 20,984    |
| Advance payments and others - unrelated parties                       | 12,790       | 10,203    |
| Advance payments and others - related parties                         | 20,841       | 624       |
| Inventories   | 79,217       | 68,050    |
| Total current assets  | 532,603      | 477,958   |
| Non-current assets:   |              |           |
| Long-term time deposits   | -            | 865       |
| Property, plant and equipment, net                                    | 126,033      | 101,478   |
| Intangible assets, net  | 661          | 617       |
| Other receivables, net - unrelated parties                            | 2,188        | 2,252     |
| Advance payment for property, plant and equipment - unrelated parties | 9,657        | 14,506    |
| Advance payment for property, plant and equipment - related parties   | 5,264        | 5,005     |
| Long-term investments   | 27,596       | 16,431    |
| Deferred tax assets   | 13,367       | 12,587    |
| Total assets  | \$717,369    | \$631,699 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                           |              |           |
| Current liabilities:  |              |           |
| Bank and government loans   | \$72,711     | \$40,820  |
| Accounts and notes payable - unrelated parties                        | 233,048      | 216,993   |
| Accounts and notes payable - related parties                          | 7,168        | 6,803     |
| Customer deposits   | 1,128        | 700       |
| Accrued payroll and related costs                                     | 8,577        | 6,971     |
| Accrued expenses and other payables                                   | 40,127       | 35,882    |
| Accrued pension costs   | 4,051        | 4,130     |
| Taxes payable   | 5,927        | 11,674    |
| Amounts due to shareholders/directors                                 | 343          | 312       |
| Advances payable (current portion)                                    | 383          | 382       |
| Total current liabilities   | 373,463      | 324,667   |
| Long-term liabilities:  |              |           |
| Long-term government loan   | 306          | 608       |

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|   |           |           |
|---|-----------|-----------|
| Advances payable  | 359       | 339       |
| Deferred tax liabilities  | 4,393     | 193       |
| Long-term taxes payable   | 32,719    | -         |
| Total liabilities   | 411,240   | 325,807   |
| Commitments and Contingencies (Note 31)   |           |           |
| Stockholders' Equity  |           |           |
| Common stock, \$0.0001 par value - Authorized - 80,000,000 shares Issued – 32,338,302 and 32,338,302 shares at December 31, 2017 and 2016, respectively | 3         | 3         |
| Additional paid-in capital  | 64,406    | 64,764    |
| Retained earnings-  |           |           |
| Appropriated  | 10,707    | 10,549    |
| Unappropriated  | 209,459   | 228,963   |
| Accumulated other comprehensive income/(loss)   | 17,780    | (892 )    |
| Treasury stock – 694,298 and 694,298 shares at December 31, 2017 and 2016, respectively   | (2,907 )  | (2,907 )  |
| Total parent company stockholders' equity   | 299,448   | 300,480   |
| Non-controlling interests   | 6,681     | 5,412     |
| Total stockholders' equity  | 306,129   | 305,892   |
| Total liabilities and stockholders' equity  | \$717,369 | \$631,699 |

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



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

|   | Year Ended December 31, |            |
|---|-------------------------|------------|
|   | 2017                    | 2016       |
| Net product sales (\$37,583 and \$39,845 sold to related parties for the years ended December 31, 2017 and 2016)            | \$499,063               | \$462,050  |
| Cost of products sold (\$28,994 and \$27,747 purchased from related parties for the years ended December 31, 2017 and 2016) | 414,429                 | 381,131    |
| Gross profit  | 84,634                  | 80,919     |
| Net gain on other sales   | 7,635                   | 3,803      |
| Operating expenses:   |                         |            |
| Selling expenses  | 19,912                  | 17,159     |
| General and administrative expenses   | 19,543                  | 16,841     |
| Research and development expenses   | 33,544                  | 27,706     |
| Total operating expenses  | 72,999                  | 61,706     |
| Operating income  | 19,270                  | 23,016     |
| Other income, net   | 678                     | 1,116      |
| Interest expense  | 1,753                   | 656        |
| Financial income, net   | 2,180                   | 1,428      |
| Income before income tax expenses and equity in earnings of affiliated companies  | 20,375                  | 24,904     |
| Less: Income taxes  | 41,633                  | 2,484      |
| Add: Investment income, net   | 2,619                   | 557        |
| Net (loss)/income   | (18,639                 | ) 22,977   |
| Net income attributable to non-controlling interest   | 707                     | 466        |
| Net (loss)/income attributable to parent company's common shareholders  | (19,346                 | ) 22,511   |
| Net (loss)/income attributable to parent company's common shareholders per share –  |                         |            |
| Basic   | \$(0.61                 | ) \$0.70   |
| Diluted   | \$(0.61                 | ) \$0.70   |
| Weighted average number of common shares outstanding –  |                         |            |
| Basic   | 31,644,004              | 31,954,407 |
| Diluted   | 31,646,897              | 31,957,052 |

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



**China Automotive Systems, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income***(In thousands of USD unless otherwise indicated)*

|  | Year Ended December 31, |           |
|--|-------------------------|-----------|
|  | 2017                    | 2016      |
| Net (loss)/income  | \$ (18,639 )            | \$ 22,977 |
| Other comprehensive income/(loss):                                   |                         |           |
| Foreign currency translation income/(loss)                           | 19,384                  | (19,996 ) |
| Comprehensive income   | 745                     | 2,981     |
| Comprehensive income/(loss) attributable to non-controlling interest | 1,352                   | (226 )    |
| Comprehensive (loss)/income attributable to parent company           | \$ (607 )               | \$ 3,207  |

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

**China Automotive Systems, Inc. and Subsidiaries****Consolidated Statements of Changes in Stockholders' Equity***(In thousands of USD, except share and per share amounts)*

|   | 2017             | 2016             |
|---|------------------|------------------|
| <b>Common Stock</b>   |                  |                  |
| Balance at January 1, 2017 and 2016 – 32,338,302 and 32,338,302 shares, respectively      | \$3              | \$3              |
| Balance at December 31, 2017 and 2016 – 32,338,302 and 32,338,302 shares, respectively    | \$3              | \$3              |
| <b>Additional Paid-in Capital</b>   |                  |                  |
| Balance at January 1  | \$64,764         | \$64,627         |
| Stock-based compensation  | 100              | 137              |
| Acquisition of the non-controlling interest in Brazil Henglong                            | (458 )           | -                |
| Balance at December 31  | \$64,406         | \$64,764         |
| <b>Retained Earnings— Appropriated</b>  |                  |                  |
| Balance at January 1  | \$10,549         | \$10,379         |
| Appropriation of retained earnings  | 158              | 170              |
| Balance at December 31  | \$10,707         | \$10,549         |
| <b>Unappropriated</b>   |                  |                  |
| Balance at January 1  | \$228,963        | 206,622          |
| Net (loss)/income attributable to parent company  | (19,346 )        | 22,511           |
| Appropriation of retained earnings  | (158 )           | (170 )           |
| Balance at December 31  | \$209,459        | \$228,963        |
| <b>Accumulated Other Comprehensive (Loss)/Income</b>                                      |                  |                  |
| Balance at January 1  | \$(892 )         | 18,412           |
| Other comprehensive loss related to the non-controlling interests acquired by the Company | (67 )            | -                |
| Net foreign currency translation adjustment attributable to parent company                | 18,739           | (19,304 )        |
| Balance at December 31  | \$17,780         | \$(892 )         |
| <b>Treasury Stock</b>   |                  |                  |
| Balance at January 1, 2017 and 2016 – 694,298 and 217,283 shares, respectively            | (2,907 )         | (1,000 )         |
| Repurchase of common stock in 2017 and 2016 – nil and 477,015 shares, respectively        | -                | (1,907 )         |
| Balance at December 31, 2017 and 2016 – 694,298 and 694,298 shares, respectively          | \$(2,907 )       | (2,907 )         |
| <b>Total parent company stockholders' equity</b>  | <b>\$299,448</b> | <b>\$300,480</b> |
| <b>Non-controlling Interest</b>   |                  |                  |
| Balance at January 1  | \$5,412          | \$8,252          |
| Net foreign currency translation adjustment attributable to non-controlling interest      | 645              | (692 )           |

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|   |           |           |
|---|-----------|-----------|
| Net income attributable to non-controlling interest   | 707       | 466       |
| Other comprehensive income related to the non-controlling interests acquired by the Company | 67        | -         |
| Acquisition of the non-controlling interest in Brazil Henglong                              | 458       | -         |
| Non-controlling interests change due to the disposal of Fujian Qiaolong                     | -         | (2,150 )  |
| Distribution of retained earnings   | (608 )    | (464 )    |
| Balance at December 31  | \$6,681   | \$5,412   |
| <br>  |           |           |
| Total stockholders' equity  | \$306,129 | \$305,892 |

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

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

|   | Year Ended December 31, |           |
|---|-------------------------|-----------|
|   | 2017                    | 2016      |
| Cash flows from operating activities:   |                         |           |
| Net income  | \$ (18,639 )            | \$ 22,977 |
| Adjustments to reconcile net income to net cash provided by operating activities:               |                         |           |
| Stock-based compensation  | 100                     | 137       |
| Depreciation and amortization   | 15,358                  | 13,926    |
| Deferred income taxes   | 4,143                   | (1,628 )  |
| Inventory write downs   | 5,109                   | 3,210     |
| Accrual/(reversal) of provision for doubtful accounts   | 887                     | (21 )     |
| Equity in earnings of affiliated companies  | (2,617 )                | (556 )    |
| Gain on disposal of Fujian Qiaolong   | -                       | (698 )    |
| Gain on disposal of fixed assets  | (2,184 )                | (23 )     |
| Changes in operating assets and liabilities (net of the impact of disposal of Fujian Qiaolong): |                         |           |
| (Increase) decrease in:   |                         |           |
| Pledged cash  | 1,254                   | (799 )    |
| Accounts and notes receivable   | 30,908                  | (56,251 ) |
| Advance payments and other  | (529 )                  | (2,331 )  |
| Inventories   | (12,156 )               | (15,442 ) |
| Increase (decrease) in:   |                         |           |
| Accounts and notes payable  | 2,533                   | 35,455    |
| Customer deposits   | 411                     | (646 )    |
| Accrued payroll and related costs   | 1,182                   | 1,143     |
| Accrued expenses and other payables   | 560                     | 10,548    |
| Accrued pension costs   | (331 )                  | (231 )    |
| Taxes payable   | (8,555 )                | 3,130     |
| Long-term taxes payable   | 32,719                  | -         |
| Advances payable  | -                       | (75 )     |
| Net cash provided by operating activities   | 50,153                  | 11,825    |
| Cash flows from investing activities:   |                         |           |
| Purchase of short-term investments and long-term time deposits                                  | (32,145 )               | (28,210 ) |
| Proceeds from maturities of short-term investments and long-term time deposits                  | 35,780                  | 20,657    |
| Decrease in other receivables   | 198                     | 2,388     |
| Cash received from disposal of Fujian Qiaolong  | -                       | 1,953     |
| Cash received from property, plant and equipment sales  | 2,231                   | 1,284     |
|   | (27,096 )               | (39,585 ) |

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|   |           |           |
|---|-----------|-----------|
| Cash paid to acquire property, plant and equipment (including \$9,791 and \$8,021 paid to related parties for the years ended December 31, 2017 and 2016, respectively) |           |           |
| Cash paid to acquire intangible assets  | (201 )    | (161 )    |
| Loan to a related party   | (29,044 ) | -         |
| Cash received from repayment of the loan to a related party   | 10,591    | -         |
| Investment under equity method  | (7,629 )  | (10,556 ) |
| Net cash used in investing activities   | (47,315 ) | (52,230 ) |
| Cash flows from financing activities:   |           |           |
| Proceeds from bank and government loans   | 72,237    | 14,313    |
| Repayment of bank and government loans  | (43,154 ) | (6,973 )  |
| Repurchase of common stock  | -         | (1,907 )  |
| Dividends paid to the holders of the Company's common stock   | -         | (544 )    |
| Dividends paid to the non-controlling interest holders of joint venture companies   | (623 )    | (464 )    |
| Net cash provided by financing activities   | 28,460    | 4,425     |
| Cash and cash equivalents affected by foreign currency  | 2,168     | (2,604 )  |
| Net increase/(decrease) in cash and cash equivalents  | 33,466    | (38,584 ) |
| Cash and equivalents at beginning of year   | 31,092    | 69,676    |
| Cash and equivalents at end of year   | \$ 64,558 | \$ 31,092 |

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

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

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

*(In thousands of USD unless otherwise indicated)*

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:**

|                            | Year Ended December 31, |          |
|----------------------------|-------------------------|----------|
|                            | 2017                    | 2016     |
| Cash paid for interest     | \$ 654                  | \$ 720   |
| Cash paid for income taxes | \$ 4,643                | \$ 1,838 |

**SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES:**

Non-cash investing activities:

|  | Year Ended December 31, |           |
|--|-------------------------|-----------|
|  | 2017                    | 2016      |
| Advance payments for acquiring property, plant and equipment | \$ 19,879               | \$ 22,254 |
| Accounts payable for acquiring property, plant and equipment | \$ 1,180                | \$ 1,349  |

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



## China Automotive Systems, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### 1. Organization and Business

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

Great Genesis Holdings Limited, a company incorporated on January 3, 2003 under the Companies Ordinance of Hong Kong as a limited liability company, “Genesis,” 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.

