

China Precision Steel, Inc.
Form 10-Q
November 15, 2010

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

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: September 30, 2010

- 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: 000-23039

CHINA PRECISION STEEL, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

14-1623047
(I.R.S. Employer Identification No.)

18th Floor, Teda Building
87 Wing Lok Street, Sheungwan, Hong Kong
People's Republic of China
(Address of principal executive offices, Zip Code)

852-2543-2290
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

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

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

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

The number of shares outstanding of each of the issuer’s classes of common stock, as of November 11, 2010 is as follows:

Class of Securities	Shares Outstanding
Common Stock, \$0.001 par value	46,562,955

CHINA PRECISION STEEL, INC.

Quarterly Report on Form 10-Q
Three Months Ended September 30, 2010

TABLE OF CONTENTS

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements	1
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3. Quantitative and Qualitative Disclosures About Market Risk	27
Item 4. Controls and Procedures	27

PART II
OTHER INFORMATION

Item 1. Legal Proceedings	28
Item 1A. Risk Factors	28
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	28
Item 3. Defaults Upon Senior Securities	28
Item 4. (Removed and Reserved)	28
Item 5. Other Information	28
Item 6. Exhibits	28

PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

CHINA PRECISION STEEL, INC.
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009

INDEX TO FINANCIAL STATEMENTS

Financial Statements

	Page(s)
Consolidated Balance Sheets (unaudited) 2	1
Consolidated Statements of Operations and Comprehensive Income (unaudited) 3	2
Consolidated Statements of Changes in Stockholders' Equity (unaudited) 4	3
Consolidated Statements of Cash Flows (unaudited) 5	4
Notes to Consolidated Financial Statements (unaudited) 6-18	5

China Precision Steel, Inc. and Subsidiaries
Consolidated Balance Sheets

Assets	Notes	September 30, 2010 (Unaudited)	June 30, 2010
Current assets			
Cash and cash equivalents		\$ 12,653,057	\$ 29,036,706
Accounts receivable			
Trade, net of allowances of \$1,027,410 and \$1,013,744 at September 30, 2010 and June 30, 2010, respectively	5	33,814,865	39,598,845
Bills receivable		4,789,873	4,760,816
Other		1,146,468	1,369,219
Inventories	6	31,392,194	28,522,198
Prepaid expenses		570,650	534,882
Advances to suppliers, net of allowance of \$1,665,573 and \$1,643,419 at September 30, 2010 and June 30, 2010, respectively	7	26,762,160	13,959,206
Total current assets		111,129,267	117,781,872
Property, plant and equipment			
Property, plant and equipment, net	8	75,802,793	69,907,194
Construction-in-progress	9	3,772,151	3,983,450
		79,574,944	73,890,644
Intangible assets, net	10	1,859,332	1,844,995
Goodwill		99,999	99,999
Total assets		\$ 192,663,542	\$ 193,617,510
Liabilities and Stockholders' Equity			
Current liabilities			
Short-term loans	11	\$ 26,263,965	\$ 25,965,421
Accounts payable and accrued liabilities		6,197,537	9,952,109
Advances from customers		2,811,901	3,266,377
Other taxes payables		3,974,265	3,868,220
Current income taxes payable		5,657,572	5,393,000
Total current liabilities		44,905,240	48,445,127
Long-term loans	12	18,319,584	18,075,914
Stockholders' equity:			

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

Preferred stock: \$0.001 per value, 8,000,000 shares
authorized, no shares issued and outstanding
at September 30, 2010 and June 30, 2010, respectively

Common stock: \$0.001 par value, 62,000,000 shares authorized, 46,562,955 and 46,562,955 issued and outstanding at September 30, 2010 and June 30, 2010, respectively	46,563	46,563
Additional paid-in capital	75,642,383	75,642,383
Accumulated other comprehensive income	12,328,713	10,630,975
Retained earnings	41,421,059	40,776,548
Total stockholders' equity	129,438,718	127,096,469

Total liabilities and stockholders' equity	\$ 192,663,542	\$ 193,617,510
--	----------------	----------------

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

China Precision Steel, Inc. and Subsidiaries
Consolidated Statements of Operations
For the Three Months Ended September 30, 2010 and 2009
(Unaudited)

	Notes	2010	2009
Sales revenues		\$ 33,896,455	\$ 17,041,989
Cost of goods sold		31,512,370	16,338,630
Gross profit		2,384,085	703,359
Operating expenses			
Selling expenses		110,205	31,809
Administrative expenses		871,470	578,698
Allowance for bad and doubtful debts		-	117,117
Depreciation and amortization expense		44,160	43,738
Total operating expenses		1,025,835	771,362
Income/(loss) from operations		1,358,250	(68,003)
Other income/(expense)			
Other revenues		1,518	19,922
Interest and finance costs		(465,113)	(228,343)
Total other expense		(463,595)	(208,421)
Income/(loss) from operations before income tax		894,655	(276,424)
Provision/(benefit) for income tax	14		
Current		250,144	(1,233)
Total income tax expense/(benefit)		250,144	(1,233)
Net income/(loss)		\$ 644,511	\$ (275,191)
Basic earnings/(loss) per share	15	\$ 0.01	\$ (0.01)
Basic weighted average shares outstanding		46,562,955	46,562,955
Diluted earnings/(loss) per share	15	\$ 0.01	\$ (0.01)
Diluted weighted average shares outstanding		46,562,955	46,562,955
Components of comprehensive income/(loss):			
Net income/(loss)		\$ 644,511	\$ (275,191)
Foreign currency translation adjustment		1,697,739	75,192

Comprehensive income/(loss)	\$ 2,342,249	\$ (199,999)
-----------------------------	--------------	--------------

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

2

China Precision Steel, Inc. and Subsidiaries
 Consolidated Statements of Changes in Stockholders' Equity
 For the Three Months Ended September 30, 2010

	Ordinary Shares		Additional	Accumulated	Retained	Total
	Share	Amount	Paid-in	Other	Earnings	Stockholders'
			Capital	Comprehensive		Equity
				Income		
Balance at June 30, 2010	-	46,563	75,642,383	10,630,975	40,776,548	127,096,469
Foreign currency translation adjustment	-	-	-	1,697,738	-	1,697,738
Net income	-	-	-	-	644,511	644,511
Balance at September 30, 2010 (Unaudited)	-	\$ 46,563	\$ 75,642,383	\$ 12,328,713	\$ 41,421,059	\$ 129,438,718

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

China Precision Steel, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
For the Three Months Ended September 30, 2010 and 2009
(Unaudited)

	2010	2009
Cash flows from operating activities		
Net income/(loss)	\$ 644,511	\$ (275,191)
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,918,682	1,210,759
Allowance for bad and doubtful debts	-	117,117
Inventory provision	-	42,534
Net changes in assets and liabilities:		
Accounts receivable, net	6,594,117	661,741
Inventories	(2,485,506)	(3,229,520)
Prepaid expenses	(33,514)	16,231
Advances to suppliers	(12,614,539)	723,173
Accounts payable and accrued expenses	(3,886,917)	2,149,699
Advances from customers	(498,508)	432,425
Other taxes payable	53,900	(2,151,427)
Income taxes payable	191,872	-
Net cash (used in) operating activities	(10,115,902)	(302,459)
Cash flows from investing activities		
Deposit for plant and machinery	-	(2,197,384)
Purchase of property, plant and equipment, including construction in progress	(6,542,428)	(749,049)
Net cash (used in) investing activities	(6,542,428)	(2,946,433)
Cash flows from financing activities		
Loan proceeds	-	3,735,552
Repayments of short-term loans	(51,479)	(439,477)
Net cash (used in)/provided by financing activities	(51,479)	3,296,075
Effect of exchange rate	326,160	6,641
Net (decrease)/increase in cash	(16,383,649)	53,824
Cash and cash equivalents, beginning of period	29,036,706	13,649,587
Cash and cash equivalents, end of period	\$ 12,653,057	\$ 13,703,411

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

China Precision Steel, Inc.
Notes to the Consolidated Financial Statements
(Unaudited)

1. Description of Business

On December 28, 2006, China Precision Steel, Inc. (the “Company”, “CPSL” or “we”), under our former name, OraLabs Holding Corp., issued 25,363,002 shares of common stock in exchange for 100% of the registered capital of Partner Success Holdings Limited (“PSHL”), a British Virgin Islands Business Company pursuant to a Stock Exchange Agreement, dated March 31, 2006. Subsequent to the closing of that transaction, on December 28, 2006, the Company redeemed 3,629,350 shares of its common stock in exchange for all of the common stock of OraLabs, Inc., a wholly-owned operating subsidiary. The Company issued 100,000 shares of its common stock to OraLabs, Inc. in exchange for \$450,690, and received additional cash payments in the aggregate amount of \$108,107 in payment of an estimated \$558,797 tax liability to be incurred by the Company in connection with the spinoff of OraLabs, Inc. and the supplemental payment received. The Company then changed its name to China Precision Steel, Inc.

These transactions were treated for financial reporting purposes as a recapitalization, with prior OraLabs, Inc. operating activities reflected on the statements of operations as income/(loss) from discontinued operations. The \$558,797 estimated tax liability incurred in connection with the spinoff of OraLabs, Inc. was treated as a transaction cost for financial reporting purposes and was treated as a reduction in additional paid in capital to the extent of the additional cash received which was also \$558,797.

PSHL, registered on April 30, 2002 in the Territory of the British Virgin Islands, had registered capital of \$50,000 as of June 30, 2010 and 2009. It has three wholly-owned subsidiaries, Shanghai Chengtong Precision Strip Company Limited (“Chengtong”), Shanghai Tuorong Precision Strip Company Limited (“Tuorong”), and Blessford International Limited (“Blessford International”).

Chengtong was registered on July 2, 2002 in Shanghai, the People’s Republic of China (the “PRC”), with a registered capital of \$3,220,000 and a defined period of existence of 50 years from July 2, 2002 to July 1, 2052. Chengtong was classified as a Sino-foreign joint venture enterprise with limited liability. On August 22, 2005, the authorized registered capital of Chengtong was increased to \$15,220,000 and on December 11, 2007, it was further increased to \$42,440,000. Pursuant to a document issued by the District Council to Xuhang Town Council on June 28, 2004, the equity transfers from China Chengtong Metal Group Limited and Eastreal Holdings Company Limited to PSHL were approved and the transformation of Chengtong from a Sino-foreign joint investment enterprise to a wholly foreign owned enterprise (WFOE) was granted.