The Company owns interests in the following subsidiaries incorporated in the PRC and Brazil as of December 31, 2017 and 2016.

| Name of Entity  | Aggregate Net Interest |   |        |   |
|---|------------------------|---|--------|---|
|   | 2017                   |   | 2016   |   |
| Jingzhou Henglong Automotive Parts Co., Ltd., “ <b>Henglong</b> ”                     | 100.00                 | % | 100.00 | % |
| Shashi Jiulong Power Steering Gears Co., Ltd., “ <b>Jiulong</b> ”                     | 100.00                 | % | 100.00 | % |
| Shenyang Jinbei Henglong Automotive Steering System Co., Ltd., “ <b>Shenyang</b> ”    | 70.00                  | % | 70.00  | % |
| Universal Sensor Application Inc, “ <b>USA</b> ”                                      | 83.34                  | % | 83.34  | % |
| Wuhu Henglong Auto Steering System Co., Ltd., “ <b>Wuh</b> ”                          | 77.33                  | % | 77.33  | % |
| Wuhan Jielong Electric Power Steering Co., Ltd., “ <b>Jielong</b> ”                   | 85.00                  | % | 85.00  | % |
| Hubei Henglong Automotive System Group Co., Ltd., “ <b>Hubei Henglong</b> ”           | 100.00                 | % | 100.00 | % |
| Jingzhou Henglong Automotive Technology (Testing) Center, “ <b>Testing Center</b> ”   | 100.00                 | % | 100.00 | % |
| Chongqing Henglong Hongyan Automotive System Co., Ltd., “ <b>Chongqing Henglong</b> ” | 70.00                  | % | 70.00  | % |
| CAAS Brazil’s Imports And Trade In Automotive Parts Ltd., “ <b>Brazil Henglong</b> ”  | 95.84                  | % | 80.00  | % |
| Wuhan Chuguanjie Automotive Science and Technology Ltd., “ <b>Wuhan Chuguanjie</b> ”  | 85.00                  | % | 85.00  | % |
|   | 100.00                 | % | 100.00 | % |

Hubei Henglong Group Shanghai Automotive Electronics Research and Development Ltd,

“**Shanghai Henglong**”<sup>1,2</sup>

Jingzhou Qingyan Intelligent Automotive Technology Research Institute Co., Ltd., “**Jingzhou Qingyan**”<sup>3</sup> 60.00 % -

1. Henglong was established in 1997 and mainly engages in the production of rack and pinion power steering gears for cars and light duty vehicles.
2. Jiulong was established in 1993 and mainly engages in the production of integral power steering gears for heavy-duty vehicles
3. Shenyang was established in 2002 and focuses on power steering parts for light duty vehicles.
4. USAI was established in 2005 and mainly engages in the production and sales of sensor modules.
5. Wuhu was established in 2006 and mainly engages in the production and sales of automobile steering systems.
6. Jielong was established in 2006 and mainly engages in the production and sales of automobile steering columns.

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

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

9. 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.

10. 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.

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

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.

## 2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation - For the years ended December 31, 2017 and 2016, the consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and joint ventures, which are described in Note 1. Significant inter-company balances and transactions have been eliminated upon consolidation. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America. The Company has no voting control in Beijing Henglong and Chongqing Jinghua, thus such investments were accounted for using the equity method.

Shenyang was formed in 2002, with 70% owned and controlled by the Company, and 30% owned by Shenyang Automotive Industry Investment Corporation, "JB Investment." The highest authority of the joint venture is Shenyang's board of directors, which is comprised of seven directors, four of whom, 57%, are appointed by the Company, and three of whom, 43%, are appointed by JB Investment. As for day-to-day operating matters, approval by more than two-thirds of the members of such board of directors, 67%, is required. The chairman of the board of directors is appointed by the Company. In March 2003, the Company and Jinbei entered into an act-in-concert agreement, under which the directors appointed by Jinbei agree to act in concert with the directors appointed by the Company. As a result, the Company obtained control of Shenyang in March 2003. The general manager of Shenyang is appointed by the Company.

USAI was formed in 2005. At December 31, 2017, 83.34% of USAI was owned by the Company, and 16.66% of USAI was owned by Hubei Wanlong Investment Inc., "Hubei Wanlong." The highest authority of the joint venture is USAI's board of directors, which is comprised of three directors, two of whom, 67%, are appointed by the Company, one of whom, 33%, is appointed by Hubei Wanlong. As for day-to-day operating matters, approval by at least two-thirds of the members of such board of directors is required. The chairman of such board of directors is appointed by the Company. The general manager of USAI is appointed by the Company.

Jielong was formed in April 2006. As at December 31, 2017, 85% of Jielong was owned by the Company, and 15% of Jielong was owned by Hubei Wanlong. The highest authority of the joint venture is Jielong's board of directors, which is comprised of three directors, two of whom, 67%, are appointed by the Company, and one of whom, 33%, is appointed by Hubei Wanlong. As for day-to-day operating matters, approval by at least two-thirds of the members of such board of directors is required. Both the chairman of such board of directors and the general manager of Jielong are appointed by the Company.

Wuhu was formed in May 2006, with 77.33% owned by the Company, and 22.67% owned by Wuhu Chery Technology Co., Ltd., "Chery Technology." The highest authority of the joint venture is Wuhu's board of directors, which is comprised of five directors, three of whom, 60%, are appointed by the Company, and two of whom, 40%, are appointed by Chery Technology. As for day-to-day operating matters, approval by at least two-thirds of the members of such board of directors is required. The directors of the Company and Chery Technology executed an "Act in Concert" agreement, resulting in the Company having voting control in the joint venture. The chairman of such board of directors is appointed by the Company. The general manager of Wuhu is appointed by the Company.

Chongqing Henglong was formed in 2012, with 70% owned by the Company and 30% owned by SAIC-IVECO. The highest authority of the joint venture is Chongqing Henglong's board of directors, which is comprised of five directors, three of whom, 60%, are appointed by the Company, and two of whom, 40%, are appointed by SAIC-IVECO. As for day-to-day operating matters, approval by at least two-thirds of the members of such board of directors is required. In February 2012, the Company and SAIC-IVECO signed an "Act in Concert" agreement. According to the agreement, the directors appointed by SAIC-IVECO agreed to execute the "Act in Concert" agreement with the directors designated by the Company. The chairman of such board of directors and the general manager of Chongqing Henglong are both appointed by the Company.

Brazil Henglong was formed in 2012, with 80% owned by the Company and 20% owned by Mr. Ozias Gaia Da Silva and Mr. Ademir Dal' Evedove. 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. The highest authority of the joint venture is Brazil Henglong's board of directors. In making operational decision, approval by voting rights representing at least 3/4 of the capital, 75%, is required and 95.84% of voting rights were owned by the Company. The chairman of such board of directors is appointed by the Company. The general manager is Mr. Ozias Gaia Da Silva.

Beijing Henglong was formed in 2010, with 50% owned by the Company and 50% owned by Beijing Hainachuan Auto Parts Co. Ltd., "Hainachuan." The highest authority of the joint venture is Beijing Henglong's board of directors, which is comprised of seven directors, four of whom, 57%, are appointed by the Company, and three of whom, 43%, are appointed by Hainachuan. As for day-to-day operating matters, approval by at least two-thirds of the members of such board of directors is required. The chairman of such board of directors is appointed by Hainachuan. The general manager of Beijing Henglong is appointed by the Company. The Company has no voting control in Beijing Henglong, thus such investment was accounted for using the equity method.



In 2014, Jielong formed a subsidiary, Wuhan Chuguanjie, with 85% owned by the Company and 15% owned by Hubei Wanlong. The highest authority of the joint venture is the board of directors, which is comprised of three directors, two of whom, 67%, are appointed by the Company, and one of whom, 33%, is appointed by Hubei Wanlong. As for day-to-day operating matters, approval by at least two-thirds of the members of such board of directors is required. Both the chairman of such board of directors and the general manager of Chuguanjie are appointed by the Company.

Chongqing Jinghua was formed in 2016, with 30% owned by the Company and 70% owned by the other five parties. The highest authority of the joint venture is Chongqing Jinghua's board of directors, which is comprised of five directors, one of whom, 20%, are appointed by the Company, and four of whom, 80%, are appointed by the other five parties. Approval by at least two-thirds of the members of the board of directors is required for day-to-day operating matters. The chairman of such board of directors is appointed by the Company. The general manager of Chongqing Jinghua is appointed by the board of directors. The Company has no voting control in Chongqing Jinghua, thus such investment was accounted for using the equity method.

The minority partners of each of the joint ventures are all private companies not controlled, directly or indirectly, by any PRC municipal government or other similar government entity.

*Use of Estimates* - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. The Company is of the opinion that the significant estimates related to impairment of long term assets and investment, the realizable value of accounts receivable and inventories, useful lives of property, plant and equipment, the amounts of accruals, warranty liabilities and deferred tax assets and the determination of fair value of identifiable assets and liabilities acquired through business combinations. Actual results could differ from those estimates.

*Cash and Cash Equivalents* - Cash and cash equivalents include all highly-liquid investments with an original maturity of three months or less at the date of purchase.

*Pledged Cash* - Pledged as guarantee for the Company's notes payable and restricted to use. The Company regularly pays some of its suppliers by bank notes. The Company has to deposit a cash deposit, equivalent to 40%-100% of the face value of the relevant bank note, in order to obtain the bank note.

*Short-term Investments* - Short-term investments are comprised of time deposits with terms of three months or more which are due within one year and wealth management financial products with maturities within one year. The carrying values of time deposits approximate fair value because of their short maturities. The interest earned is recognized in the consolidated statements of income over the contractual term of the deposits. The wealth management financial products are measured at fair value and classified as Level 2 within the fair value measurement hierarchy. The fair values were measured by using directly or indirectly observable inputs in the marketplace. Changes in the fair value are reflected in other income in the consolidated statements of operations and comprehensive income.

*Allowance for Doubtful Accounts* - In order to determine the value of the Company's accounts receivable, the Company records a provision for doubtful accounts to cover estimated credit losses. Management reviews and adjusts this allowance periodically based on historical experience and its evaluation of the collectability of outstanding accounts receivable. The Company evaluates the credit risk of its customers utilizing historical data and estimates of future performance.

*Inventories* - Inventories are stated at the lower of cost and net realizable value. Cost is calculated on the moving-average basis and includes all costs to acquire and other costs to bring the inventories to their present location and condition. The Company evaluates the net realizable value of its inventories on a regular basis and records a provision for loss to reduce the computed moving-average cost if it exceeds the net realizable value.

*Advance Payments* - These amounts represent advances to acquire various assets to be utilized in the future in the Company's normal business operations, such as machine equipment, raw materials and technology. Such amounts are paid according to their respective contract terms. Advance payment for machinery and equipment is classified as advance payment for property, plant and equipment in the consolidated balance sheet and advance payment of raw materials and technology are classified as advance payments and others in the consolidated balance sheet.

*Property, Plant and Equipment* – Property, plant and equipment are stated at cost. Major renewals and improvements are capitalized; minor replacements and maintenance and repairs are charged to operations. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets as follows:

| Category                       | Estimated Useful Life (Years) |
|--------------------------------|-------------------------------|
| Land use rights and buildings: |                               |
| Land use rights                | 45 -50                        |
| Buildings                      | 25                            |
| Machinery and equipment        | 6                             |
| Electronic equipment           | 4                             |
| Motor vehicles                 | 8                             |

*Assets under Construction* - represent buildings under construction and plant and equipment pending installation— are stated at cost. Cost includes construction and acquisitions, and interest charges arising from borrowings used to finance assets during the period of construction or installation and testing. No provision for depreciation is made on assets under construction until such time as the relevant assets are completed and ready for their intended commercial use.



Gains or losses on disposal of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the relevant asset, and are recognized in the consolidated statements of income on the date of disposal.

*Interest Costs Capitalized* - Interest costs incurred in connection with borrowings for the acquisition, construction or installation of property, plant and equipment are capitalized (if significant) and depreciated as part of the asset's total cost when the respective asset is placed into service. Interest costs capitalized for the years ended December 31, 2017 and 2016, were \$0.7 million and \$0.3 million, respectively.