In the year ended June 30, 2007, we added three indirect subsidiaries to our corporate structure. On April 9, 2007, we purchased Shanghai Tuorong Precision Strip Company Limited, or Tuorong, through PSHL. The sole activity of Tuorong is the ownership of a land use right with respect to facilities utilized by Chengtong. On April 10, 2007, PSHL purchased the entire equity interest in Blessford International Limited, a British Virgin Islands company, for a cash consideration of \$100,000. Blessford International does not conduct any business, but it owns a single subsidiary, Shanghai Blessford Alloy Company Limited (“Shanghai Blessford”), that is a wholly-foreign owned enterprise with limited liability. Shanghai Blessford was registered on February 24, 2006 in Shanghai, the PRC, with a registered capital of \$12,000,000 and a defined period of existence of 50 years from February 24, 2006 to February 23, 2056. On May 27, 2008, the authorized registered capital was increased to \$22,000,000. We intend to hold Blessford International as a shell subsidiary. As used herein, the “Group” refers to the Company, PSHL, Chengtong, Tuorong, Blessford International and Shanghai Blessford on a consolidated basis.

The Company’s principal activities are conducted through its two operating subsidiaries, Chengtong and Shanghai Blessford. Chengtong and Shanghai Blessford are niche precision steel processing companies principally engaged in

the manufacture and sale of cold-rolled and hot-rolled precision steel products and plates for downstream applications in the automobile industry (components and spare parts), kitchen tools and functional parts of electrical appliances. Raw materials, hot-rolled de-scaled (pickled) steel coils, will go through certain cold reduction processing procedures to give steel rolls and plates in different cuts and thickness for deliveries in accordance with customers' specifications. Specialty precision steel offers specific control of thickness, shape, width, surface finish and other special quality features that compliment the emerging need for highly engineered end use applications. Precision steel pertains to the precision of measurements and tolerances of the above factors, especially thickness tolerance.

2. Basis of Preparation of Financial Statements

The financial statements have been prepared in order to present the consolidated financial position and consolidated results of operations in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) and are expressed in terms of US dollars (see Note 3 “Foreign Currencies” below).

The accompanying unaudited consolidated financial statements as of September 30 and June 30, 2010 and for the periods ended September 30, 2010 and 2009 have been prepared in accordance with US GAAP and with the instructions to Form 10-Q and Regulation S-X applicable to smaller reporting companies. In the opinion of management, these unaudited consolidated financial statements include all adjustments considered necessary to make the financial statements not misleading. The results of operations for the three months ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year ending June 30, 2011.

3. Summary of Significant Accounting Policies

The following is a summary of significant accounting policies:

Accounting Standards Codifications - In June 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Codifications (“ASC”) 105 “Generally Accepted Accounting Principles”. This section designates ASC as the source of authoritative U.S. GAAP. ASC 105 is effective for interim or fiscal periods ending after September 15, 2009. We have used the new guidelines and numbering system when referring to GAAP in the accompanying financial statements. The adoption of ASC 105 did not have a material impact on our financial position, results of operation or cash flows.

Cash and Cash Equivalents - The Company considers all highly liquid debt instruments purchased with maturity period of three months or less to be cash equivalents. The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents approximate their fair value.

Accounts Receivable – Credit periods vary substantially across industries, segments, types and size of companies in the PRC where we operate our business. Because of the niche products that we process, our customers are usually also niche players in their own respective segment, who then sell their products to end product manufacturers. The business cycle is relatively long, as well as the credit periods. The Company offers credit to its customers for periods of 60 days, 90 days, 120 days and 180 days. We generally offer longer credit terms to long-standing recurring customers with good payment histories and sizable operations. Accounts receivable are recorded at the time revenue is recognized and are stated net of allowance for doubtful accounts.

Allowance for Doubtful Accounts - The Company maintains an allowance for doubtful accounts based on its assessment of the collectability of the accounts receivable. Management determines the collectability of outstanding accounts by maintaining regular communication with such customers and obtaining confirmation of their intent to fulfill their obligations to the Company. Management also considers past collection experience, our relationship with customers and the impact of current economic conditions on our industry and market. However, we note that the continuation or intensification of the current global economic crisis may have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations. To reserve for potentially uncollectible accounts receivable, management has made a 50% provision for all accounts receivable that are over 180 days past due and full provision for all accounts receivable over 1 year past due. From time to time, we will review these credit periods, along with our collection experience and the other factors discussed above, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. If our actual collection experience or other conditions change, revisions to our allowances may be required, including a further provision which could adversely affect our operating income, or write back of provision when estimated uncollectible accounts are actually collected. At September 30, 2010 and June 30, 2010, the Company had \$1,027,410

and \$1,013,744 of allowances for doubtful accounts, respectively.

Bad debts are written off for past due balances over two years or when it becomes known to management that such amount is uncollectible. Provision for bad debts recognized for the three months ended September 30, 2010 and 2009 were nil and \$117,117, respectively. The prior year charge reflects a provision for doubtful accounts based on our policy described above. Our management is continually working to ensure that any known uncollectible amounts are immediately written off as bad debt against outstanding balances.

6

Inventories - Inventories are stated at the lower of cost or market. Cost is determined using the weighted average method. Market value represents the estimated selling price in the ordinary course of business less the estimated costs necessary to complete the sale.

Cost of inventories comprises all costs of purchases, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Costs of conversion of inventories include fixed and variable production overheads, taking into account the stage of completion.

Intangible Assets and Amortization – Intangible assets represent land use rights in China acquired by the Company and are stated at cost less amortization. Amortization of land-use rights is calculated on the straight-line method, based on the period over which the right is granted by the relevant authorities in China.

Advances to Suppliers - In order to insure a steady supply of raw materials, the Company is required from time to time to make cash advances to its suppliers when placing purchase orders, for a guaranteed minimum delivery quantity at future times when raw materials are required. The advance is seen as a deposit to suppliers and guarantees our access to raw materials during periods of shortages and market volatility, and is therefore considered an important component of our operations. Contracted raw materials are priced at prevailing market rates agreed by us with the suppliers prior to each delivery date. Advances to suppliers are shown net of an allowance which represents potentially unrecoverable cash advances at each balance sheet date. Such allowances are based on an analysis of past raw materials receipt experience and the credibility of each supplier according to its size and background. In general, we do not provide allowances against advances paid to those PRC state-owned companies as there is minimal risk of default. Our allowances for advances to suppliers are subjective critical estimates that have a direct impact on reported net earnings, and are reviewed quarterly at a minimum to reflect changes from our historic raw materials receipt experience and to ensure the appropriateness of the allowance in light of the circumstances present at the time of the review. It is reasonably possible that the Company's estimate of the allowance will change, such as in the case when the Company becomes aware of a supplier's inability to deliver the contracted raw materials or meet its financial obligations. As of September 30, 2010 and June 30, 2010, the Company had allowances of advances to suppliers of \$1,665,573 and \$1,643,419, respectively.

Allowances for advances to suppliers are written off when all efforts to collect the materials or recover the cash advances have been unsuccessful, or when it has become known to the management that there is no intention by the suppliers to deliver the contracted raw materials or refund the cash advances. To date, we have not written off any advances to suppliers.

Property, Plant and Equipment - Property, plant and equipment are stated at cost less accumulated depreciation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its present working condition and location for its intended use.

Depreciation is computed on a straight-line basis over the estimated useful lives of the related assets for financial reporting purposes. The estimated useful lives for significant property and equipment are as follows:

Plant and machinery	10 years
Buildings	10 years
Motor vehicles	5 years
Office equipment	5 years

Repairs and maintenance costs are normally charged to the statement of operations in the year in which they are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalized as an additional cost of the asset.

Impairment of Long-Lived Assets - The Company accounts for impairment of property, plant and equipment and amortizable intangible assets in accordance with ASC 360, which requires the Company to evaluate a long-lived asset for recoverability when there is an event or circumstance that indicates the carrying value of the asset may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset or asset group is not recoverable (when carrying amount exceeds the gross, undiscounted cash flows from use and disposition) and is measured as the excess of the carrying amount over the asset's (or asset group's) fair value.

Capitalized Interest - The Company capitalizes interest cost on borrowings incurred during the new construction or upgrade of qualified assets. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. During the three months ended September 30, 2010 and 2009, the Company capitalized \$135,313 and \$123,551, respectively, of interest to construction-in-progress.

Construction-in-Progress - Plant and production lines currently under development are accounted for as construction-in-progress. Construction-in-progress is recorded at acquisition cost, including land rights cost, development expenditure, professional fees and the interest expenses capitalized during the course of construction for the purpose of financing the project. Upon completion and readiness for use of the project, the cost of construction-in-progress is to be transferred to property, plant and equipment.

Contingent Liabilities and Contingent Assets - A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. It can also be a present obligation arising from past events that is not recognized because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognized but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, the contingency is then recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Company.

Contingent assets are not recognized but are disclosed in the notes to the financial statements when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognized.

Advances from Customers - Advances from customers represent advance cash receipts from customers and for which goods have not been delivered or services have not been rendered at each balance sheet date. Advances from customers for goods to be delivered or services to be rendered in the subsequent period are carried forward as deferred revenue.

Revenue Recognition - Revenue from the sale of goods and services is recognized on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed and services have been rendered. Revenue is reported net of all VAT taxes. Other income is recognized when it is earned.

Functional Currency and Translating Financial Statements – The Company’s principal country of operations is the PRC. Our functional currency is Chinese Renminbi; however, the accompanying consolidated financial statements have been expressed in United States Dollars (“USD”). The consolidated balance sheets have been translated into USD at the exchange rates prevailing at each balance sheet date. The consolidated statements of operations and cash flows have been translated using the weighted-average exchange rates prevailing during the periods of each statement. The registered equity capital denominated in the functional currency is translated at the historical rate of exchange at the time of capital contribution. All translation adjustments resulting from the translation of the financial statements into the reporting currency are dealt with as other comprehensive income in stockholders’ equity.

Accumulated Other Comprehensive Income – Accumulated other comprehensive income represents the change in equity of the Company during the periods presented from foreign currency translation adjustments.

Taxation - Taxation on overseas profits has been calculated on the estimated assessable profits for the period at the rates of taxation prevailing in the country in which the Company operates.

United States

China Precision Steel, Inc. is subject to United States federal income tax at a tax rate of 34%. No provision for income taxes in the United States has been made as China Precision Steel, Inc. had no taxable income in the 2010 and 2009

periods.

BVI

PSHL and Blessford International were incorporated in the British Virgin Islands and, under the current laws of the British Virgin Islands, are not subject to income taxes.

8

PRC

Provision for the PRC enterprise income tax is calculated at the prevailing rate based on the estimated assessable profits less available tax relief for losses brought forward. The Company does not accrue taxes on unremitted earnings from foreign operations as it is the Company's intention to invest these earnings in the foreign operations indefinitely.

Enterprise income tax

On March 16, 2007, the National People's Congress of China passed The Enterprise Income Tax Law (the "New EIT Law"), and on December 6, 2007, the State Council of China passed the Implementing Rules for the EIT Law ("Implementing Rules") which took effect on January 1, 2008. The New EIT Law and Implementing Rules impose a unified enterprise income tax ("EIT") of 25% on all domestic-invested enterprises and foreign invested entities ("FIEs"), unless they qualify under certain limited exceptions. Therefore, nearly all FIEs are subject to the new tax rate alongside other domestic businesses rather than benefiting from the old FIE tax laws, and its associated preferential tax treatments, beginning January 1, 2008.

Despite these changes, the EIT Law gives the FIEs established before March 16, 2007 ("Old FIEs") a five-year grandfather period during which they can continue to enjoy their existing preferential tax treatments, commonly referred to as "tax holidays", until these holidays expire. As an Old FIE, Chengtong's tax holiday of a 50% reduction in the 25% statutory rates expired on December 31, 2008 and it is currently subject to the 25% statutory rates since January 1, 2009; Shanghai Blessford's full tax exemption from the enterprise income tax expired on December 31, 2009, and it is subject to a 50% reduction for the three subsequent years expiring on December 31, 2012. Subsequent to the expiry of their tax holidays, Chengtong and Shanghai Blessford will be subject to enterprise income taxes at 25% or the prevailing statutory rates. The discontinuation of any such special or preferential tax treatment or other incentives would have an adverse effect on any organization's business, fiscal condition and current operations in China.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carry forwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Effective January 1, 2007, the Company adopted the provisions of the ASC Topic No. 740 "Accounting for Income Taxes" and "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("ASC 740"). ASC 740 requires the recognition of tax benefits or expenses based on the estimated future tax effects of temporary differences between the financial statements and tax bases of its assets and liabilities. Deferred tax assets and liabilities primarily relate to tax basis differences on unrealized gains on corporate equities, stock-based compensation, amortization periods of certain intangible assets and differences between the financial statements and tax bases of assets acquired.

The Company recognizes that virtually all tax positions in the PRC are not free of some degree of uncertainty due to tax law and policy changes in the PRC. However, the Company cannot reasonably quantify political risk factors and thus must depend on guidance issued by current officials in the PRC.

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of September 30, 2010 is not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax benefits as of September 30, 2010, if recognized, would not have a material effect on its effective tax rate. The Company further believes that there are no tax positions for which it is reasonably possible, based on current Chinese tax law and policy, that the unrecognized tax benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on the Company's results of operations, financial condition or cash flows.

Value added tax

The Provisional Regulations of the People’s Republic of China Concerning Value Added Tax promulgated by the State Council came into effect on January 1, 1994. Under these regulations and the Implementing Rules of the Provisional Regulations of the People’s Republic of China Concerning Value Added Tax, value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

Value added tax payable in the PRC is charged on an aggregated basis at a rate of 13% or 17% (depending on the type of goods involved) on the full price collected for the goods sold or, in the case of taxable services provided, at a rate of 17% on the charges for the taxable services provided, but excluding, in respect of both goods and services, any amount paid in respect of value added tax included in the price or charges, and less any deductible value added tax already paid by the taxpayer on purchases of goods and services in the same financial year.

The revised People’s Republic of China Tentative Regulations on Value Added Tax became effective on January 1, 2009 with the issuance of Order of the State Council No. 538. With the implementation of this VAT reform, input VAT associated with the purchase of fixed assets is now deductible against output VAT.

Retirement Benefit Costs - According to the PRC regulations on pension, Chengtong and Shanghai Blessford contribute to a defined contribution retirement scheme organized by municipal government in the province in which Chengtong and Shanghai Blessford were registered and all qualified employees are eligible to participate in the scheme. Contributions to the scheme are calculated at 23.5% of the employees’ salaries above a fixed threshold amount and the employees contribute 2% to 8%, while Chengtong and Shanghai Blessford contribute the balance contribution of 15.5% to 21.5%. The Group has no other material obligation for the payment of retirement benefits beyond the annual contributions under this scheme.

For the three months ended September 30, 2010 and 2009, the Company’s pension cost charged to the statements of operations under the plan amounted to \$55,935 and \$82,666, respectively, all of which have been paid to the National Social Security Fund.

Fair Value of Financial Instruments - The carrying amounts of certain financial instruments, including cash, accounts receivable, other receivables, short-term loans, accounts payable, accrued expenses, and other payables approximate their fair values as at September 30, 2010 and June 30, 2010 because of the relatively short-term maturity of these instruments. The Company considers the carrying amount of long-term loans to approximate their fair values based on the interest rates of the instruments and the current market rate of interest.

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

4. Concentrations of Business and Credit Risk

The Company’s list of customers whose purchases from us were 10% or more of total sales during the three months ended September 30, 2010 and 2009 is as follows:

a. Customers	2010	% to sales	2009	% to sales
Shanghai Shengdejia Metal Co. Ltd	9,097,037	27	_*	_*

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

Shanghai Changshuo Steel Company, Ltd	5,825,690	17	3,848,354	23
Zhangjiagang Gangxing Innovative Construction Material Co., Ltd.	-*	-*	1,735,287	10
Shaoxing Wancheng Metal Plate Co., Ltd	-*	-*	1,768,383	10

* Not 10% customers for the relevant period

10

The Company's list of suppliers whose sales to us exceeded 10% of our total purchases during the three months ended September 30, 2010 and 2009 is as follows:

b. Suppliers	2010	% to consumption	2009	% to consumption
Dachang Huizu Baosheng Steel Products Co., Ltd.	8,767,582	24	-*	-*
Zhejinag Wuchan Metal Group Co., Ltd.	8,209,383	22	-*	-*
Hangzhou Steel Materials Co., Ltd.	7,576,264	21	-*	-*
Guangzhou Zhujiang Steel Co., Ltd.	-*	-*	4,679,267	31
Wuxi Hangda Trading Co., Ltd.	-*	-*	2,876,549	19
BaoSteel Steel Products Trading Co. Ltd	-*	-*	2,654,920	17

* Not 10% suppliers for the relevant period

Our management continues to take appropriate actions to perform ongoing business and credit reviews of our customers to reduce our exposure to new and recurring customers who have been deemed to pose a high credit risk to our business based on their commercial credit reports, our collection history, and our perception of the risk posed by their geographic location.

5. Accounts Receivable

The Company provides credit in the normal course of business. The Company performs ongoing credit evaluations of its domestic and international customers and clients and maintains allowances for bad and doubtful accounts based on factors surrounding the credit risk of specific customers and clients, historical trends, and other information. Trade accounts receivable, net totaled \$33,814,865 and \$39,598,845 as of September 30, 2010 and June 30, 2010, respectively.

From time to time, accounts receivable are reviewed for changes from the historic collection experience to ensure the appropriateness of the allowances. These estimates have been relatively accurate in the past and currently there is no need to revise such estimates. However, we will review such estimates more frequently when needed, and make revisions if necessary. The continuation or intensification of the current global economic crisis and turmoil in the global financial markets may have negative consequences for the business operations of our customers and adversely impact their ability to meet their obligations to us. A significant change in our collection experience, deterioration in the aging of receivables and collection difficulties could require that we increase our estimate of the allowance for doubtful accounts. Any such additional bad debt charges could materially and adversely affect our future operating results.

6. Inventories

The Company was required under GAAP to write down the value of our inventories to their net realizable values (average selling prices less reasonable costs to convert the inventories into completed form) in the amount of \$42,816 for the year ended June 30, 2010.

As of September 30, 2010 and June 30, 2010, inventories consisted of the following:

At cost:	September 30, 2010	June 30, 2010
Raw materials	\$ 7,097,739	\$ 5,551,003
Work in progress	12,092,822	15,443,410
Finished goods	9,238,055	4,291,384

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

Consumable items	2,963,578	3,279,217
	31,392,194	28,565,014
Less: provision	-	(42,816)
	\$ 31,392,194	\$ 28,522,198

Costs of finished goods include direct labor, direct materials, and production overhead before the goods are ready for sale.

Consumable items represent parts used in our cold rolling mills and other equipment that need to be replaced from time to time when necessary to ensure optimal operating results, such as bearings and rollers.

Inventories amounting to \$7,068,379 (June 30, 2010: \$6,588,535) were pledged for short-term loans totaling \$18,382,353 (June 30, 2010: \$18,137,848) at September 30, 2010.

7. Advances to Suppliers

Cash advances are shown net of allowances of \$1,665,573 and \$1,643,419 at September 30, 2010 and June 30, 2010, respectively.

The majority of our advances to suppliers greater than 180 days as of September 30, 2010 is attributable to our advances to a single supplier, a subsidiary of a state-owned company in the PRC. We believe that advances paid to state-owned companies are ultimately collectible because they are backed by the full faith and credit of the PRC government. As such, we generally do not provide allowances against such advances.

8. Property, Plant and Equipment

Property, plant and equipment, stated at cost less accumulated depreciation, consisted of the following:

	September 30, 2010	June 30, 2010
Plant and machinery	\$ 70,078,172	\$ 62,486,750
Buildings	22,260,841	21,964,748
Motor vehicles	675,425	554,368
Office equipment	500,002	472,537
	93,514,440	85,478,403
Less: Accumulated depreciation	(17,711,647)	(15,571,209)
	\$ 75,802,793	\$ 69,607,194

Depreciation expense related to manufacturing is included as a component of cost of goods sold. During the three months ended September 30, 2010 and 2009, depreciation totaling \$1,217,525 and \$733,899, respectively, was included as a component of cost of goods sold.

Plant and machinery amounting to \$40,046,619 (June 30, 2010: \$40,543,231) and \$22,856,501 (June 30, 2010: \$23,161,753) were pledged for short-term loans totaling \$26,263,965 and long-term loans totaling \$18,319,584, respectively, at September 30, 2010.