*Intangible Assets* - Intangible assets, representing patents and technical know-how acquired, are stated at cost less accumulated amortization and impairment losses. Amortization is calculated on the straight-line method over the estimated useful life of 5 to 15 years.

*Long-term Time Deposits* - Long-term time deposits are comprised of time deposits with terms of more than one year. The carrying values of time deposits approximate fair value because changes in fair value, after considering the discount rate, are immaterial. The interest earned is recognized in the consolidated statements of income over the contractual term of the deposits.

*Long-Lived Assets* - The Company has adopted the provisions of *ASC Topic 360*, "Accounting for the Impairment or Disposal of Long-Lived Assets." Property, plant and equipment and definite life intangible assets are reviewed periodically for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If required, an impairment loss is recognized as the difference between the carrying value and the fair value of the assets.

In assessing long-lived assets for impairment, management considered the Company's product line portfolio, customers and related commercial agreements, labor agreements and other factors in grouping assets and liabilities at the lowest level for which identifiable cash flows are largely independent. The Company considers projected future undiscounted cash flows, trends and other factors in its assessment of whether impairment conditions exist. Whilst the Company believes that its estimates of future cash flows are reasonable, different assumptions regarding such factors as future automotive production volumes, customer pricing, economics and productivity and cost saving initiatives, could significantly affect its estimates. In determining fair value of long-lived assets, management uses appraisals, management estimates or discounted cash flow calculations.

*Long-term Investments* - Investments in corporations which the Company does not have the ability to exert significant influence are stated at cost (if they have no readily determinable fair value), and are reviewed periodically for realization; investments in corporations which the Company has the ability to exert significant influence are accounted for using the equity method. Investments in limited partnerships which the Company has virtually no influence are stated at cost (if they have no readily determinable fair value), and are reviewed periodically for realization; investments in limited partnerships which the Company has more than virtually no influence are accounted for using the equity method.

The Company continually reviews its investment to determine whether a decline in fair value below the carrying value is other than temporary. The primary factors the Company considers in its determination are the length of time that the fair value of the investment is below the Company's carrying value and the financial condition, operating performance and near term prospects of the investee. In addition, the Company considers the reason for the decline in fair value, including general market conditions, industry-specific or investee-specific reasons, changes in valuation subsequent to

the balance sheet date and the Company's intent and ability to hold the investment for a period of time sufficient to allow for a recovery in fair value. If the decline in fair value is deemed to be other than temporary, the carrying value of the security is written down to fair value. There were no impairment losses for its long-term investment in the years ended December 31, 2017 and 2016.

*Business Combinations* – A business combination is recorded using the purchase method of accounting, and the cost of an acquisition is measured as the aggregate of the fair values at the date of exchange of the assets given, liabilities incurred and equity instruments issued as well as the contingent considerations and all contractual contingencies as of the acquisition date. The costs directly attributable to the acquisition are expensed as incurred. Identifiable assets, liabilities and contingent liabilities acquired or assumed are measured separately at their fair value as of the acquisition date, irrespective of the extent of any non-controlling interests. The excess of (i) the total of consideration of acquisition, fair value of the non-controlling interests and acquisition date fair value of any previously held equity interest in the subsidiary acquired over (ii) the fair value of the identifiable net assets of the subsidiary acquired is recorded as goodwill. If the consideration of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statements of income.

*Revenue from Product Sales Recognition* - The Company recognizes revenue when the significant risks and rewards of ownership have been transferred to the customers including factors such as when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, sales and value added tax laws have been complied with, and collectability is probable. The Company recognizes product sales generally at the time the product is installed on OEMs' production line, and a small number of product sales is recognized at the time the product is shipped. Concurrent with the recognition of revenue, the Company reduces revenue for estimated product returns. Revenue is presented net of any sales tax and value added tax.

*Revenue from Materials and Other Assets Sales Recognition* – Normally, the Company purchases materials only for its production. Occasionally, some materials will be sold to other suppliers in case of temporary inventory overage of such materials and to make a profit on any price difference. The Company is essentially the agent in these transactions because it does not have any risk of product return. When there is any quality or quantity loss, the suppliers are obligated to restitution. Income generated from selling materials is recorded as the net amount retained, that is, the amount billed to the customers less the amount paid to suppliers, in the consolidated statement of income in accordance with the provisions of *ASC Topic 350*. Revenue from other asset sales represents gains or losses from other assets, for example, unused property, plant and equipment. Income generated from selling other assets is recorded as the net sales amount less the carrying value of the assets. The Company has classified such revenue from materials and other asset sales into gain on other sales in its consolidated statements of income.

*Government Subsidies* - The Company's PRC based subsidiaries received government subsidies according to related policy from local government. The Company's government subsidies consisted of specific subsidies and other subsidies. Specific subsidies are the subsidies that the Chinese government has specified its purpose for, such as product development and renewal of production facilities. Other subsidies are the subsidies that the Chinese government has not specified its purpose for and are not tied to future trends or performance of the Company; receipt of such subsidy income is not contingent upon any further actions or performance of the Company and the amounts do not have to be refunded under any circumstances. The Company recorded specific purpose subsidies as advances payable when received. For specific purpose subsidies, upon government acceptance of the related project development or asset acquisition, the specific purpose subsidies are recognized to reduce related R&D expenses or cost of asset acquisition. The unspecific purpose subsidies are recognized as other income upon receipt as further performance by the Company is not required.



*Sales Taxes* - The Company is subject to value added tax, "VAT." The applicable VAT tax rate is 17% for products sold in the PRC. The amount of VAT liability is determined by applying the applicable tax rate to the invoiced amount of goods sold less VAT paid on purchases made with the relevant supporting invoices. VAT is collected from customers by the Company on behalf of the PRC tax authorities and is therefore not charged to the consolidated statements of income.

*Uncertain Tax Positions* - In order to assess uncertain tax positions, the Company applies a more likely than not threshold and a two-step approach for tax position measurement and financial statement recognition. For the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement. As of December 31, 2017, the Company has no uncertain tax positions.

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

For the years ended December 31, 2017 and 2016, the warranties activities were as follows (figures are in thousands of USD):

|                                  | Year Ended December 31, |           |
|----------------------------------|-------------------------|-----------|
|                                  | 2017                    | 2016      |
| Balance at the beginning of year | \$ 26,225               | \$ 23,059 |
| Additions during the year        | 23,354                  | 16,522    |
| Settlement within the year       | (22,034 )               | (11,781 ) |
| Foreign currency translation     | 1,488                   | (1,575 )  |
| Balance at end of year           | \$ 29,033               | \$ 26,225 |

*Pension* - Most of the operations and employees of the Company are located in China. The Company records pension costs and various employment benefits in accordance with the relevant Chinese social security laws, which is approximately at a total of 30% of base salary as required by local governments. Base salary levels are the average salary determined by the local governments.

*Concentration of Credit Risk* - Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of trade accounts receivable. The Company performs ongoing credit evaluations with respect to the financial condition of its debtors, but does not require collateral. In order to determine the value of the Company's accounts receivable, the Company records a provision for doubtful accounts to cover probable credit losses. Management reviews and adjusts this allowance periodically based on historical experience and its evaluation of the collectability of outstanding accounts receivable.

*Interest Rate Risk* - As of December 31, 2017, the Company had bank loans of \$20.6 million which were charged at floating interest rates. The remaining bank loans were charged at fixed interest rates. Management is monitoring the change of floating interest rates. The Company plans to repay the bank loans with floating interest rates when the floating interest rates exceed fixed interest rates, because such bank loans are short-term and the Company has sufficient credit lines with fixed interest rates.

*Income Taxes* - The Company accounts for income taxes using the liability method whereby deferred income taxes are recognized for the tax consequences of temporary differences by applying statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of certain assets and liabilities, changes in deferred tax assets and liabilities, if any, include the impact of any tax rate changes enacted during the year. *ASC Topic 350*, "Accounting for Income Taxes," requires that deferred tax assets be reduced by a valuation allowance if, based on all available evidence, it is considered more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. Additionally, the Company accounts for uncertainty in income taxes using a two-step approach to recognize and measure uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. The Company classifies the liability for unrecognized tax benefits as current to the extent that the Company anticipates payment (or receipt) of cash within one year. Interest and penalties related to uncertain tax positions are recognized in the provision for income taxes.

If the amount of the Company's taxable income or income tax liability is a determinant of the amount of a grant, the grant is treated as a reduction of the income tax provision in the year the grant is realized.

*Research and Development Costs* - Research and development costs are expensed as incurred.

*Advertising, Shipping and Handling Costs* - Advertising, shipping and handling costs are expensed as incurred and recorded in selling expenses. Shipping and handling costs relating to sales of \$7.4 million and \$6.0 million were included in selling expenses for the years ended December 31, 2017 and 2016, respectively.

*Income Per Share* - Basic income per share is computed by dividing net income attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period using the two-class method. Under the two-class method, net income is allocated between ordinary shares and other participating securities, convertible note holders, based on their participating rights. Diluted income per share is calculated by dividing net income attributable to ordinary shareholders, as adjusted for the effects on income of participating securities as if they were dilutive ordinary shares, if any, by the weighted average number of ordinary and dilutive ordinary equivalent shares outstanding during the period. Ordinary equivalent shares consist of ordinary shares issuable upon the conversion of the convertible notes using the if-converted method, and shares issuable upon the exercise of stock options and warrants for the purchase of ordinary shares using the treasury stock method. Ordinary equivalent shares are not included in the denominator of the diluted earnings per share calculation when inclusion of such shares would be antidilutive.



*Comprehensive Income* – *ASC Topic 220* establishes standards for the reporting and display of comprehensive income, its components and accumulated balances in a full set of general purpose financial statements. *ASC Topic 220* defines comprehensive income to include all changes in equity except those resulting from investments by owners and distributions to owners, including adjustments to minimum pension liabilities, accumulated foreign currency translation, and unrealized gains or losses on marketable securities.

*Fair Value Measurements* – For purposes of fair value measurements, the Company applies the applicable provisions of ASC 820 “Fair Value Measurements and Disclosures.” Accordingly, fair value for the Company’s financial accounting and reporting purposes represents the estimated price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the designated measurement date. With an objective to increase consistency and comparability in fair value measurements and related disclosures, the Financial Accounting Standard Board established the fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels.

Level 1 Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available. As at December 31, 2017 and 2016, the Company did not have any fair value assets and liabilities classified as Level 1.

Level 2 Inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. As at December 31, 2017 and 2016, wealth management financial products were classified as Level 2.

Level 3 Inputs are unobservable inputs for the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the reporting entity’s own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). As of December 31, 2017 and 2016, the Company did not have any fair value assets and liabilities classified as Level 3.

The Company’s financial instruments consist principally of cash and cash equivalents, pledged cash, time deposits, accounts and notes receivable, accounts and notes payable, advance payment or payable, other receivable or payable, accrued expenses and bank loans. As of December 31, 2017 and 2016, the respective carrying values of all financial instruments approximated fair value because any changes in fair value, after considering the discount rate, are immaterial.

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

The stockholders of the Company approved a stock incentive plan at the Annual Meeting of the Company held on June 28, 2005, and the maximum number of common shares for issuance under this plan is 2,200,000. The term of the plan is 10 years. The stock incentive plan provides for the issuance, to the Company's officers, directors, management and employees, of options to purchase shares of the Company's common stock. Under the stock incentive plan, the Company has issued 591,350 stock options, and 1,608,650 stock options remain to be issuable in the future. As of December 31, 2017, the Company had 112,500 stock options outstanding.

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

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

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

#### *Certain Relationships And Related Transactions*

The following are the related parties of the Company. The major shareholders of the Company directly or indirectly have interests in these related parties:

- Jingzhou Henglong Fulida Textile Co., Ltd., “ **Fulida** ”
- Xiamen Joylon Co., Ltd., “ **Xiamen Joylon** ”
- Shanghai Tianxiang Automotive Parts Co., Ltd., “ **Shanghai Tianxiang** ”
- Shanghai Jinjie Industrial & Trading Co., Ltd., “ **Shanghai Jinjie** ”
- Changchun Hualong Automotive Technology Co., Ltd., “ **Changchun Hualong** ”
- Jiangling Tongchuang Machining Co., Ltd., “ **Jiangling Tongchuang** ”
- Shanghai Hongxi Investment Inc, “ **Hongxi** ”
- Hubei Wiselink Equipment Manufacturing Co., Ltd., “ **Hubei Wiselink** ”
- Jingzhou Derun Agricultural S&T Development Co., Ltd., “ **Jingzhou Derun** ”

- Jingzhou Tongying Alloys Materials Co., Ltd., “ **Jingzhou Tongying** ”
- WuHan Dida Information S&T Development Co., Ltd., “ **WuHan Dida** ”
- Hubei Wanlong Investment Co., Ltd., “ **Hubei Wanlong** ”
- Jingzhou Yude Machining Co., Ltd., “ **Jingzhou Yude** ”
- Wiselink Holdings Limited, “ **Wiselink** ”
- Beijing Hainachuan HengLong Automotive Steering System Co., Ltd., “ **Beijing Henglong** ”
- Honghu Changrun Automotive Parts Co., Ltd., “ **Honghu Changrun** ”
- Jingzhou Henglong Real Estate Co., Ltd., “ **Henglong Real Estate** ”
- Xiamen Joylon Automotive Parts Co., Ltd., “ **Xiamen Automotive Parts** ”
- Jingzhou Jiulong Machinery and Electronic Trading Co., Ltd., “ **Jiulong Machinery** ”
- WuHan Tongkai Automobile Motor Co., Ltd., “ **WuHan Tongkai** ”
- Jingzhou Natural Astaxanthin Inc, “ **Jingzhou Astaxanthin** ”
- Hubei Asta Biotech Inc, “ **Hubei Asta** ”
- Shanghai Yifu Automotive Electronics Technology Co., Ltd., “ **Shanghai Yifu** ”
- Suzhou Qingyan Venture Capital Fund L.P, “ **Suzhou Qingyan** ”
- Chongqing Qingyan Venture Capital Fund L.P, “ **Chongqing Qingyan** ”
- Chongqing Jinghua Automotive Intelligent Manufacturing Technology Research Co., Ltd., “ **Chongqing Jinghua** ”

Principal policies of the Company in connection with transactions with related parties are as follows:

*Products Sold to Related Parties* – The Company sold products to related parties at fair market prices, and also granted them credit of three to four months on an open account basis. These transactions were consummated under similar terms as the Company's other customers.

*Materials Purchased from Related Parties* – The Company purchased materials from related parties at fair market prices, and also received from them credit of three to four months on an open account basis. These transactions were consummated under similar terms as the Company's other suppliers.

*Equipment and Production Technology Purchased from Related Parties* - The Company purchased equipment and production technology from related parties at fair market prices, or reasonable cost plus pricing if fair market prices are not available and was required to pay in advance based on the purchase agreement between the two parties, because such equipment manufacturing and technology development was required for a long period. These transactions are consummated under similar terms as the Company's other suppliers.

*Short-term Loans Extended to Related Parties* - The Company provides short-term loans to related parties and assists the borrowing entities in addressing certain cash flow needs. The contractual period of each loan is three months or less from the date of the extension of the loan. In general, the Company charges interest by referencing to the prevailing borrowing interest rates published by PBOC except for the loans to related parties with repayment terms less than 3 days, which bear no interest rate due to their short-term maturities and are required to be approved by the audit committee of the board of directors of the Company.

### ***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.

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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.

### 3. Short-term investments

The Company's short-term investments as of December 31, 2017 and 2016, are summarized as follows (figures are in thousands of USD):

|   | December 31 |          |
|---|-------------|----------|
|   | 2017        | 2016     |
| Time deposits   | \$12,019    | \$30,217 |
| Wealth management financial products measured at fair value | 17,568      | 258      |
| Total   | \$29,587    | \$30,475 |

As of December 31, 2017 and 2016, the Company had pledged short-term investments of RMB 13.0 million and RMB 39.9 million, equivalent to approximately \$2.0 million and \$5.7 million, respectively, to secure standby letters of credit under HSBC Bank (Note 13) and China CITIC Bank. The use of the pledged short-term investments is restricted.

### 4. Accounts and Notes Receivable

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

|   | December 31, |           |
|---|--------------|-----------|
|   | 2017         | 2016      |
| Accounts receivable - unrelated parties <sup>(1)</sup>    | \$166,889    | \$154,403 |
| Notes receivable - unrelated parties <sup>(2) (3)</sup>   | 109,183      | 132,409   |
| Total accounts and notes receivable - unrelated parties   | 276,072      | 286,812   |
| Less: allowance for doubtful accounts - unrelated parties | (1,083 )     | (1,081 )  |

|   |           |           |
|---|-----------|-----------|
| Accounts and notes receivable - unrelated parties | 274,989   | 285,731   |
| Accounts and notes receivable - related parties   | 19,086    | 20,984    |
| Accounts and notes receivable, net                | \$294,075 | \$306,715 |

- (1) Notes receivable represents accounts receivable in the form of bills of exchange whose acceptances and settlements are handled by banks.

As of December 31, 2017, the Company collateralized its notes receivable in an amount of RMB 258.5 million, equivalent to approximately \$39.6 million, as security for the credit facilities with banks in China and the Chinese government, including RMB 238.4 million, equivalent to approximately \$36.5 million, in favor of Industrial and Commercial Bank of China, Jingzhou Branch, “ICBC Jingzhou”, and China CITIC Bank, Wuchang branch, “CITIC Wuchang” for the purpose of obtaining the Henglong Standby Letters of Credit (as defined in Note 13), which are used as security for the non-revolving credit facility in the amount of \$20.0 million provided by Industrial and Commercial Bank of China (Macau) Limited, “ICBC Macau” and the non-revolving credit facility in the amount of \$10.0 million provided by Taishin Bank, and RMB 20.0 million, equivalent to approximately \$3.1 million, as security in favor of the Chinese government for the low-interest government loan (See Note 13).

- (2)

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

The activity in the Company's allowance for doubtful accounts of accounts receivable during the years ended December 31, 2017 and 2016, is summarized as follows (figures are in thousands of USD):

|  | Year Ended December 31, |          |
|--|-------------------------|----------|
|  | 2017                    | 2016     |
| Balance at beginning of year                   | \$ 1,081                | \$ 1,208 |
| Amounts provided for during the year           | 31                      | 65       |
| Amounts reversed of collection during the year | (90 )                   | (115 )   |
| Foreign currency translation                   | 61                      | (77 )    |
| Balance at end of year                         | \$ 1,083                | \$ 1,081 |

### 5. Advance payments and others

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

|  | Year Ended<br>December 31, |          |
|--|----------------------------|----------|
|  | 2017                       | 2016     |
| Advance payments and others - unrelated parties                          | \$13,801                   | \$10,203 |
| Less: allowance for doubtful accounts – unrelated parties <sup>(2)</sup> | (1,011 )                   | -        |
| Advance payments and others, net – unrelated parties                     | 12,790                     | 10,203   |
| Advance payments and others - related parties <sup>(1)</sup>             | 20,841                     | 624      |
| Total advance payments and others  | 33,631                     | 10,827   |

(1) On March 16, 2017, in order to generate higher returns for the Company's idle cash, one of the Company's subsidiaries, Hubei Henglong, lent RMB 200 million to Henglong Real Estate, one of the Company's related parties, through an independent financial institution by way of an entrusted loan. The term of the loan is one year and the annual interest rate is 6.05%. On December 28, 2017, Henglong Real Estate repaid RMB 70 million to Hubei Henglong. As of December 31, 2017, the outstanding loan balance is RMB 130 million (equivalent to \$19.9 million).

(2) Provision for the doubtful accounts amounted to \$1.0 million and nil for December 31, 2017 and 2016, respectively.

**6. Inventories**

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

|                        | December 31, |          |
|------------------------|--------------|----------|
|                        | 2017         | 2016     |
| Raw materials          | \$20,033     | \$15,007 |
| Work in process        | 17,951       | 10,852   |
| Finished goods         | 41,233       | 42,191   |
| Balance at end of year | \$79,217     | \$68,050 |

Provision for inventories amounted to \$5.1 million and \$3.2 million for the years ended December 31, 2017 and 2016, respectively.

**7. Other Receivables**

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

|   | December 31, |         |
|---|--------------|---------|
|   | 2017         | 2016    |
| Other receivables - unrelated parties <sup>(1)</sup>      | \$1,109      | \$738   |
| Other receivables - employee housing loans <sup>(2)</sup> | 1,187        | 1,577   |
| Less: allowance for doubtful accounts - unrelated parties | (108 )       | (63 )   |
| Balance at end of year                                    | \$2,188      | \$2,252 |

|   | December 31, |       |
|---|--------------|-------|
|   | 2017         | 2016  |
| Other receivables - related parties                     | \$585        | \$559 |
| Less: allowance for doubtful accounts - related parties | (585)        | (559) |
| Balance at end of year                                  | \$-          | \$-   |

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

- (2) On May 28, 2014, the board of directors of the Company approved a loan program under which the Company will lend an aggregate of up to RMB50.0 million (equivalent to approximately \$7.7 million) to the employees of the Company to assist them in purchasing houses. Employees are required to pay interest at an annual rate of 3.8%. These loans are unsecured and the term of the loans is generally for five years.

The activity in the Company's allowance for doubtful accounts of other receivable during the years ended December 31, 2017 and 2016, are summarized as follows (figures are in thousands of USD):

|  | Year Ended December 31, |       |
|--|-------------------------|-------|
|  | 2017                    | 2016  |
| Balance at beginning of year - unrelated parties                   | \$ 63                   | \$ 63 |
| Amounts provided for during the year - unrelated parties           | 41                      | 4     |
| Amounts reversed of collection during the year - unrelated parties | -                       | -     |
| Foreign currency translation - unrelated parties                   | 4                       | (4 )  |
| Balance at end of year   | \$ 108                  | \$ 63 |



|  | Year Ended December 31, |        |
|--|-------------------------|--------|
|  | 2017                    | 2016   |
| Balance at beginning of year - related parties                       | \$ 559                  | \$ 607 |
| Amounts provided for during the year - related parties               | 18                      | -      |
| Amounts reversed due to collection during the year - related parties | (26 )                   | (9 )   |
| Foreign currency translation - related parties                       | 34                      | (39 )  |
| Balance at end of year   | \$ 585                  | \$ 559 |

### 8. Long-term Time Deposits

Long-term time deposits are time deposits with maturities of longer than one year. Time deposits with original maturities of longer than one year but due within the next 12 months are included in short-term investments. As of December 31, 2017, short-term investments include \$7.0 million of time deposits with original maturities of longer than one year but due within the next 12 months.

As of December 31, 2017 and 2016, the Company had pledged long-term time deposits of nil and RMB6.0 million (equivalent to approximately \$0.9 million) to secure loans under the credit facility issued by Bank of China (Brazil). The use of the pledged long-term time deposits is restricted (See Note 13).

### 9. Long-term Investments

In January 2010, the Company invested \$3.1 million to establish a joint venture company, Beijing Henglong, with Hainachuan. The Company owns 50% equity in Beijing Henglong and can exercise significant influence over Beijing Henglong's operating and financial policies. The Company accounted for Beijing Henglong's operational results with the equity method. As of December 31, 2017 and 2016, the Company had \$4.1 million and \$3.8 million, respectively, of net equity in Beijing Henglong.

In September 2014, Hubei Henglong entered into an agreement with other parties to establish a venture capital fund, the "Venture Fund", which mainly focuses on investments in emerging automobiles and parts industries. As of December 31, 2017, Hubei Henglong has completed a capital contribution of RMB50.0 million, equivalent to approximately \$7.6 million, representing 14.7% of the Venture Fund's shares. As a limited partner, Hubei Henglong has more than virtually no influence over the Venture Fund's operating and financial policies. The investment is accounted for using the equity method. As of December 31, 2017 and 2016, the Company had \$10.3 million and \$5.3 million, respectively, of net equity in Venture Fund.

In May 2016, Hubei Henglong entered into an agreement with other parties to establish a venture capital fund, the “Chongqing Venture Fund”. Hubei Henglong has committed to make investments of RMB 120.0 million, equivalent to approximately \$18.0 million, 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. As a limited partner, Hubei Henglong has more than virtually no influence over Chongqing Venture Fund’s operating and financial policies. The investment is accounted for using the equity method. As of December 31, 2017 and 2016, the Company had \$12.7 million and \$6.8 million, respectively, of net equity in Chongqing Venture Fund.

In October 2016, Hubei Henglong invested RMB 3.0 million, equivalent to approximately \$0.4 million, to establish a joint venture company, Chongqing Jinghua Automotive Intelligent Manufacturing Technology Research Co., Ltd., “Chongqing Jinghua”, with five other parties. The Company owns 30% of the equity in Chongqing Jinghua, and can exercise significant influence over Chongqing Jinghua’s operating and financial policies. The Company accounted for Chongqing Jinghua’s operational results with the equity method. As of December 31, 2017 and 2016, the Company had \$0.5 million and \$0.4 million, respectively, of net equity in Chongqing Jinghua.

The Company’s consolidated financial statements contain the net income of non-consolidated affiliates of \$2.6 million and \$0.6 million for the years ended December 31, 2017 and 2016, respectively.