9. Construction-In-Progress

As of September 30, 2010 and June 30, 2010, construction-in-progress consisted of the following:

	September 30, 2010	June 30, 2010
Construction costs	\$ 3,772,151	\$ 3,983,450

Construction-in-progress represents construction and installations of annealing furnaces.

10. Intangible Assets

Land use rights amounting to \$1,852,050 (June 30, 2010: \$1,837,140) were pledged for short-term loans totaling \$26,263,965 (June 30, 2010: \$25,965,421).

The Company acquired land use rights in August 2004 and December 2006 for 50 years that expire in August 2054 and December 2056, respectively. The land use rights are amortized over a fifty-year term. An amortization amount of approximately \$37,000 is to be recorded each year starting from the financial year ended June 30, 2009 for the

remaining lease period.

Amortizable intangible assets of the Company are reviewed when there are triggering events to determine whether their carrying value has become impaired, in conformity with ASC 360. The Company also re-evaluates the periods of amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives.

12

11. Short-Term Loans

Short-term loans consisted of the following:

	September 30, 2010	June 30, 2010
Bank loan dated June 18, 2010, due July 31, 2011 with an interest rate at 115% of the standard market rate set by the People's Bank of China for Renminbi loans (6.11% at September 30, 2010) (Notes 8 and 10)	7,881,612	5,300,000
Bank loan dated July 23, 2009, due July 31, 2010 with an interest rate at 115% of the standard market rate set by the People's Bank of China for Renminbi loans (6.11% at September 30, 2010) (Notes 8 and 10)	-	2,527,573
Bank loan dated June 18, 2010, due July 31, 2011 with an interest rate at 115% of the standard market rate set by the People's Bank of China for Renminbi loans (6.11% at September 30, 2010) (Notes 6, 8 and 10)	18,382,353	18,137,848
	\$ 26,263,965	\$ 25,965,421

The above bank loans outstanding as at September 30, 2010 carry an interest rate of 1.15 times of the standard market rate set by the People's Bank of China for Renminbi loans, due on July 31, 2010, and are secured by inventories, land use rights, buildings and plant and machinery, and guaranteed by PSHL and our Chairman, Mr. Wo Hing Li. In addition, pursuant to a bank loan agreement entered into between the Company and Raiffeisen Zentralbank Osterreich AG ("RZB"), Mr. Li undertakes to maintain a shareholding percentage in the Company of not less than 33.4% unless otherwise agreed to with RZB.

The weighted-average interest rate on short-term loans at September 30, 2010 and June 30, 2010 was 6.11% and 5.59%, respectively.

12. Long-Term Loan

	September 30, 2010	June 30, 2010
Bank loan dated June 23, 2010, due June 22, 2017 with an interest rate of the London Interbank Offered Rate ("LIBOR") plus 4.5% (5.27775% at September 30, 2010) (Note 8)	\$ 18,319,584	\$ 18,075,914

On January 29, 2010, Shanghai Blessford entered into a Senior Loan Agreement with DEG-Deutsche Investitions-Und Entwicklungsgesellschaft Mbh ("DEG") for a loan amount up to \$18,000,000 at an annual interest rate of 4.5% above the six-month USD LIBOR rate. The loan is to be repaid semi-annually over five years starting on December 15, 2011 and is secured by a mortgage on the new cold rolling line and annealing furnaces at Shanghai Blessford's facilities.

Maturities of long-term loan for the years ending June 30:

2011	\$ -
2012	\$ 3,663,917
2013	\$ 3,663,917
2014	\$ 3,663,917
2015	\$ 3,663,917

2016	\$ 3,663,916
Total	\$ 18,319,584

13. Stock Warrants

In connection with a Stock Purchase Agreement dated February 16, 2007 for the Company's private placement offerings (the "Private Placement"), on February 22, 2007, the Company issued warrants to the placement agents to purchase an aggregate of 1,300,059 shares of Common Stock as partial compensation for services rendered in connection with the Private Placement valued at \$2,770,349. The value of the warrants was considered syndication fees and was recorded to additional paid-in capital. 851,667 of these warrants were exercised during the year ended June 30, 2008.

On February 22, 2007, the Company issued warrants to purchase up to 100,000 shares of Common Stock to the Company's then investor relations consultants valued at \$447,993. The value of these was considered syndication fees in association with the Private Placement and was recorded to additional paid-in capital. These warrants were not exercised and expired on February 22, 2010.

On November 6, 2007, in connection with the Subscription Agreement, the Company issued to certain institutional accredited investors warrants to purchase 1,420,000 shares of Common Stock valued at \$5,374,748, and Roth Capital Partners, LLC, as placement agent, received warrants to purchase 225,600 shares of Common Stock valued at \$887,504. These amounts were recorded as syndication fees offsetting additional paid-in capital.

Information with respect to stock warrants outstanding is as follows:

Exercise Price	Outstanding June 30, 2010	Granted	Expired or Exercised	Outstanding September 30, 2010	Expiration Date
\$ 7.38	225,600	-0-	-0-	225,600	November 5, 2010
\$ 3.00	358,392	-0-	-0-	358,392	February 22, 2011
\$ 8.45	1,420,000	-0-	-0-	1,420,000	May 5, 2013

14. Income Taxes

For PRC enterprise income tax reporting purposes, the Company is required to compute a 10% salvage value when computing depreciation expense and add back the allowance for doubtful debts. For financial reporting purposes, the Company does not take into account a 10% salvage value when computing depreciation expenses.

The tax holiday resulted in tax savings as follows:

	Three months ended September 30,	
	2010	2009
Tax savings	\$ 50,295	\$ 197,198
Benefit per share		
Basic	\$ 0.00	\$ 0.00
Diluted	\$ 0.00	\$ 0.00

Significant components of the Group's deferred tax assets and liabilities as of September 30, 2010 and June 30, 2010 are as follows:

	September 30, 2010	June 30, 2010
Deferred tax assets and liabilities:		
Net operating loss carried forward	\$ 2,031,538	\$ 1,938,915
Temporary differences resulting from allowances	1,945,180	1,906,348
Net deferred income tax asset	3,976,718	3,845,263
Valuation allowance	(3,976,718)	(3,845,263)
	\$ -	\$ -

The Company has not recognized a deferred tax liability in respect of the undistributed earnings of its foreign subsidiaries of approximately US\$19,086,541 as of September 30, 2010 because the Company currently plans to

reinvest those unremitted earnings such that the remittance of the undistributed earnings of those foreign subsidiaries to the Company will be postponed indefinitely. A deferred tax liability will be recognized when the Company no longer plans to permanently reinvest undistributed earnings.

A reconciliation of the provision for income taxes with amounts determined by the PRC income tax rate to income tax expense per books is as follows.

	Three months ended September 30,	
	2010	2009
Computed tax at the PRC statutory rate of 25%	\$ 197,611	\$ (93,565)
Valuation allowance	92,637	290,897
Income not subject to tax	-	(134)
Overprovision	10,191	(1,233)
Benefit of tax holiday	(50,295)	(197,198)
Income tax expense per books	\$ 250,144	(1,233)

Income tax expense consists of:

	Three months ended September 30,	
	2010	2009
Income tax expense for the year - PRC	\$ 250,144	\$ (1,233)
Deferred income tax benefit - PRC	-	-
Income tax expense/(benefit) per books	\$ 250,144	\$ (1,233)

15. Earnings/(loss) Per Share

ASC 260-10 requires a reconciliation of the numerator and denominator of the basic and diluted earnings/(loss) per share (EPS) computations.

For the three months ended September 30, 2010, warrants to purchase 358,392 shares of common stock at an exercise price of \$3.00, 1,420,000 shares at an exercise price of \$8.45 and 225,600 shares at an exercise price of \$7.38 were not included as their effect would have been anti-dilutive, however, these securities could potentially dilute basic earnings per share in the future.

For the three months ended September 30, 2009, warrants to purchase 358,392 shares of common stock at an exercise price of \$3.00; 100,000 shares at an exercise price of \$3.60; 1,420,000 shares at an exercise price of \$8.45 and 225,600 shares at an exercise price of \$7.38 were not included as their effect would have been anti-dilutive, however, these securities could potentially dilute basic earnings per share in the future.

The following reconciles the components of the EPS computation:

	Income/(loss) (Numerator)	Shares (Denominator)	Per Share Amount
For the three months ended September 30, 2010:			
Net income	\$ 644,511		
Basic EPS income available to common shareholders	\$ 644,511	46,562,955	\$ 0.01
Effect of dilutive securities:			
Warrants			-
Diluted EPS income available to common shareholders	\$ 644,511	46,562,955	\$ 0.01
For the three months ended September 30, 2009:			
Net loss	\$ (275,191)		
Basic EPS loss available to common shareholders	\$ (275,191)	46,562,955	\$ (0.01)

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

Effect of dilutive securities:

Warrants			--		
Diluted EPS loss available to common shareholders	\$	(275,191)	46,562,955	\$	(0.01)

15

16. Capital Commitments

As of September 30, 2010, the Company had contractual commitments of \$4,728,012 (June 30, 2010: \$4,556,039) for interest relating to its short-term and long-term loans and share capital injection commitment related to Shanghai Blessford.

17. Impairment

We determine impairment of long-lived assets, including property, plant and equipment and amortizable intangible assets, by measuring the estimated undiscounted future cash flows generated by these assets, comparing the result to the assets' carrying values and adjust the assets to the lower of its carrying value or fair value and charging current operations for the measured impairment. The determination of the undiscounted future cash flows and fair value of these assets are subject to significant judgment.

The recent decline in our market capitalization and stock price has triggered an impairment test under ASC 360 for the three months ended September 30, 2010 and no impairment charges were recognized for the relevant period. As of September 30, 2010, the Company expects these assets to be fully recoverable based on the result of the impairment test. Goodwill amounting to \$99,999 as at September 30, 2010 was considered immaterial and not tested for impairment in accordance with ASC 350.