## 10. Property, Plant and Equipment

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

|                                | December 31, |           |
|--------------------------------|--------------|-----------|
|                                | 2017         | 2016      |
| Costs:                         |              |           |
| Land use rights and buildings  | \$63,173     | \$47,448  |
| Machinery and equipment        | 165,863      | 134,361   |
| Electronic equipment           | 5,819        | 4,979     |
| Motor vehicles                 | 4,945        | 4,395     |
| Construction in progress       | 22,352       | 24,890    |
|                                | 262,152      | 216,073   |
| Less: Accumulated depreciation | (136,119)    | (114,595) |
| Balance at end of year         | \$126,033    | \$101,478 |

Depreciation charges for the years ended December 31, 2017 and 2016, were \$14.4 million and \$13.6 million, respectively.

As of December 31, 2017, the Company has pledged property, plant and equipment with a net book value of approximately \$57.8 million as security for its comprehensive credit facilities with banks in China.

During the year ended December 31, 2017, \$0.5 million of government subsidies were recorded as a reduction of the cost of property, plant and equipment.

## 11. Intangible Assets

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

|   | December 31, |         |
|---|--------------|---------|
|   | 2017         | 2016    |
| Costs:  |              |         |
| Patent technology <sup>(1)</sup>              | \$2,108      | \$1,986 |
| Management software license                   | 1,441        | 1,165   |
| Total intangible assets - at cost             | 3,549        | 3,151   |
| Less: Accumulated amortization <sup>(2)</sup> | (2,888)      | (2,534) |
| Balance at end of the year, net               | \$661        | \$617   |

(1) For the year ended December 31, 2016, patent technology with a cost of \$2.5 million and accumulated amortization of \$0.5 million was disposed of along with the disposal of Fujian Qiaolong as disclosed in Note 1 to the consolidated financial statements. As a result of the disposal, goodwill which arose during the acquisition of Fujian Qiaolong was also reduced to zero.

(2) Amortization expenses were \$0.3 million and \$0.3 million for the years ended December 31, 2017 and 2016, respectively. The estimated amortization expense for each of the years from 2018 to 2022 are \$0.2 million, \$0.2 million, \$0.1 million, \$0.1 million and \$0.1 million, respectively.

## 12. Deferred Income Tax Assets

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

The components of deferred income tax assets at December 31, 2017 and 2016, were as follows (figures are in thousands of USD):

|  | December 31, |           |
|--|--------------|-----------|
|  | 2017         | 2016      |
| Losses carryforward (U.S.) <sup>(1)</sup>                      | \$3,580      | \$6,216   |
| Losses carryforward (Non-U.S.)                                 | 2,178        | 2,887     |
| Product warranties and other reserves                          | 5,264        | 4,766     |
| Property, plant and equipment                                  | 4,607        | 4,204     |
| Share-based compensation                                       | 156          | 247       |
| Bonus accrual  | 287          | 231       |
| Other accruals   | 1,535        | 1,551     |
| Deductible temporary difference related to revenue recognition | 465          | 191       |
| Others   | 1,353        | 1,206     |
| Total deferred tax assets                                      | 19,425       | 21,499    |
| Less: valuation allowance                                      | (6,058 )     | (8,912 )  |
| Total deferred tax assets, net of valuation allowance          | \$ 13,367    | \$ 12,587 |

The net operating loss carry forwards for the U.S. entity for income tax purposes are available to reduce future years' taxable income. These carry forwards will expire, if not utilized, at varying times over the next 20 years. Net operating loss carryforwards for China entities can be carried forward for 5 years to offset taxable income.

However, as of December 31, 2017, valuation allowance was \$6.1 million, including \$3.8 million allowance for the (1)Company's deferred tax assets in the United States and \$2.3 million allowance for the Company's non-U.S. deferred tax assets in China. Based on the Company's current operations in the United States, management believes that the deferred tax assets in the United States are not likely to be realized in the future. For the non-U.S. deferred tax assets, pursuant to certain tax laws and regulations in China, the management believes such amount will not be used to offset future taxable income.

The activity in the Company's valuation allowance for deferred tax assets during the years ended December 31, 2017 and 2016, are summarized as follows (figures are in thousands of USD):

|   | Year Ended December 31, |          |
|---|-------------------------|----------|
|   | 2017                    | 2016     |
| Balance at beginning of year                                    | \$ 8,912                | \$ 9,379 |
| Amounts provided for during the year                            | 860                     | 401      |
| Amounts used during the year                                    | (1,309 )                | (698 )   |
| The effect of change in the tax rate due to the U.S. Tax Reform | (2,490 )                | -        |
| Foreign currency translation                                    | 85                      | (170 )   |
| Balance at end of year  | \$ 6,058                | \$ 8,912 |

### 13. Bank and Government Loans

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

|   | December 31, |          |
|---|--------------|----------|
|   | 2017         | 2016     |
| Short-term bank loans <sup>(1)</sup>              | \$9,948      | \$2,162  |
| Short-term bank loans <sup>(2) (3) (4)</sup>      | 30,454       | 35,054   |
| Short-term bank loans <sup>(5)</sup>              | 29,248       | -        |
| Short-term government loan <sup>(6)</sup>         | 3,061        | 3,604    |
| Total short-term bank and government loans        | \$72,711     | \$40,820 |
| Long-term bank and government loan <sup>(7)</sup> | 306          | 608      |
| Total bank and government loans                   | \$73,017     | \$41,428 |

(1) These loans are secured by property, plant and equipment of the Company and are repayable within one year (See Note 10). As of December 31, 2017 and 2016, the weighted average interest rate was 4.7% and 5.2% per annum, respectively. Interest is to be paid monthly or quarterly on the twentieth day of the applicable month or quarter and the principal repayment is at maturity.

(2) On May 18, 2012, the Company entered into a credit facility agreement, the "Credit Agreement," with ICBC Macau to obtain a non-revolving credit facility in the amount of \$30.0 million, the "Credit Facility". The Credit Facility would have expired on November 3, 2012 unless the Company drew down the line of credit in full prior to such expiration date, and the maturity date for the loan drawdown was the earlier of (i) 18 months from the drawdown or (ii) one month before the expiry of the standby letter of credit obtained by Henglong from ICBC Jingzhou as security for the Credit Facility, the "Henglong Standby Letter of Credit". The interest rate of the Credit Facility was calculated based on a three-month LIBOR plus 2.25% per annum, subject to the availability of funds and

fluctuation at ICBC Macau's discretion. The interest is calculated daily based on a 360-day year and it is fixed one day before the first day of each interest period. The interest period is defined as three months from the date of drawdown. As security for the Credit Facility, the Company was required to provide ICBC Macau with the Henglong Standby Letter of Credit for a total amount of not less than \$31.6 million if the Credit Facility is fully drawn.

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

On April 20, 2017, the Company entered into a credit facility agreement, the "2017 Credit Agreement," with ICBC Macau to obtain a non-revolving credit facility in the amount of \$20.0 million, the "2017 Credit Facility". The 2017 Credit Facility will expire on May 12, 2018 unless the Company draws down the line of credit in full prior to such expiration date, and the maturity date for the loan drawdown is the earlier of (i) 12 months from the date of drawdown or (ii) one month before the expiry of the standby letter of credit obtained by Henglong from ICBC Jingzhou as security for the 2017 Credit Facility, the "Henglong Standby Letter of Credit". The interest rate of the 2017 Credit Facility is calculated based on a three-month LIBOR plus 1.30% per annum, subject to the availability of funds and fluctuation at ICBC Macau's discretion. Interest is calculated daily based on a 360-day year and it is fixed one day before the first day of each interest period. The interest period is defined as three months from the date of drawdown. As security for the 2017 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 2017 Credit Facility is fully drawn.

On May 5, 2017, the Company drew down the full amount of \$20.0 million under the 2017 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 2017 Credit Facility is May 12, 2018.



On April 25, 2017, Great Genesis entered into a credit facility agreement, the “Taishin Bank Credit Facility”, with Taishin Bank to obtain a non-revolving credit facility in the amount of \$10.0 million. The Taishin Bank Credit Facility will expire on April 25, 2018 and has an annual interest rate of 2.7%. Interest is paid quarterly and the principal repayment is payable at maturity. As security for the Taishin Bank Credit Facility, the Company’s subsidiary Henglong was required to provide Taishin Bank with the Standby Letter of Credit for a total amount of not less than \$10.0 million if the Taishin Bank Credit Facility is fully drawn. On April 28, 2017, Great Genesis (3) drew down the amount of \$9.9 million under the Taishin Bank Credit Facility and provided the Henglong Standby Letter of Credit for an amount of \$10.0 million in favor of Taishin Bank. Henglong’s Standby Letter of Credit issued by China CITIC Bank Wuchang branch is collateralized by Henglong’s short-term investments of RMB 4.0 million, equivalent to approximately \$0.6 million, and notes receivable of RMB 79.4 million, equivalent to approximately \$12.2 million.

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

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

(4)

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 January 15, 2018. As security for the Bank of China Credit Facility, the Company’s subsidiary Hubei Henglong is required to provide Bank of China (Brazil) with a Standby Letter of Credit for a total amount of \$0.9 million if the Bank of China Credit Facility is fully drawn.

On August 26, 2016, Brazil Henglong drew down a loan amounting to \$0.6 million provided by Bank of China (Brazil). The loan matured on January 15, 2018 and has an annual interest rate of 4.05%. Interest is paid semiannually and the principal repayment is at maturity. Hubei Henglong provided a Standby Letter of Credit for an amount of \$0.9 million in favor of Bank of China (Brazil). Hubei Henglong’s Standby Letter of Credit was issued by Bank of China Jingzhou branch and is collateralized by long-term time deposits of Hubei Henglong of RMB 6.0 million, equivalent to approximately \$0.9 million. The Company repaid this bank loan on January 16, 2018.



On September 26, 2016, Henglong entered into a credit facility agreement with China CITIC Bank to obtain credit facilities in the amount of RMB 170.0 million (equivalent to approximately \$25.6 million), the “Henglong CITIC Credit Facility”. The Henglong CITIC Credit Facility expired on September 26, 2017. As security for the Henglong CITIC Credit Facility, Henglong’s property, plant and equipment were pledged and Hubei Henglong provided a guarantee. On March 3, 2017, Henglong drew down loans amounting to RMB 32.5 million, RMB 32.5 million and 30.6 million (equivalent to \$5.0 million, \$5.0 million and \$4.7 million as of December 31, 2017), respectively. The loans matured on February 5, 6 and 7, 2018, respectively. The annual interest rate of the loans is 4.99%. The principal and interest have been repaid.

On October 27, 2017, Henglong entered into a credit facility agreement with China CITIC Bank to obtain credit facilities in the amount of RMB 224.0 million (equivalent to \$34.3 million as of December 31, 2017), the “Henglong CITIC Credit Facility”. The Henglong CITIC Credit Facility will expire on October 27, 2018. As security for the Henglong CITIC Credit Facility, Henglong’s property, plant and equipment were pledged and Hubei Henglong provided a guarantee.

(5)

On September 26, 2016, Hubei Henglong entered into a credit facility agreement with China CITIC Bank to obtain credit facilities in the amount of RMB 100.0 million (equivalent to approximately \$15.1 million), the “Hubei Henglong CITIC Credit Facility”. The Hubei Henglong CITIC Credit Facility expired on September 26, 2017. Henglong provided a guarantee for the Hubei Henglong CITIC Credit Facility. On March 3, 2017, Hubei Henglong drew down loans amounting to RMB 28.7 million, RMB 28.7 million and 38.2 million (equivalent to \$4.4 million, \$4.4 million and \$5.8 million), respectively. The loans matured on February 2, 8 and 9, 2018, respectively. The annual interest rate of the loans was 4.99%. The principal and interest have been repaid.

On October 27, 2017, Henglong entered into a credit facility agreement with China CITIC Bank to obtain credit facilities in the amount of RMB 140.0 million (equivalent to \$21.4 million as of December 31, 2017), the “Hubei Henglong CITIC Credit Facility”. The Hubei Henglong CITIC Credit Facility will expire on October 27, 2018. Henglong provided a guarantee for the Hubei Henglong CITIC Credit Facility.

On August 17, 2017, the Company received a Chinese government loan of RMB 20.0 million, equivalent to approximately \$3.0 million, with an interest rate of 1.50% per annum, which will mature on August 16, 2018. The annual interest rate of the loan is 1.50%. Henglong pledged RMB 20.0 million, equivalent to approximately \$3.0 million, of notes receivable as security for the Chinese government loan (See Note 4).

(6)

On April 21, 2017, the Company received an interest-free Chinese government loan of RMB 10.0 million, equivalent to approximately \$1.5 million, which will mature on December 8, 2017. Jiulong pledged RMB 10.0 million, equivalent to approximately \$1.5 million, of notes receivable as security for the Chinese government loan (See Note 4). The Company repaid this government loan on December 5, 2017.

(7)

On November 13, 2017, the Company received a Chinese government loan of RMB 2.0 million, equivalent to approximately \$0.3 million, with an interest rate of 4.75% per annum, which will mature on November 12, 2020.

The Company must use the loans for the purpose specified in the borrowing agreement. If it fails to do so, it may be charged penalty interest or triggered early repayment. Management believes that the Company complied with such financial covenants as of December 31, 2017, and will continue to comply with them.

#### 14. Accounts and Notes Payable

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

|  | December 31, |            |
|--|--------------|------------|
|  | 2017         | 2016       |
| Accounts payable - unrelated parties             | \$ 149,200   | \$ 138,053 |
| Notes payable - unrelated parties <sup>(1)</sup> | 83,848       | 78,940     |
| Accounts and notes payable - unrelated parties   | 233,048      | 216,993    |
| Accounts and notes payable - related parties     | 7,168        | 6,803      |
| Balance at end of year                           | \$ 240,216   | \$ 223,796 |

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

## 15. Accrued Expenses and Other Payables

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

|                                  | December 31, |          |
|----------------------------------|--------------|----------|
|                                  | 2017         | 2016     |
| Accrued expenses                 | \$7,944      | \$8,605  |
| Accrued interest                 | 1,347        | 88       |
| Other payables                   | 1,803        | 964      |
| Warranty reserves <sup>(1)</sup> | 29,033       | 26,225   |
| Balance at end of year           | \$40,127     | \$35,882 |

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

## 16. Taxes Payable

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

|  | December 31, |          |
|--|--------------|----------|
|  | 2017         | 2016     |
| Value-added tax payable                | \$1,813      | \$7,662  |
| Income tax payable                     | 3,450        | 3,390    |
| Other tax payable                      | 664          | 622      |
| Short-term taxes payable               | 5,927        | 11,674   |
| Long-term taxes payable <sup>(1)</sup> | 32,719       | -        |
| Taxes payable                          | \$38,646     | \$11,674 |

(1) A one-time transition tax of \$35.6 million was recognized in the fourth quarter 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. As of December 31, 2017, \$2.7 million was included in taxes payable as a current liability which the Company believes will be paid within one year and the remaining balance was included in long-term taxes payable. See Note 27 for more details about the U.S. Tax Reform.

### **17. Advances Payable**

On December 31, 2017 and 2016, advances payable of the Company was \$0.7 million and \$0.7 million, respectively.

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

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

## 18. Additional Paid-In Capital

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

|   | Year Ended December 31, |           |
|---|-------------------------|-----------|
|   | 2017                    | 2016      |
| Balance at beginning of year  | \$ 64,764               | \$ 64,627 |
| Acquisition of the non-controlling interest in Brazil Henglong <sup>(1)</sup> | (458 )                  | -         |
| Share-based compensation <sup>(2)</sup>                                       | 100                     | 137       |
| Balance at end of year  | \$ 64,406               | \$ 64,764 |

In May 2017, the Company obtained an additional 15.84% equity interest in Brazil Henglong for nil consideration.

(1) The Company retained its controlling interest in Brazil Henglong and the acquisition of the non-controlling interest was accounted for as an equity transaction.

On December 2, 2016 and August 16, 2017, the Company granted 22,500 and 22,500 stock options, respectively, to the Company's independent directors, with the exercise price equal to the closing price of the Company's common stock traded on NASDAQ one day before the date of grant and on the date of grant, respectively. The fair value of the stock options was determined at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option model requires management to make various estimates and assumptions, including expected (2) term, expected volatility, risk-free rate and dividend yield. The expected term represents the period of time that stock-based compensation awards granted are expected to be outstanding and is estimated based on considerations including the vesting period, contractual term and anticipated employee exercise patterns. Expected volatility is based on the historical volatility of the Company's stock. The risk-free rate is based on the U.S. Treasury yield curve in relation to the contractual life of stock-based compensation instruments. The dividend yield assumption is based on historical patterns and future expectations for the Company's dividends.

## 19. Stock Options

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 available for issuance under this plan is 2,200,000. The term of the plan was extended to June 27, 2025. The stock incentive plan provides for the issuance, to the Company's officers, directors, management and employees who served over three years or have given outstanding performance, of options to purchase shares of the Company's common stock. The Company has issued 593,600 stock options under this plan, and there remain 1,586,150 stock options issuable in the future as of December 31, 2017.

Under the aforementioned plan, the stock options granted will have an exercise price equal to the closing price of the Company's common stock traded on NASDAQ on the date of grant, and will expire two to five years after the grant date. Except for the 298,850 options granted to management in December 2008, which became exercisable on a ratable basis over the vesting period (3 years), the others were exercisable immediately on the grant date. Stock options will be settled in shares of the Company's common stock upon exercise and are recorded in the Company's consolidated balance sheets under the caption "Additional paid-in capital." As of December 31, 2017, the Company has sufficient unissued registered common stock for settlement of the stock incentive plan mentioned above.

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



For 2017 and 2016, assumptions used to estimate the fair value of stock options on the grant dates are as follows:

| Issuance Date    | Expected volatility | Risk-free rate | Expected term (years) | Dividend yield |
|------------------|---------------------|----------------|-----------------------|----------------|
| December 2, 2016 | 134.8               | % 1.84         | 5                     | 0.00 %         |
| August 16, 2017  | 139.2               | % 1.79         | 5                     | 0.00 %         |

The stock options granted during 2017 and 2016 were exercisable immediately and their fair value on the grant date using the Black-Scholes option pricing model were \$0.1 million and \$0.1 million, respectively. For the years ended December 31, 2017 and 2016, the Company recognized stock-based compensation expenses of \$0.1 million and \$0.1 million, respectively.

The activities of stock options are summarized as follows, including granted, exercised and forfeited.

|                                 | Shares    | Weighted-Average<br>Exercise Price | Weighted-Average<br>Contractual<br>Term (years) |
|---------------------------------|-----------|------------------------------------|---|
| Outstanding - January 1, 2016   | 105,000   | \$ 7.03                            | 5   |
| Granted                         | 22,500    | 6.95                               | 5   |
| Expired                         | (15,000 ) | 4.84                               | 5   |
| Outstanding - December 31, 2016 | 112,500   | \$ 7.31                            | 5   |
| Granted                         | 22,500    | 5.04                               | 5   |
| Expired                         | (22,500 ) | 3.71                               | 5   |
| Outstanding - December 31, 2017 | 112,500   | \$ 7.57                            | 5   |

The following is a summary of the range of exercise prices for stock options that are outstanding and exercisable at December 31, 2017:

| Range of Exercise Prices | Outstanding Stock<br>Options | Weighted Average<br>Remaining Life | Weighted Average<br>Exercise Price | Number of Stock<br>Options Exercisable |
|--------------------------|------------------------------|------------------------------------|------------------------------------|--|
| \$3.50 - \$10.00         | 112,500                      | 2.76                               | \$ 7.57                            | 112,500                                |
| \$10.01 - \$18.00        | -                            | -                                  | \$ -                               | -                                      |
|                          | 112,500                      |                                    |                                    | 112,500                                |

As of December 31, 2017 and 2016, the total intrinsic value of the Company's stock options that were exercisable was \$0.1 million and \$0.1 million, respectively.

For the years ended December 31, 2017 and 2016, no Company's stock options were exercised.

During the years ended December 31, 2017 and 2016, the weighted average fair value of the Company's stock options granted was \$4.46 and \$6.08, respectively.

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## 20. Retained Earnings

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

When the statutory surplus reserve reaches 50% of the registered capital of a company, additional reserve is no longer required. However, the reserve cannot be distributed to joint venture partners. Based on the business licenses of the PRC subsidiaries, the registered capital of Henglong, Jiulong, Shenyang, USAI, Jielong, Wuhu, Hubei Henglong and Chongqing are \$10.0 million, \$4.2 million (equivalent to RMB35.0 million), \$8.1 million (equivalent to RMB67.5 million), \$2.6 million, \$6.0 million, \$3.8 million (equivalent to RMB30.0 million), \$39 million and \$9.5 million (equivalent to RMB60.0 million), respectively.

For the years ended December 31, 2017 and 2016, the subsidiaries in China appropriated statutory reserves of \$0.2 million and \$0.2 million, respectively, in respect of the dividends that were declared.

## 21. Accumulated other comprehensive income

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

|   | Year Ended December 31, |           |
|---|-------------------------|-----------|
|   | 2017                    | 2016      |
| Balance at beginning of year  | \$ (892 )               | \$ 18,412 |
| Other comprehensive income related to the non-controlling interests acquired by the Company | (67 )                   | -         |
| Foreign currency translation adjustment attributable to parent company                      | 18,739                  | (19,304 ) |
| Balance at end of year  | \$ 17,780               | \$ (892 ) |

**22. Treasury stock**

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

**23. Non-controlling interests**

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

|   | Year Ended December 31, |          |
|---|-------------------------|----------|
|   | 2017                    | 2016     |
| Balance at beginning of year  | \$ 5,412                | \$ 8,252 |
| Change of the non-controlling interests due to disposal of Fujian Qiaolong                  | -                       | (2,150 ) |
| Income attributable to non-controlling interests  | 707                     | 466      |
| Dividends declared to the non-controlling interest holders of joint-venture companies       | (608 )                  | (464 )   |
| Acquisition of the non-controlling interest in Brazil Henglong                              | 458                     | -        |
| Other comprehensive income related to the non-controlling interests acquired by the Company | 67                      | -        |
| Foreign currency translation adjustment attributable to non-controlling interests           | 645                     | (692 )   |
| Balance at end of year  | \$ 6,681                | \$ 5,412 |

**24. Gain on Other Sales**

Gain on other sales mainly consisted of net amount retained from sales of materials, property, plant and equipment and scraps. For the year ended December 31, 2017, gain on other sales amounted to \$7.6 million, as compared to \$3.8 million for 2016, mainly resulting from the gain on disposal of a building of \$2.2 million and increased sales volumes of materials.

**25. Other Income, Net**

The Company recorded government subsidies received with no further condition to be met as other income. As of December 31, 2017 and 2016, the Company has recognized such subsidies in the amounts of \$1.2 million and \$1.8 million, respectively.

The Chinese government provides subsidies to support enterprises in their Research and development, "R&D," and renewal of equipment. Government subsidies are generally classified as specific purpose subsidies, such as R&D activities and renewal of equipment, and unspecified purpose subsidies. For specific purpose subsidies, accounting by the occurred evidence, subsidies for the R&D activities first offset related R&D expenses that occurred, and subsidies for renewal of equipment offset the cost of related assets. Unspecific purpose subsidies are generally recognized as other income.

**26. Financial Income, Net**

During the years ended December 31, 2017 and 2016, the Company recorded financial income/(expenses) which are summarized as follows (figures are in thousands of USD):

|                               | Year Ended December 31, |          |
|-------------------------------|-------------------------|----------|
|                               | 2017                    | 2016     |
| Interest income               | \$ 3,438                | \$ 2,080 |
| Foreign exchange loss, net    | (778 )                  | (46 )    |
| Gain on notes discounted, net | -                       | 3        |
| Bank fees                     | (480 )                  | (609 )   |
| Total financial income, net   | \$ 2,180                | \$ 1,428 |

**27. Income Taxes**PRC Corporate Income Tax

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

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

Genesis, the Company's wholly-owned subsidiary and the direct holder of the equity interests in the Company's subsidiaries in China, is incorporated in Hong Kong. According to the Mainland China and Hong Kong Taxation Arrangement, dividends paid by a foreign-invested enterprise in China to its direct holding company in Hong Kong would be subject to withholding tax at a rate of 10% if Genesis could not obtain the Hong Kong tax resident certificate

from the Hong Kong Inland Revenue Department. If Genesis obtains the Hong Kong tax resident certificate, owns directly at least 25% of the shares of the foreign invested enterprise and is qualified as the beneficial owner, it could benefit from a lower rate of 5%.

According to PRC tax regulation, the Company should withhold income taxes for the profits distributed from the PRC subsidiaries to Genesis, the subsidiaries' holding company incorporated in Hong Kong. For the profits that the PRC subsidiaries intended to distribute to Genesis, the Company accrues the withholding income tax as deferred tax liabilities. As of December 31, 2017, the Company has recognized deferred tax liabilities of \$4.5 million for the undistributed profits of \$44.8 million which are expected to be distributed to Genesis in the future. The Company intended to re-invest the remaining undistributed profits generated from the PRC subsidiaries in those subsidiaries indefinitely. As of December 31, 2017 and 2016, the Company still has undistributed earnings of approximately \$294.2 million and \$256.1 million, respectively, from investment in the PRC subsidiaries that are considered indefinitely reinvested. Had the undistributed earnings been distributed to Genesis and not indefinitely reinvested, the tax provision as of December 31, 2017 and 2016, of approximately \$29.4 million and \$25.6 million, respectively, would have been recorded. Such undistributed profits will be reinvested in Genesis and not further distributed to the parent company incorporated in the United States going forward.