18. Recent Accounting Pronouncements

In June 2009, the FASB issued guidance now codified as ASC 810, "Amendments to FASB Interpretation No. 46(R)" ("ASC 810"), which amends FASB Interpretation No. 46 (revised December 2003), now codified as ASC 810-10, to address the elimination of the concept of a qualifying special purpose entity. ASC 810 also replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. Additionally, ASC 810 provides more timely and useful information about an enterprise's involvement with a variable interest entity. ASC 810 will become effective in July 2010. We do not expect that the adoption of ASC 810 will have a material impact on our financial statements.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05, "Measuring Liabilities at Fair Value" ("ASU 2009-05"). ASU 2009-05 amends ASC 820, "Fair Value Measurements" ("ASC 820"). Specifically, ASU 2009-05 provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following methods: 1) a valuation technique that uses a) the quoted price of the identical liability when traded as an asset or b) quoted prices for similar liabilities or similar liabilities when traded as assets and/or 2) a valuation technique that is consistent with the principles of ASC 820 (e.g. an income approach or market approach). ASU 2009-05 also clarifies that when estimating the fair value of a liability, a reporting entity is not required to adjust to include inputs relating to the existence of transfer restrictions on that liability. The adoption of this standard did not have an impact on the Company's financial position or results of operations.

In October 2009, the FASB issued ASU No. 2009-13 on ASC 605, "Revenue Recognition" ("ASC 605"), regarding multiple-deliverable revenue arrangements. This ASU provides amendments to the existing criteria for separating consideration in multiple-deliverable arrangements. The amendments establish a selling price hierarchy for determining the selling price of a deliverable, eliminate the residual method of allocation of arrangement consideration to all deliverables and require the use of the relative selling price method in allocation of arrangement consideration to all deliverables, require the determination of the best estimate of a selling price in a consistent manner, and significantly expand the disclosures related to the multiple-deliverable revenue arrangements. The

amendments will be effective in fiscal years beginning on or after June 15, 2010, and early adoption is permitted. We do not expect that the adoption of ASU 2009-13 will have a material impact on our financial statements.

In October 2009, the FASB issued ASU No. 2009-15, "Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing" ("ASU 2009-15"). ASU 2009-15 amends ASC 470, "Debt with Conversion and Other Options" ("ASC 470"), and ASC 260, "Earnings Per Share" ("ASC 260"). Specifically, ASU 2009-15 requires companies to mark stock loan agreements at fair value and recognize the cost of the agreements by reducing the amount of additional paid-in capital on their financial statements. The amendments will be effective for fiscal years beginning on or after December 15, 2009. We do not expect that the adoption of ASU 2009-15 will have a material impact on our financial statements.

In December 2009, the FASB issued ASU 2009-17, “Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities” (“ASU 2009-17”). ASU 2009-17 details the amendments to ASC 810, “Consolidation”, which are the result of FASB Statement No. 167, “Amendments to FASB Interpretation No. 46(R)”. That statement was issued by the FASB in June 2009. ASU 2009-17 amends the variable-interest entity guidance in ASC 810 to clarify the accounting treatment for legal entities in which equity investors do not have sufficient equity at risk for the entity to finance its activities without financial support. ASU 2009-17 is effective at the start of the first fiscal year beginning after November 15, 2009. We do not expect that the adoption of ASU 2009-17 will have a material impact on our financial statements.

In January 2010, the FASB issued ASU 2010-06, “Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements” (“ASU 2010-06”). ASU 2010-06 requires reporting entities to provide information about movements of assets among Levels 1 and 2 of the three-tier fair value hierarchy established by ASC 820. The guidance is effective for any fiscal year that begins after December 15, 2010 and should be used for quarterly and annual filings. We are currently evaluating the impact on our financial statements of adopting the amendments in ASU 2010-06 and cannot estimate the impact of adoption at this time.

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

Special Note Regarding Forward Looking Statements

In addition to historical information, this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We use words such as “believe,” “expect,” “anticipate,” “project,” “target,” “plan,” “optimistic,” “intend,” “aim,” “will,” and other similar expressions which are intended to identify forward-looking statements. Such statements include, among others, those concerning market and industry segment growth and demand and acceptance of new and existing products; any projections of sales, earnings, revenue, margins or other financial items; any statements of the plans, strategies and objectives of management for future operations; and any statements regarding future economic conditions or performance, as well as all assumptions, expectations, predictions, intentions or beliefs about future events. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, as well as assumptions, which, if they were to ever materialize or prove incorrect, could cause the results of the Company to differ materially from those expressed or implied by such forward-looking statements. Potential risks and uncertainties include, among other things, factors such as: plans to expand our exports outside of China; plans to increase our production capacity and the anticipated dates that such facilities may commence operations; our ability to obtain additional funding for our continuing operations and to fund our expansion; our ability to meet our financial projections for any financial year; our ability to retain our key executives and to hire additional senior management; continued growth of the Chinese economy and industries demanding our products; our ability to secure at acceptable prices the raw materials we need to produce our products; political changes in China that may impact our ability to produce and sell our products in our target markets; general business conditions and competitive factors, including pricing pressures and product development; and changes in our relationships with customers and suppliers. You should carefully review the risk factors described in other documents we file from time to time with the U.S. Securities and Exchange Commission, including our Annual Report on Form 10-K for our fiscal year ended June 30, 2010.

Because the factors discussed in this report could cause actual results or outcomes to differ materially from those expressed in any forward-looking statement made by us or on our behalf, you should not place undue reliance on any such forward-looking statement. Further, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as required by law. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

Use of Terms

Except as otherwise indicated by the context, all references in this report to:

- “CPSL,” “Company,” “Group,” “we,” “us” or “our” are to China Precision Steel, Inc., a Delaware corporation, and its direct and indirect subsidiaries;
- “PSHL” are to our subsidiary Partner Success Holdings Limited, a BVI company;
 - “Blessford International” are to our subsidiary Blessford International Limited, a BVI company;
- “Shanghai Blessford” are to our subsidiary Shanghai Blessford Alloy Company Limited, a PRC company;
- “Chengtong” are to our subsidiary Shanghai Chengtong Precision Strip Company Limited, a PRC company;
 - “Tuorong” are to our subsidiary Shanghai Tuorong Precision Strip Company Limited, a PRC company;

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

- “SEC” are to the United States Securities and Exchange Commission;
 - “Securities Act” are to the Securities Act of 1933, as amended;
- “Exchange Act” are to the Securities Exchange Act of 1934, as amended;
 - “RMB” are to Renminbi, the legal currency of China;
- “U.S. dollar,” “USD,” “US\$” and “\$” are to the legal currency of the United States;
 - “China,” “Chinese” and “PRC” are to the People’s Republic of China; and
 - “BVI” are to the British Virgin Islands.

Overview of our Business

We are a niche and high value-added steel processing company principally engaged in the manufacture and sale of high precision cold-rolled steel products, in the provision of heat treatment and in the cutting and slitting of medium and high-carbon hot-rolled steel strips. We use commodity steel to create a high value-added specialty premium steel. Specialty precision steel pertains to the precision of measurements and tolerances of thickness, shape, width, surface finish and other special quality features of highly-engineered end-use applications.

We produce and sell precision ultra-thin and high strength cold-rolled steel products ranging from 7.5 mm to 0.03 mm. We also provide heat treatment and cutting and slitting of medium and high-carbon hot-rolled steel strips not exceeding 7.5 mm thickness. Our process puts hot-rolled de-scaled (pickled) steel coils through a cold-rolling mill, utilizing our patented systems and high technology reduction processing procedures, to make steel coils and sheets in customized thicknesses according to customer specifications. Currently, our specialty precision products are mainly used in the manufacture of automobile parts and components, steel roofing, plane friction discs, appliances, food packaging materials, saw blades, textile needles, and microelectronics.

We conduct our operations principally in China through our wholly-owned operating subsidiaries, Chengtong and Shanghai Blessford, which are wholly owned subsidiaries of our direct subsidiary, PSHL. Most of our sales are made domestically in China; however, we began exporting during fiscal 2007 and our overseas market currently covers Indonesia, Thailand, the Philippines, Nigeria and Ethiopia. We intend to further expand into additional overseas markets in the future, subject to suitable market conditions and favorable regulatory controls.

First Quarter Financial Performance Highlights

During the first fiscal quarter of 2011, we saw robust growth in demand for our cold rolled steel products as market sentiment continued to improve. We have seen gradually increasing demand and orders from both our long term and new customers, especially in the low-carbon cold-rolled steel segment and the high-carbon cold-rolled steel segment, due to favorable policies and PRC government subsidies for the home appliance industry and the auto industry, where our products in these two segments are used in the manufacturing of certain components. However, despite the positive growth we have seen during the current period, general industry problems such as excess capacity, low industrial concentration and a lack of access to natural resources that have long plagued China's steel sector still remain. Starting January 1, 2010, we have commenced production from our 3rd cold rolling mill and we are operating a total of three cold rolling mills at our facilities now, at a combined utilization rate of approximately 80% as of September 30, 2010.

During the three months ended September 30, 2010, we sold a total of 42,513 tons of products, an increase of 20,220 tons from 22,293 tons during the same period a year ago, due to an increase in demand in a gradually improving market as well as the addition of our 3rd mill which increases our total annual production capacity from 120,000 tons to 160,000 tons during its first year of operation and ultimately to 220,000 tons when it reaches its full design capacity in the next three to four years. We believe that such increase was mainly caused by increases in demand from construction materials and home appliance products due to PRC government subsidies to encourage consumer spending in these segments during the period ended September 30, 2010. Increased volume and sales have led to a gross profit of \$2,384,085 and a net income of \$644,511 for the three months ended September 30, 2010. Total company backlog as of September 30, 2010 was \$33,772,326.

We continue to take appropriate actions to perform business and credit reviews of customers and suppliers and reduce exposure by avoiding entry into contracts in countries or with customers with high credit risks. We strive to optimize our product mix, prioritize higher margin products, and strengthen collection of accounts receivable in the existing business environment with the goal to maintain overall healthy sales volume, margins and cash positions. We believe that there are high barriers to entry in the Chinese domestic precision cold-rolled steel industry because of the level of

technology expertise required for operation. Although we expect a continuation of volatility in demand in both domestic and international markets, and in steel prices which could have adverse impacts on our gross margins in the foreseeable future, the medium to long term prospects of our niche remain highly optimistic. We believe that our unique capabilities and know-how give us a competitive advantage to grow sales and build a globally recognized brand as we continue to carry out research and development (“R&D”) and expand to new segments, customers and markets.

The following are some financial highlights for the third fiscal quarter:

Revenues: Our revenues were approximately \$33.9 million for the first quarter, an increase of 98.9% from last year.