In 2014, Jiulong was awarded the title of "High& New Technology Enterprise", and based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% from 2014 to 2016. It passed the reassessment of "High& New Technology Enterprise" in 2017. Therefore, it is subject to enterprise income tax at a rate of 15% from 2017 to 2019.

In 2014, Henglong was awarded the title of "High& New Technology Enterprise", and based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% from 2014 to 2016. It passed the reassessment of "High& New Technology Enterprise" in 2017. Therefore, it is subject to enterprise income tax at a rate of 15% from 2017 to 2019.

In 2014, Hubei Henglong was awarded the title of "High& New Technology Enterprise", and based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% from 2014 to 2016. It passed the reassessment of "High& New Technology Enterprise" in 2017. Therefore, it is subject to enterprise income tax at a rate of 15% from 2017 to 2019.

In 2014, Wuhu was awarded the title of "High& New Technology Enterprise", and based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% from 2014 to 2016. It passed the reassessment of "High& New Technology Enterprise" in 2017. Therefore, it is subject to enterprise income tax at a rate of 15% from 2017 to 2019.

In 2015, Shenyang was awarded the title of "High & New Technology Enterprise", and based on the PRC income tax law, it was subject to enterprise income tax at a rate of 15% from 2015 to 2017.



In 2013, Jielong was awarded the title of “High& New Technology Enterprise” and, based on the PRC income tax law, it is subject to enterprise income tax at a rate of 15% from 2016 to 2018.

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

### Brazil Corporate Income Tax

Based on Brazilian income tax laws, Brazil Henglong is subject to income tax at a uniform rate of 15%, and a resident legal person is subject to additional tax at a rate of 10% for the part of taxable income over \$0.12 million, equivalent to approximately BRL 0.24 million. The Company had no assessable income in Brazil for the years ended December 31, 2017 and 2016.

### Hong Kong Corporate Income Tax

The profits tax rate of Hong Kong is 16.5%. No provision for Hong Kong tax is made as Genesis is an investment holding company, and had no assessable income in Hong Kong for the years ended December 31, 2017 and 2016.

### U.S. Corporate Income Tax

The Company is a Delaware corporation that is subject to U.S. corporate income tax on its taxable income at a rate of up to 21% for taxable years beginning after December 31, 2017 and U.S. corporate income tax on its taxable income of up to 35% for prior tax years. Recent 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.

The U.S. Tax Reform also includes provisions for a new tax on GILTI effective for tax years of foreign 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 controlled foreign corporations (“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.

The Company’s management is still evaluating the effect of the U.S. Tax Reform on the Company. Management may update its judgment of that effect based on its continuing evaluation and on future regulations or guidance issued by

the U.S. Department of the Treasury, and specific actions the Company may take in the future.

To the extent that portions of the Company's U.S. taxable income, such as Subpart F income or GILTI, are determined to be from sources outside of the U.S., subject to certain limitations, the Company may be able to claim foreign tax credits to offset its U.S. income tax liabilities. If dividends that the Company receives from its subsidiaries are determined to be from sources outside of the U.S., subject to certain limitations, the Company will generally not be required to pay U.S. corporate income tax on those dividends. Any liabilities for U.S. corporate income tax will be accrued in the Company's consolidated statements of comprehensive income and estimated tax payments will be made when required by U.S. law.

One-Time Transition Tax Related to U.S. Tax Reform

In the fourth quarter of 2017, the Company recognized a one-time transition tax of \$35.6 million 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. The actual impact of the U.S. Tax Reform on the Company may differ from management's estimates, and management may update its judgments based on future regulations or guidance issued by the U.S. Department of the Treasury, and specific actions the Company may take in the future.

The provision for income taxes was calculated as follows (figures are in thousands of USD):

|  | Year Ended December 31, |   |           |   |
|--|-------------------------|---|-----------|---|
|  | 2017                    |   | 2016      |   |
| Tax rate   | 35                      | % | 35        | % |
| Income before income taxes   | \$ 20,375               |   | \$ 24,904 |   |
| Income tax at federal statutory tax rate   | 7,131                   |   | 8,716     |   |
| Tax benefit of super deduction of R&D expense                                      | (5,328)                 | ) | (3,969)   | ) |
| Effect of differences in foreign tax rate  | (1,830)                 | ) | (3,367)   | ) |
| Change in provision on valuation allowance for deferred income tax – U.S.          | (2,725)                 | ) | (258)     | ) |
| Change in provision on valuation allowance for deferred income tax – Non-U.S.      | (128)                   | ) | (208)     | ) |
| One-time transition tax related to U.S. Tax Reform                                 | 35,564                  |   | -         |   |
| Withholding tax resulting from the distribution of dividends from PRC subsidiaries | 3,952                   |   | -         |   |
| The effect of change in the tax rate due to the U.S. Tax Reform                    | 2,490                   |   | -         |   |
| Other differences  | 2,507                   |   | 1,570     |   |
| Total income tax expense   | \$ 41,633               |   | \$ 2,484  |   |

The combined effects of the income tax exemption and reduction available to the Company are as follows (figures are in thousands of USD unless otherwise indicated):

|                                     | Year Ended December 31, |          |
|-------------------------------------|-------------------------|----------|
|                                     | 2017                    | 2016     |
| Tax holiday effect                  | \$ 1,830                | \$ 3,367 |
| Basic net income per share effect   | 0.06                    | 0.11     |
| Diluted net income per share effect | 0.06                    | 0.11     |

The Company is subject to examination in the United States and China. The Company's tax years for 2013 through 2017 are still open for examination in China. The Company's tax years for 2008 through 2017 are still open for examination in the United States.

*Uncertain Tax Positions*

The Company did not have any uncertain tax positions for the years ended December 31, 2017 and 2016.

**28. Income Per Share**

Basic net income per share is computed using the weighted average number of the ordinary shares outstanding during the year.

For diluted income per share, the Company uses the treasury stock method for options, assuming the issuance of common shares, if dilutive, resulting from the exercise of options.

The calculations of basic and diluted income per share attributable to the parent company were (figures are in thousands of USD):

|  | Year Ended December 31, |            |
|--|-------------------------|------------|
|  | 2017                    | 2016       |
| Numerator:   |                         |            |
| Net (loss)/income attributable to the parent company's common shareholders – Basic and Diluted | \$(19,346               | ) 22,511   |
| Denominator:   |                         |            |
| Weighted average ordinary shares outstanding – Basic   | 31,644,004              | 31,954,407 |
| Dilutive effects of stock options  | 2,893                   | 2,645      |
| Denominator for dilutive income per share – Diluted  | 31,646,897              | 31,957,052 |
| Net (loss)/income per share attributable to the parent company's common shareholders           |                         |            |
| Basic  | (0.61                   | ) 0.70     |
| Diluted  | (0.61                   | ) 0.70     |

As of December 31, 2017 and 2016, the exercise prices for 90,000 shares and 90,000 shares, respectively, of outstanding stock options were above the weighted average market price of the Company's common stock during the year ended December 31, 2017 and 2016, respectively, and these stock options were excluded from the calculation of the diluted income per share for the corresponding periods presented.

**29. Significant Concentrations**

A significant portion of the Company's business is conducted in China where the currency is the RMB. Regulations in China permit foreign owned entities to freely convert the RMB into foreign currency for transactions that fall under the "current account", which includes trade related receipts and payments, interest and dividends. Accordingly, the Company's Chinese subsidiaries may use RMB to purchase foreign exchange for settlement of such "current account"

transactions without pre-approval.

China Automotive, the parent company, may depend on Genesis and HLUSA dividend payments, which are generated from their subsidiaries and their subsidiaries' interests in the Sino-foreign joint ventures in China, "China-based Subsidiaries," after they receive payments from the China-based Subsidiaries. Regulations in the PRC currently permit payment of dividends of a PRC company only out of accumulated profits as determined in accordance with accounting standards and regulations in China. Under PRC law China-based Subsidiaries are required to set aside at least 10% of their after-tax profit based on PRC accounting standards each year to their general reserves until the cumulative amount reaches 50% of their paid-in capital. These reserves are not distributable as cash dividends, or as loans or advances. These foreign-invested enterprises may also allocate a portion of their after-tax profits, at the discretion of their boards of directors, to their staff welfare and bonus funds. Any amounts so allocated may not be distributed and, accordingly, would not be available for distribution to Genesis and HLUSA.

The PRC government also imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currencies out of China, the China-based Subsidiaries may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currencies. If China Automotive is unable to receive dividend payments from its subsidiaries and China-based subsidiaries, China Automotive may be unable to effectively finance its operations or pay dividends on its shares.

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

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

The Company grants credit to its customers including Xiamen Joylon, Shanghai Fenglong, Beijing Henglong and Jiangling Yude, which are related parties of the Company. The Company's customers are mostly located in the PRC except for Fiat Chrysler North America, which is in the U.S.

In 2017, the Company's five largest customers accounted for 36.8 % of the Company's consolidated sales, with one customer accounting for more than 10% of consolidated sales (14.5% of consolidated sales, which comprised a total of \$72.2 million in sales included in the Hubei Henglong segment (Note 34)).

In 2016, the Company's five largest customers accounted for 41.7% of the Company's consolidated sales, with one customer accounting for more than 10% of consolidated sales (11.5% of consolidated sales, which comprised a total of \$53.1 million in sales included in the Hubei Henglong segment (Note 34)).



At December 31, 2017 and 2016, approximately 4.3% and 3.2% of accounts receivable were from trade transactions with the aforementioned customer (accounting for more than 10% of consolidated sales).

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**30. Related Party Transactions**

The Company's related party transactions include product sales, material purchases and purchases of equipment and technology. These transactions were consummated at fair market price and under similar terms as those with the Company's customers and suppliers. On some occasions, the Company's related party transactions also include purchase/sale of capital stock of the joint ventures and sale of property, plant and equipment.

Related sales and purchases: During the years ended December 31, 2017 and 2016, the joint ventures entered into related party transactions with companies with common directors as shown below (figures are in thousands of USD):

**Merchandise Sold to Related Parties**

|                         | Year Ended December 31, |           |
|-------------------------|-------------------------|-----------|
|                         | 2017                    | 2016      |
| Beijing Henglong        | \$ 31,089               | \$ 32,284 |
| Xiamen Automotive Parts | 6,042                   | 7,216     |
| Wuhan Tongkai           | 290                     | 193       |
| Shanghai Jinjie         | 161                     | 152       |
| Jingzhou Yude           | 1                       | -         |
| Total                   | \$ 37,583               | \$ 39,845 |

**Rental Income Obtained from Related Parties**

|               | Year Ended December 31, |        |
|---------------|-------------------------|--------|
|               | 2017                    | 2016   |
| Rental income | \$ 147                  | \$ 116 |

**Materials Sold to Related Parties**

|                   | Year Ended December 31, |        |
|-------------------|-------------------------|--------|
|                   | 2017                    | 2016   |
| Jingzhou Yude     | \$ 711                  | \$ 670 |
| Honghu Changrun   | 575                     | 272    |
| Jingzhou Tongying | 288                     | 227    |

|                       |          |          |
|-----------------------|----------|----------|
| Jiangling Tongchuang  | 27       | 34       |
| Beijing Henglong      | 2        | 14       |
| Other Related Parties | 2        | 8        |
| Total                 | \$ 1,605 | \$ 1,225 |

## Materials Purchased from Related Parties

|                       | Year Ended December 31, |           |
|-----------------------|-------------------------|-----------|
|                       | 2017                    | 2016      |
| Jingzhou Tongying     | \$ 11,078               | \$ 11,873 |
| Jiangling Tongchuang  | 7,930                   | 7,550     |
| Wuhan Tongkai         | 7,454                   | 6,457     |
| Hubei Wiselink        | 1,374                   | 848       |
| Honghu Changrun       | 1,157                   | 1,003     |
| Other Related Parties | 1                       | 16        |
| Total                 | \$ 28,994               | \$ 27,747 |

## Technology and Services Purchased from Related Parties (R&amp;D Expenses)

|                       | Year Ended December 31, |          |
|-----------------------|-------------------------|----------|
|                       | 2017                    | 2016     |
| Hubei Wiselink        | \$ 507                  | \$ 251   |
| Changchun Hualong     | 454                     | 404      |
| Jingzhou Yude         | 117                     | 128      |
| Jingzhou Derun        | 46                      | 151      |
| Jiulong Machinery     | 25                      | -        |
| Hubei Asta            | 10                      | 170      |
| Shanghai Tianxiang    | -                       | 89       |
| Other Related Parties | -                       | 29       |
| Total                 | \$ 1,159                | \$ 1,222 |

## Property, Plant and Equipment Purchased from Related Parties

|                | Year Ended December 31, |           |
|----------------|-------------------------|-----------|
|                | 2017                    | 2016      |
| Hubei Wiselink | \$ 9,113                | \$ 11,941 |

Related receivables, advance payments and accounts payable: As of December 31, 2017 and 2016, accounts receivable, advance payments and accounts payable between the Company and related parties are as shown below (figures are in thousands of USD):

## Accounts and Notes Receivable from Related Parties

|                         | December 31, |          |
|-------------------------|--------------|----------|
|                         | 2017         | 2016     |
| Beijing Henglong        | \$13,533     | \$14,961 |
| Xiamen Joylon           | 2,601        | 1,117    |
| Jingzhou Yude           | 1,559        | 1,252    |
| Xiamen Automotive Parts | 1,186        | 3,374    |
| Shanghai Jinjie         | 101          | 158      |
| Wuhan Tongkai           | 90           | 60       |
| Jingzhou Tongying       | 16           | 62       |
| Total                   | \$19,086     | \$20,984 |

Other Receivables from Related Parties

|                                | December 31, |       |
|--------------------------------|--------------|-------|
|                                | 2017         | 2016  |
| Jiulong Machinery              | \$585        | \$559 |
| Total                          | 585          | 559   |
| Less: provisions for bad debts | (585)        | (559) |
| Balance at end of year         | \$-          | \$-   |

Other receivables from related parties are primarily unsecured demand loans, with no stated interest rate or due date.