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

Gross Margin: Gross margin was 7.0% for the first quarter, as compared to 4.1% last year.

Income/(loss) from operations before tax: Income from operations before tax was approximately \$0.9 million for the first quarter, as compared to loss from operations before tax of \$0.3 million last year.

Net Income/(loss): Net income was approximately \$0.6 million for the third quarter, as compared to a net loss of approximately \$0.3 million last year.

Fully diluted Income/(loss) per share: Fully diluted income per share was \$0.01 for the first quarter compared to a fully diluted loss per share of \$0.01 last year.

Results of Operations

The following table sets forth key components of our results of operations for the periods indicated, in USD and as a percentage of revenues.

	Three months Ended September 30, 2010		Three months Ended September 30, 2009	
	Amount	% of Revenues	Amount	% of Revenues
Revenues	33,896,455	100.0	17,041,989	100.0
Cost of sales (including depreciation and amortization)	\$ 31,512,370	93.0	16,338,630	95.9
Gross profit	2,384,085	7.0	703,359	4.1
Selling and marketing	110,205	0.3	31,809	0.2
Administrative expenses	871,470	2.6	578,698	3.4
Allowance for bad and doubtful debts	-	-	117,117	0.7
Depreciation and amortization	44,160	0.1	43,738	0.3
Income/(loss) from operations	1,358,249	4.0	(68,003)	(0.4)
Total other expense	(463,595)	(1.4)	(208,421)	(1.2)
Income/(loss) from operations before income tax	894,654	2.6	(276,424)	(1.6)
Income tax expense/(benefit)	250,144	0.7	(1,233)	<0.1
Net income/(loss)	644,511	1.9	(275,191)	(1.6)
Basic earnings/(loss) per share	\$ 0.01		(0.01)	
Diluted earnings/(loss) per share	\$ 0.01		(0.01)	

Comparison of Three Months Ended September 30, 2010 and 2009

Sales Revenues. Sales volume increased by 20,220 tons, or 90.7%, period-on-period to 42,513 tons for the period ended September 30, 2010 from 22,293 tons for the period ended September 30, 2009 and, as a result, sales revenues increased by \$16,854,466, or 98.9%, period-on-period, to \$33,896,455 for the period ended September 30, 2010 from \$17,041,989 for the period ended September 30, 2009. The increase in sales revenues is mainly attributable to an increase in demand for low-carbon cold-rolled products used in construction and home appliances production due to favorable government policies and subsidies to encourage consumer spending.

Sales by Product Line

A break-down of our sales by product line for the three months ended September 30, 2010 and 2009 is as follows:

2010

2009

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

Product Category			% of Sales			% of Sales	Period-on-Period Qty.
	Quantity (tons)	\$ Amount		Quantity (tons)	\$ Amount		Variance
Low carbon hard rolled	3,625	2,800,212	8	4,560	3,064,585	18	(935)
Low carbon cold-rolled	23,498	21,082,008	62	10,633	6,361,255	37	12,865
High-carbon hot-rolled	1,652	1,402,884	4	1,981	1,556,728	9	(329)
High-carbon cold-rolled	5,472	5,136,462	15	2,497	4,321,739	25	2,975
Subcontracting income	8,266	3,145,202	10	2,622	1,648,876	10	5,644
Sales of scrap metal	-	329,687	1	-	88,806	1	-
Total	42,513	33,896,455	100	22,293	17,041,989	100	20,220

20

There were different trends of demand across various product categories during the three months ended September 30, 2010. High-carbon cold-rolled steel products accounted for 15% of the current sales mix at an average selling price of \$939 per ton for the period ended September 30, 2010, compared to 25% of the sales mix at an average selling price per ton of \$1,731 for the period ended September 30, 2009. The products in this category are mainly used in the automobile industry and the decrease in sales volume was due to demand volatilities period-on-period, however, we are generally optimistic about sales in this category for the remainder of the year due to the Chinese government's automobile stimulus policies which management expects to increase demand.

Low-carbon cold-rolled steel products accounted for 62% of the current sales mix at an average selling price of \$897 per ton for the three months ended September 30, 2010, compared to 37% of the sales mix at an average selling price per ton of \$598 for the three months ended September 30, 2009. The increase in demand in this category during the period was a result of increased orders of steel used in the production of construction and home appliances due to subsidies granted by the Chinese government to encourage consumer spending. Low-carbon hard-rolled steel products accounted for 8% of the current sales mix at an average selling price of \$772 per ton for the three months ended September 30, 2010, compared to 18% of the sales mix at an average selling price per ton of \$672 for the three months ended September 30, 2009, due to improved pricing but a decrease in demand in the international market period-on-period. Subcontracting income revenues accounted for \$3,145,202, or 10% of the sales mix for the three months ended September 30, 2010, as compared to \$1,648,876, or 10%, of the sales mix for the three months ended September 30, 2009.

	Three Months Ended September 30,		Variance	
	2010 (\$)	2009 (\$)	(\$)	(%)
Average Selling Prices				
Low-carbon hard rolled	772	672	100	15
Low-carbon cold-rolled	897	598	299	50
High-carbon hot-rolled	849	786	63	8
High-carbon cold-rolled	939	1,731	(792)	(46)
Subcontracting income	380	629	(249)	(40)

The average selling price per ton increased to \$797 for the three months ended September 30, 2010, compared to the \$764 in 2009, representing an increase of \$33, or 4%, period-on-period. This increase was mainly due to increases in general steel prices and therefore our selling prices, but was offset by a higher concentration in carbon products with lower average selling prices during the period. There were increases in average selling prices across all product categories except high-carbon cold-rolled and subcontracting work during the period.

Sales Breakdown by Major Customer

Customers	Three Months Ended September 30,		2009	
	2010 \$	% of Sales	\$	% of Sales
Shanghai Shengdejia Metal Products Co., Ltd.	9,097,037	27	*	*
Shanghai Changshuo Steel Co., Ltd.	5,825,690	17	3,848,354	23
SUMEC International Technology Co., Ltd.	2,590,163	8	1,046,660	6
Zhangjiagang Gangxing Innovative Construction Materials	2,453,522	7	1,735,287	10
Zhejiang Zhongwei Materials Co., Ltd.	2,298,702	7	*	*
Shaoxing Wangheng Metal Plate Co., Ltd.	*	*	1,768,383	10
Unimax & Far Corporation	*	*	1,069,184	6
	22,265,144	66	9,467,868	55
Others	11,631,311	34	7,574,121	45

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

Total	33,896,455	100	17,041,989	100
-------	------------	-----	------------	-----

* Not major customers for the relevant periods

21

Sales revenues generated from our top five major customers as a percentage of total sales increased to 66% for the period ended September 30, 2010, compared to 55% for the period ended September 30, 2009. Sales to two new major customers, Shanghai Shengdejia Metal Products Co., Ltd. and Zhejiang Zhongwei Materials Co., Ltd. for the three months accounted for 34% of our sales revenues. The change in customer mix reflects management's continuous efforts in expanding our customer base and geographical coverage during the course of the quarter.

Cost of Goods Sold. Cost of sales increased by \$15,173,740, or 92.9%, period-on-period, to \$31,512,370 for the period ended September 30, 2010, from \$16,338,630 for the period ended September 30, 2009. Cost of sales represented 93.0% of sales revenues for the period ended September 30, 2010 compared to 95.9% for the period ended September 30, 2009. Average cost of production per ton increased to \$741 for the period ended September 30, 2010, compared to an average cost of production per ton of \$733 for the period ended September 30, 2009, representing an increase of \$8 per ton, or 1.1%, period-on-period.

	Three Months Ended September 30,		Variance	
	2010 (\$)	2009 (\$)	(\$)	(%)
Cost of goods sold				
- Raw materials	28,570,179	14,305,303	14,264,876	99.7
- Direct labor	129,859	97,832	32,027	32.7
- Manufacturing overhead	2,812,332	1,935,495	876,837	45.3
	31,512,370	16,338,630	15,173,740	92.9
Cost per unit sold				
Total units sold (tons)	42,513	22,293	20,220	90.7
Average cost per unit sold (\$/ton)	741	733	8	1.1

The increase in cost of sales is represented by the combined effect of:

- an increase in cost of raw materials per unit sold of \$30, or 4.7%, from \$642 for the period ended September 30, 2009 compared to \$672 for the period ended September 30, 2010;
- a decrease in direct labor per unit sold of \$1, or 25.0%, from \$4 for the period ended September 30, 2009 compared to \$3 for the period ended September 30, 2010;
- a decrease in factory overhead per unit sold of \$21, or 24.1%, from \$87 for the period ended September 30, 2009 compared to \$66 for the period ended September 30, 2010.

The cost of raw materials consumed increased by \$14,264,876, or 99.7%, period-on-period, to \$28,570,179 for the period ended September 30, 2010 from \$14,305,303 for the period ended September 30, 2009. This increase was mainly due to the increases in total units sold as well as increase in the average cost per unit sold.

Direct labor costs increased by \$32,027, or 32.7%, period-on-period, to \$129,859 for the period ended September 30, 2010, from \$97,832 for the period ended September 30, 2009. The increase was due to increase in total units sold offset by decrease in average cost per unit sold as a result of economies of scale during the period.

Manufacturing overhead costs increased by \$876,837, or 45.3%, period-on-period, to \$2,812,332 for the period ended September 30, 2010, from \$1,935,495 for the period ended September 30, 2009. The increase was mainly attributable

to the combined effect of an increase in depreciation of \$483,626, or 65.9%, period-on-period, to \$1,217,525 for the period ended September 30, 2010, from \$733,899 for the period ended September 30, 2009, an increase in utilities of \$451,111, or 91.2%, period-on-period, to \$945,981 for the period ended September 30, 2010, from \$494,870 for the period ended September 30, 2009 due to increased consumption of electricity associated with the production of 20,220 additional tons of steel period-on-period, and an increase in low consumables of \$198,459, or 73.6%, period-on-period, to \$467,925 for the period ended September 30, 2010, from \$269,466 for the period ended September 30, 2009.

Gross Profit. Gross profit in absolute terms increased by \$1,680,726, or 239.0%, period-on-period, to \$2,384,085 for the period ended September 30, 2010, from \$703,359 for the period ended September 30, 2009, while gross profit margin increased to 7.0% for the period ended September 30, 2010, from 4.1% for the period ended September 30, 2009. The increase in gross profit is mainly attributable to a 98.9% period-on-period increase in sales revenues, offset by a 92.9% period-on-period increase in cost of goods sold. The increase in gross profit margin principally resulted from an increase in average selling prices and a higher equipment utilization rate due to the increase in prices and demand during the first quarter.

Selling Expenses. Selling expenses increased by \$78,396, or 246.5%, period-on-period, to \$110,205 for the period ended September 30, 2010 compared to the corresponding period in 2009 of \$31,809. The increase was mainly attributable to increased focus on sales and marketing efforts period-on-period.

Administrative Expenses. Administrative expenses increased by \$292,772, or 50.6%, period-on-period, to \$871,470 for the period ended September 30, 2010, compared to \$578,698 for the period ended September 30, 2009. This increase was chiefly associated with increased travelling costs in connection with attendance at investor and steel conferences and professional fees during the period ended September 30, 2010.

Provision for bad debt. Provision for bad debt decreased by \$117,117, or 100.0%, period-on-period, as no bad debt expense was recognized in the quarter ended September 30, 2010, compared to a provision for bad debt in the amount of \$117,117 recognized during the prior year based on our policy for allowance for doubtful accounts.

Income from Operations. Income from operations before income tax increased by \$1,426,252, or 2,097.3%, period-on-period, to \$1,358,249 for the period ended September 30, 2010 from a loss of \$68,003 for the period ended September 30, 2009, as a result of the factors discussed above.

Other income. Our other income decreased \$18,404, or 92.4%, to \$1,518 for the period ended September 30, 2010 from \$19,922 for the period ended September 30, 2009. As a percentage of revenues, other income decreased to 0.0% for the period ended September 30, 2010 from 0.1% for the period ended September 30, 2009. Such percentage decrease in other income was primarily due to lower cash balances and decrease in interest rate period-on-period.

Interest Expense. Total interest expense increased \$236,770, or 103.7%, to \$465,113 for the period ended September 30, 2010, from \$228,343 for the period ended September 30, 2009 due to an increase in loan balances period-on-period.

Income Tax. For the period ended September 30, 2010, we recognized an income tax expense of \$250,144, compared to an income tax benefit of \$1,233 for the period ended September 30, 2009. The increase in taxes reflects a higher income from operations period-on-period.

Net Income(loss). Net income increased by \$919,702, or 334.2%, period-on-period, to net income of \$644,511 for the period ended September 30, 2010 from a net loss of \$275,191 for the period ended September 30, 2009. The increase in net income is attributable to a combination of factors discussed above, including increase in tons sold due to strengthening demand and increase in average selling prices.

Liquidity and Capital Resources

General

Our business is capital intensive and requires substantial expenditures for, among other things, the purchase and maintenance of plant and equipment used in our operations. Our short-term and long-term liquidity needs arise primarily from capital expenditures, working capital requirements and principal and interest payments related to our outstanding indebtedness. We have met these liquidity requirements with cash provided by operations, equity financing, and bank debt. As of September 30, 2010, we had cash and cash equivalents of approximately \$12.6 million.

The following table provides detailed information about our net cash flow for all financial statement periods presented in this report:

CASH FLOW

	Three Months Ended September 30,	
	2010	2009
Net cash used in operating activities	\$ (10,115,902)	\$ (302,459)
Net cash used in investing activities	(6,542,428)	(2,946,433)
Net cash (used in)/provided by financing activities	(51,479)	3,296,075
Net cash flow	(16,383,649)	53,824

Operating Activities

Net cash flows used in operating activities for the period ended September 30, 2010 was \$10,115,902, as compared to \$302,459 for the period ended September 30, 2009, for a net increase of \$9,813,443 used. The increase during the period ended September 30, 2010 was mainly due to a reduction in cash flows caused by an increase in advances to suppliers of \$13,337,712 due to increased orders on hand, as well as a decrease in accounts payable and accrued expenses of \$6,036,616.

For the period ended September 30, 2010, sales revenues generated from our top five major customers as a percentage of total sales increased to 66%, as compared to 55% for the period ended September 30, 2009. The loss of all or portion of the sales volume from a significant customer would have an adverse effect on our operating cash flows. We note that the continuation or intensification of the current economic downturn may have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations to us, resulting in unrecoverable losses on our accounts receivable. We have been strengthening our collection activities and will continue to closely monitor any changes in collection experience and the credit ratings of our customers. From time to time we will review credit periods offered, along with our collection experience and the other relevant factors, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. Delays or non-payment of accounts receivable would have an adverse effect on our operating cash flows.

Investing Activities

Our main uses of cash for investing activities during the period ended September 30, 2010 were for the purchase of property, plant and equipment related to the addition of the new annealing furnaces at our Shanghai Blessford facilities. We believe these capital investments increase our capacity, expand our product line and improve the quality of our products, thereby creating opportunities to grow sales, enter new markets and further strengthen our leading position in the market for niche cold rolling steel.

Net cash flows used in investing activities for the period ended September 30, 2010 was \$6,542,428, as compared with \$2,946,433 for the period ended September 30, 2009. The increase in investing activity was due to payment of the construction project related to the annealing furnaces and backup rolls used in our mills during the period ended September 30, 2010.

As of September 30, 2010, the Company had \$4,728,012 in commitments for interest relating to its short-term and long-term loans and a share capital injection commitment related to Shanghai Blessford. Management believes that we currently have sufficient capital resources to meet these contractual commitments.

Financing Activities

Net cash flows used in financing activities for the period ended September 30, 2010 was \$51,479, as compared with \$3,296,075 provided by financing activities for the period ended September 30, 2009. During the period ended September 30, 2009, the Company received short-term loans of \$3,735,552, which was partially offset by repayment of short-term loans in the amount of \$439,477.

On December 30, 2008, we filed a universal shelf registration statement with the SEC for the issuance of securities valued at up to an aggregate of \$40 million. The shelf registration statement was declared effective on December 10, 2009 and provides us with the flexibility to issue registered securities, from time to time, in one or more separate offerings or other transactions with the size, price and terms to be determined at the time of issuance. Although we do not have any commitments or current intentions to sell securities under the registration statement, we believe that it is prudent to have a shelf registration statement in place to ensure financing flexibility should the need arise.

While we currently generate sufficient operating cash flows to support our working capital requirements, our working capital requirements and the cash flow provided by future operating activities will vary from quarter to quarter, and are dependent on factors such as volume of business and payment terms with our customers. As such, we may need to rely on access to the financial markets to provide us with significant discretionary funding capacity. However, the current uncertainty arising out of domestic and global economic conditions, including the recent disruption in credit markets, poses a risk to the economies in which we operate and may adversely impact our potential sources of capital financing. The general unavailability of credit could make capital financing more expensive for us or impossible altogether. Even if we are able to obtain credit, the incurrence of indebtedness could result in increased debt service obligations. Our inability to renew our short-term bank loans that are due in July 2011, and the unavailability of additional debt financing as a result of economic pressures on the credit and equity markets could have a material adverse effect on our business operations.

Current Assets

Current assets decreased by \$6,652,605, or 5.6%, period-on-period, to \$111,129,267 as of September 30, 2010, from \$117,781,872 as of June 30, 2010, principally as a result of a decrease in accounts receivable of \$5,783,980, or 14.6%, period-on-period, as a result of strengthened efforts in credit collection during the period, cash by \$16,383,649, or 56.4%, period-on-period, offset by an increase in inventories of \$2,869,996, or 10.1%, period-on-period, and advances to suppliers of \$12,802,954, or 91.7%.

Accounts receivable, representing 30.4% of total current assets as of September 30, 2010, is a significant asset of the Company. We offer credit to our customers in the normal course of our business and accounts receivable is stated net of allowance for doubtful accounts. Credit periods vary substantially across industries, segments, types and size of companies in China where we operate our business. Because of the niche products that we process, our customers are usually also niche players in their own respective segment, who then sell their products to the end product manufacturers. The business cycle is relatively long, as well as the credit periods. The Company offers credit to its customers for periods of 60 days, 90 days, 120 days and 180 days. We generally offer the longer credit terms to longstanding recurring customers with good payment histories and sizable operations. From time to time we review these credit periods, along with our collection experience and the other factors discussed above, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. If our actual collection experience or other conditions change, revisions to our allowances may be required, including a further provision which could adversely affect our operating income, or write back of provision when estimated uncollectible accounts are actually collected.

Our management determines the collectability of outstanding accounts by maintaining quarterly communication with such customers and obtaining confirmation of their intent to fulfill their obligations to the Company. In making this determination, our management also considers past collection experience, our relationship with customers and the impact of current economic conditions on our industry and market. We note that the continuation or intensification of the current global economic crisis may have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations. To reserve for potentially uncollectible accounts receivable, for the period ended September 30, 2009, our management has made a 50% provision for all accounts receivable that are over 180 days past due and full provision for all accounts receivable over one year past due. From time to time, we will review these credit periods, along with our collection experience and the other factors discussed above, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. If our actual collection experience or other conditions change, revisions to our allowances may be required, including a further provision which could adversely affect our operating income, or write back of provision when estimated uncollectible accounts are actually collected.

The following table reflects the aging of our accounts receivable September 30, 2010 and June 30, 2010:

		September 30, 2010					
US\$	Total	Current	1 to 30 days	31 to 90 days	91 to 180 days	181 to 360 days	over 1 year
TOTAL	34,842,275	14,983,167	2,114,872	4,631,085	12,009,620	209,961	893,570
%	100	43	6	13	34	1	3
		June 30, 2010					
US\$	Total	Current	1 to 30 days	31 to 90 days	91 to 180 days	181 to 360 days	over 1 year
TOTAL	40,612,589	16,750,361	1,521,900	5,485,380	15,398,743	1,177,748	278,457

%	100	41	4	14	38	3	<1
---	-----	----	---	----	----	---	----

24

Management continues to take appropriate actions to perform business and credit reviews of any prospective customers (whether new or returning) to protect the Company from any who might pose a high credit risk to our business based on their commercial credit reports, our past collection history with them, and our perception of the risk posed by their geographic location. Management is also of the opinion that we do not currently have any high risk receivables on our accounts.

Current Liabilities

Current liabilities decreased by \$3,539,888, or 7.3%, period-on-period, to \$44,905,239 as of September 30, 2010, from \$48,445,127 as of June 30, 2010. The decrease was mainly attributable to a decrease in accounts payable and accrued expenses of \$3,754,572, or 37.7%, period-on-period, offset by an increase in current income taxes payable of \$264,572, or 4.9%, period-on-period.