## Accounts and Notes Payable to Related Parties

|                      | December 31, |         |
|----------------------|--------------|---------|
|                      | 2017         | 2016    |
| Jingzhou Tongying    | \$2,720      | \$1,979 |
| Wuhan Tongkai        | 2,259        | 2,158   |
| Hubei Wiselink       | 1,379        | 1,754   |
| Jiangling Tongchuang | 739          | 828     |
| Honghu Changrun      | 57           | 27      |
| Shanghai Tianxiang   | 12           | 11      |
| Jingzhou Yude        | 2            | 2       |
| Henglong Real Estate | -            | 44      |
| Total                | \$7,168      | \$6,803 |

## Advance Payments for Property, Plant and Equipment to Related Parties

|                      | December 31, |         |
|----------------------|--------------|---------|
|                      | 2017         | 2016    |
| Hubei Wiselink       | \$5,158      | \$5,005 |
| Henglong Real Estate | 106          | -       |
| Total                | \$5,264      | \$5,005 |

## Other Advance Payments and Others to Related Parties

|                       | December 31, |       |
|-----------------------|--------------|-------|
|                       | 2017         | 2016  |
| Henglong Real Estate  | \$19,895     | \$-   |
| Honghu Changrun       | 481          | 361   |
| Wuhan Tongkai         | 188          | -     |
| Jingzhou Derun        | 118          | 161   |
| Changchun Hualong     | 76           | 72    |
| Jiangling Tongchuang  | -            | 2     |
| Other Related Parties | 83           | 28    |
| Total                 | \$20,841     | \$624 |

As of March 29, 2018, the date the Company issued the financial statements, Hanlin Chen, Chairman, owns 55.6% of the common stock of the Company and has the effective power to control the vote on substantially all significant matters without the approval of other stockholders.



**31. Commitments and Contingencies**

## a. Legal proceedings

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

## b. Commitments

In addition to bank loans, notes payables and the related interest, the following table summarizes the Company's noncancelable commitments and contingencies as of December 31, 2017 (figures are in thousands of USD):

|   | Payment Obligations by Period |         |      |            |          |
|---|-------------------------------|---------|------|------------|----------|
|   | 2018                          | 2019    | 2020 | Thereafter | Total    |
| Obligations for investment contracts <sup>(1)</sup> | \$6,428                       | \$-     | \$ - | \$ -       | \$6,428  |
| Obligations for purchasing and service              | 18,253                        | 7,064   | -    | -          | 25,317   |
| Total   | \$24,681                      | \$7,064 | \$ - | \$ -       | \$31,745 |

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.

(1)

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% of Jingzhou Qingyan's shares, and will be paid in 2018.

**32. 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.

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### 33. Segment Reporting

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

As of December 31, 2017, the Company had 12 product sectors, five of which were principal profit makers and were reported as separate sectors and engaged in the production and sales of power steering (Henglong, Jiulong, Shenyang, Wuhu and Hubei Henglong), and one holding company (Genesis). The other seven sectors were engaged in the production and sale of sensor modular (USAI), column (Jielong), provision of after sales and R&D services (HLUSA), production and sale of power steering (Chongqing Henglong), trade (Brazil Henglong), manufacture and sale of automobile electronic systems and parts (Wuhan Chuguanjie) and research and development of intelligent automotive technology (Jingzhou Qingyan). Since the revenues, net income and net assets of these seven sectors collectively are less than 10% of consolidated revenues, net income and net assets, respectively, in the consolidated financial statements, the Company incorporated these seven sectors into "Other Sectors."

As of December 31, 2016, the Company had 11 product sectors, five of which were principal profit makers and were reported as separate sectors and engaged in the production and sales of power steering (Henglong, Jiulong, Shenyang, Wuhu and Hubei Henglong), and one holding company (Genesis). The other six sectors were engaged in the production and sale of sensor modular (USAI), column (Jielong), provision of after sales and R&D services (HLUSA), production and sale of power steering (Chongqing Henglong), trade (Brazil Henglong), and manufacture and sales of automobile electronic systems and parts (Wuhan Chuguanjie). Since the revenues, net income and net assets of these six sectors collectively are less than 10% of consolidated revenues, net income and net assets, respectively, in the consolidated financial statements, the Company incorporated these six sectors into "Other Sectors."

The Company's product sector information from continuing operations is as follows (figures are in thousands of USD):

|          | Net Sales                       |            | Net Income (Loss)               |           |
|----------|---------------------------------|------------|---------------------------------|-----------|
|          | Year Ended December 31,<br>2017 | 2016       | Year Ended December 31,<br>2017 | 2016      |
| Henglong | \$ 279,706                      | \$ 301,367 | \$ 3,737                        | \$ 14,407 |
| Jiulong  | 100,776                         | 76,968     | 4,064                           | 3,501     |
| Shenyang | 40,182                          | 35,191     | 2,107                           | 1,932     |
| Wuhu     | 25,599                          | 23,968     | 264                             | 255       |

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|                    |            |            |              |           |
|--------------------|------------|------------|--------------|-----------|
| Hubei Henglong     | 92,293     | 57,311     | 10,416       | 4,043     |
| Other Sectors      | 59,075     | 46,928     | 1,358        | 1,352     |
| Total Segments     | 597,631    | 541,733    | 21,946       | 25,490    |
| Corporate          | -          | -          | (39,069 )    | (1,529 )  |
| Eliminations       | (98,568 )  | (79,683 )  | (1,516 )     | (984 )    |
| Total consolidated | \$ 499,063 | \$ 462,050 | \$ (18,639 ) | \$ 22,977 |

|                    | Inventories             |           | Total Assets            |            |
|--------------------|-------------------------|-----------|-------------------------|------------|
|                    | Year Ended December 31, |           | Year Ended December 31, |            |
|                    | 2017                    | 2016      | 2017                    | 2016       |
| Henglong           | \$ 34,392               | \$ 29,332 | \$ 346,199              | \$ 324,049 |
| Jiulong            | 14,868                  | 11,536    | 82,940                  | 67,508     |
| Shenyang           | 2,137                   | 4,739     | 44,693                  | 42,870     |
| Wuhu               | 2,511                   | 3,388     | 26,008                  | 24,799     |
| Hubei Henglong     | 25,404                  | 15,647    | 318,422                 | 252,465    |
| Other Sectors      | 6,390                   | 9,466     | 88,850                  | 113,287    |
| Total Segments     | 85,702                  | 74,108    | 907,112                 | 824,978    |
| Corporate          | -                       | -         | 121,756                 | 118,409    |
| Eliminations       | (6,485 )                | (6,058 )  | (311,499 )              | (311,688 ) |
| Total consolidated | \$ 79,217               | \$ 68,050 | \$ 717,369              | \$ 631,699 |

|                    | Depreciation and Amortization |           | Capital Expenditures    |           |
|--------------------|-------------------------------|-----------|-------------------------|-----------|
|                    | Year Ended December 31,       |           | Year Ended December 31, |           |
|                    | 2017                          | 2016      | 2017                    | 2016      |
| Henglong           | \$ 4,721                      | \$ 4,537  | \$ 4,183                | \$ 2,010  |
| Jiulong            | 2,901                         | 2,619     | 3,477                   | 2,378     |
| Shenyang           | 605                           | 460       | 1,265                   | 330       |
| Wuhu               | 597                           | 666       | 81                      | 2,187     |
| Hubei Henglong     | 5,500                         | 4,161     | 21,309                  | 16,990    |
| Other Sectors      | 1,991                         | 1,422     | 3,600                   | 8,826     |
| Total Segments     | 16,315                        | 13,865    | 33,915                  | 32,721    |
| Corporate          | 56                            | 61        | -                       | 1         |
| Eliminations       | -                             | -         | -                       | -         |
| Total consolidated | \$ 16,371                     | \$ 13,926 | \$ 33,915               | \$ 32,722 |

Financial information segregated by geographic region is as follows (figures are in thousands of USD):

| Geographic region:      | Net Sales <sup>(1)</sup> |            | Long-term assets          |                           |
|-------------------------|--------------------------|------------|---------------------------|---------------------------|
|                         | Year Ended December 31,  |            | As of December 31,        |                           |
|                         | 2017                     | 2016       | 2017                      | 2016                      |
| China                   | \$ 383,415               | \$ 399,526 | \$ 169,346                | \$ 142,818                |
| United States           | 84,240                   | 55,628     | 797                       | 768                       |
| Other foreign countries | 31,408                   | 6,896      | 596                       | 572                       |
| Total consolidated      | \$ 499,063               | \$ 462,050 | \$ 170,739 <sup>(2)</sup> | \$ 144,158 <sup>(2)</sup> |

(1) Revenue is attributed to each country based on location of customers.

Pursuant to ASC 280-10-50-41, the non-current deferred tax assets of \$4.5 million and \$4.6 million and the

(2) intangible assets, net of \$0.7 million and \$0.6 million were excluded from long-term assets as of December 31, 2017 and 2016, respectively.

## EXHIBIT INDEX

### Exhibit

### Number Description

|         |  |
|---------|--|
| 3.1(i)  | <u>Certificate of Incorporation (incorporated by reference from the filing on Form 10KSB File No. 000-33123)</u>   |
| 3.1(ii) | <u>Bylaws (incorporated by reference from the Form 10KSB for the year ended December 31, 2002)</u>   |
| 10.5    | <u>Joint-venture Agreement, dated March 31, 2006, as amended on May 2, 2006, between Great Genesis Holdings Limited and Wuhu Chery Technology Co., Ltd. (incorporated by reference to the exhibit 10.8 to the Company's Form 10-Q Quarterly Report on May 10, 2006)</u>                                    |
| 10.20   | <u>Translation of the Equity Transfer Agreement dated March 31, 2008 in English (incorporated by reference to exhibit 99.1 of the Company's Form 8-K filed on April 2, 2008)</u>   |
| 10.21   | <u>English Translation of the Sino-Foreign Equity Joint Venture Contract dated January 24, 2010 between Great Genesis Holdings Limited and Beijing Hainachuan Auto Parts Co., Ltd. (incorporated by reference to the Company's Form 10-K for the year ended December 31, 2009 filed on March 25, 2010)</u> |
| 21      | <u>Schedule of Subsidiaries (incorporated by reference to Note 1 of the consolidated financial statements of the Company in this Annual Report on Form 10-K)</u>   |
| 23.1    | <u>Consent of PricewaterhouseCoopers Zhong Tian LLP*</u>   |
| 31.1    | <u>Rule 13a-14(a) Certification*</u>   |
| 31.2    | <u>Rule 13a-14(a) Certification*</u>   |
| 32.1    | <u>Section 1350 Certification*</u>   |
| 32.2    | <u>Section 1350 Certification*</u>   |
| 101*    | The following materials from the China Automotive Systems, Inc. Annual Report on Form 10-K for the year ended December 31, 2017, filed on March 29, 2018, formatted in Extensible Business Reporting Language (XBRL):  |
|         | (i) Consolidated Balance Sheets;   |
|         | (ii) Consolidated Statements of Income;  |
|         | (iii) Consolidated Statements of Comprehensive Income;   |
|         | (iv) Consolidated Statements of Changes in Stockholders' Equity;   |
|         | (v) Consolidated Statements of Cash Flows; and   |
|         | (vi) Related Notes.  |

\* Filed herewith.

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