As of September 30, 2010, we had \$26,263,965 in short term-loans. These short term loans were renewed in June 2010 for one year and will be due on July 31, 2011. We expect to refinance such debt at its maturity, but we cannot assure you that we will be able to do so on terms favorable to the Company or at all.

Capital Expenditures

During the period ended September 30, 2010, we invested \$6,542,428 in purchases of property, plant and equipment, and construction projects in relation to the new annealing furnaces and backup rolls for our cold rolling mills.

Loan Facilities

The following table illustrates our credit facilities as of September 30, 2010, providing the name of the lender, the amount of the facility, the date of issuance and the maturity date:

All amounts in U.S. dollars						
Lender	Date of Loan	Maturity Date	Duration	Interest Rate		Principal Amount
Raiffeisen Zentralbank Österreich AG	June 18, 2010	July 31, 2011	1 year	1.15 times of the PBOC rate	\$	7,881,612 (RMB 52,737,444)
Raiffeisen Zentralbank Österreich AG	June 18, 2010	July 31, 2011	1 year	1.15 times of the PBOC rate	\$	18,382,353 (RMB 123,000,000)
DEG – Deutsche Investitions – und Entwicklungsgesellschaft mbH	June 29, 2010	June 15, 2016	6 years	6 month USD LIBOR + 4.5%	\$	18,319,584
Total					\$	44,583,549

As of September 30, 2010, we had \$26,263,965 in short-term loans secured by inventories, land use rights, buildings, plant and machinery, and \$18,319,584 in long-term loans secured by plant and machinery, as illustrated in the above table.

The short-term loans will be due and renewable on July 31, 2011. We are not aware of any existing issues that may lead to a withdrawal of such loan at its maturity. Our inability to renew and the unavailability of additional debt financing as a result of economic pressures on the credit and equity markets could have a material adverse effect on our business operations.

We believe that our currently available working capital and the credit facilities referred to above should be adequate to sustain our operations at our current levels and support our contractual commitments through the next twelve months. However, our working capital requirements and the cash flow provided by future operating activities vary from quarter to quarter, depending on the volume of business during the period and payment terms with our customers. As we expect a continuation of volatility in demand and steel prices in both domestic and international markets in the foreseeable future, our operating cash flows might be significantly negatively impacted by reduced sales and margins. Management has strengthened its sales and marketing activities, and continues to be in talks with potential customers whose past orders we had been unable to fill due to full capacity, which if successful, could result in additional sales and mitigate the impact of the weakened demand and margins on our operating cash flow. As of September 30, 2010, the Company also had \$4,728,012 in contractual commitments for interest relating to its short-term and long-term loans and share capital injection commitment related to Shanghai Blessford. As such, we may need to rely on access to the financial markets to provide us with significant discretionary funding capacity. However, continued uncertainty arising out of domestic and global economic conditions, including the recent disruption in credit markets, poses a risk to the economies in which we operate and may adversely impact our potential sources of capital financing. The general unavailability of credit could make capital financing more expensive for us or impossible altogether. Even if we are able to obtain credit, the incurrence of indebtedness could result in increased debt service obligations and could result in operating and financing covenants that could restrict our present and future operations.

Obligations under Material Contracts

Below is a table setting forth our material contractual obligations as of September 30, 2010, debt obligations include principal repayments and interest payments:

	Total	Payments Due By Year			
		Fiscal Year 2011	Fiscal Year 2012-2013	Fiscal Year 2014-2015	Fiscal Years 2016 and Beyond
Contractual obligations:					
Short-Term Debt Obligations	\$ 29,473,422	\$ 1,604,729	\$ 27,868,693	\$ —	\$ —
Long-Term Debt Obligations	\$ 21,950,687	\$ 972,233	\$ 8,971,499	\$ 8,198,009	\$ 3,808,946
Share Capital Injection Commitments	\$ 2,151,050	2,151,050	—	—	—
Total	\$ 53,575,159	\$ 4,728,012	\$ 36,840,192	\$ 8,198,009	\$ 3,808,946

Critical Accounting Policies

There have been no changes in our critical accounting policies from those disclosed in under Item 7, “Management's Discussion and Analysis of Results of Operations and Financial Condition” in our Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

Recent Accounting Pronouncements

In June 2009, the FASB issued guidance now codified as ASC 810, “Amendments to FASB Interpretation No. 46(R)” (“ASC 810”), which amends FASB Interpretation No. 46 (revised December 2003), now codified as ASC 810-10, to address the elimination of the concept of a qualifying special purpose entity. ASC 810 also replaces the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. Additionally, ASC 810 provides more timely and useful information about an enterprise’s involvement with a variable interest entity. ASC 810 will become effective in July 2010. We do not expect that the adoption of ASC 810 will have a material impact on our financial statements.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05, “Measuring Liabilities at Fair Value” (“ASU 2009-05”). ASU 2009-05 amends ASC 820, “Fair Value Measurements” (“ASC 820”). Specifically, ASU 2009-05 provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following methods: 1) a valuation technique that uses a) the quoted price of the identical liability when traded as an asset or b) quoted prices for similar liabilities or similar liabilities when traded as assets and/or 2) a valuation technique that is consistent with the principles of ASC 820 (e.g. an income approach or market approach). ASU 2009-05 also clarifies that when estimating the fair value of a liability, a reporting entity is not required to adjust to include inputs relating to the existence of transfer restrictions on that liability. The adoption of this standard did not have an impact on the Company’s financial position or results of operations.

In October 2009, the FASB issued ASU No. 2009-13 on ASC 605, “Revenue Recognition” (“ASC 605”), regarding multiple-deliverable revenue arrangements. This ASU provides amendments to the existing criteria for separating consideration in multiple-deliverable arrangements. The amendments establish a selling price hierarchy for determining the selling price of a deliverable, eliminate the residual method of allocation of arrangement consideration to all deliverables and require the use of the relative selling price method in allocation of arrangement consideration to all deliverables, require the determination of the best estimate of a selling price in a consistent

manner, and significantly expand the disclosures related to the multiple-deliverable revenue arrangements. The amendments will be effective in fiscal years beginning on or after June 15, 2010, and early adoption is permitted. We do not expect that the adoption of ASU 2009-13 will have a material impact on our financial statements.

In October 2009, the FASB issued ASU No. 2009-15, “Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing” (“ASU 2009-15”). ASU 2009-15 amends ASC 470, “Debt with Conversion and Other Options” (“ASC 470”), and ASC 260, “Earnings Per Share” (“ASC 260”). Specifically, ASU 2009-15 requires companies to mark stock loan agreements at fair value and recognize the cost of the agreements by reducing the amount of additional paid-in capital on their financial statements. The amendments will be effective for fiscal years beginning on or after December 15, 2009. We do not expect that the adoption of ASU 2009-15 will have a material impact on our financial statements.

In December 2009, the FASB issued ASU 2009-17, “Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities” (“ASU 2009-17”). ASU 2009-17 details the amendments to ASC 810, “Consolidation”, which are the result of FASB Statement No. 167, “Amendments to FASB Interpretation No. 46(R)”. That statement was issued by the FASB in June 2009. ASU 2009-17 amends the variable-interest entity guidance in ASC 810 to clarify the accounting treatment for legal entities in which equity investors do not have sufficient equity at risk for the entity to finance its activities without financial support. ASU 2009-17 is effective at the start of the first fiscal year beginning after November 15, 2009. We do not expect that the adoption of ASU 2009-17 will have a material impact on our financial statements.

In January 2010, the FASB issued ASU 2010-06, “Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements” (“ASU 2010-06”). ASU 2010-06 requires reporting entities to provide information about movements of assets among Levels 1 and 2 of the three-tier fair value hierarchy established by ASC 820. The guidance is effective for any fiscal year that begins after December 15, 2010 and should be used for quarterly and annual filings. We are currently evaluating the impact on our financial statements of adopting the amendments in ASU 2010-06 and cannot estimate the impact of adoption at this time.

Seasonality

Our operating results and operating cash flows historically have been subject to seasonal variations. Our revenues are usually higher in the second half of the year than in the first half of the year and the first quarter is usually the slowest quarter because fewer projects are undertaken during and around the Chinese New Year holidays.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable.

ITEM 4. CONTROLS AND PROCEDURES.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) that are designed to ensure that information that would be required to be disclosed in Exchange Act reports is recorded, processed, summarized and reported within the time period specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including to our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As required by Rule 13a-15 under the Exchange Act, our management, including our Chief Executive Officer, Mr. Hai Sheng Chen, and Chief Financial Officer, Ms. Leada Tak Tai Li, evaluated the effectiveness of the design and

operation of our disclosure controls and procedures as of September 30, 2010. Based on our assessment, Mr. Chen and Ms. Li determined that, as of September 30, 2010, and as of the date that the evaluation of the effectiveness of our disclosure controls and procedures was completed, our disclosure controls and procedures were effective to satisfy the objectives for which they are intended.

Changes in Internal Controls over Financial Reporting

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There were no changes in our internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may become involved in various lawsuits and legal proceedings, which arise, in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these, or other matters, may arise from time to time that may harm our business. We are currently not aware of any such legal proceedings or claims that we believe will have a material adverse affect on our business, financial condition or operating results.

ITEM 1A. RISK FACTORS.

Not Applicable.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. (REMOVED AND RESERVED).

ITEM 5. OTHER INFORMATION.

We have no information to disclose that was required to be in a report on Form 8-K during the period covered by this report, but was not reported. There have been no material changes to the procedures by which security holders may recommend nominees to our board of directors.

ITEM 6. EXHIBITS.

The following exhibits are filed as part of this report or incorporated by reference:

Exhibit

No.	Description
31.1	Certifications of Principal Executive Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Edgar Filing: China Precision Steel, Inc. - Form 10-Q

- 31.2 Certifications of Principal Financial Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certifications of Principal Executive Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certifications of Principal Financial Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

28

SIGNATURES

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

Date: November 15, 2010

CHINA PRECISION STEEL, INC.

By: /s/ Hai Sheng Chen
Hai Sheng Chen, Chief Executive
Officer
(Principal Executive Officer)

By: /s/ Leada Tak Tai Li
Leada Tak Tai Li, Chief Financial
Officer
(Principal Financial Officer and
Principal
Accounting Officer)