

China Precision Steel, Inc.
Form 10-Q
February 16, 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: December 31, 2009

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

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

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

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 February 10, 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 and Six Months Ended December 31, 2009

TABLE OF CONTENTS

PART I
FINANCIAL INFORMATION

| | | |
|---------|---|----|
| Item 1. | Financial Statements | 2 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 22 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 40 |
| Item 4. | Controls and Procedures | 40 |

PART II
OTHER INFORMATION

| | | |
|----------|---|----|
| Item 1. | Legal Proceedings | 40 |
| Item 1A. | Risk Factors | 40 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 40 |
| Item 3. | Defaults Upon Senior Securities | 40 |
| Item 4. | Submission of Matters to a Vote of Security Holders | 40 |
| Item 5. | Other Information | 41 |
| Item 6. | Exhibits | 41 |

PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

CHINA PRECISION STEEL, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2009 AND 2008

| Contents | Page(s) |
|--|---------|
| Consolidated Balance Sheets as of December 31, 2009 (unaudited) and June 30, 2009 | 3 |
| Consolidated Statements of Operations and Comprehensive Income for the three and six months ended December 31, 2009 and 2008 (unaudited) | 4 |
| Consolidated Statements of Stockholders' Equity for the six months ended December 31, 2009 and 2008 (unaudited) | 5 |
| Consolidated Statements of Cash Flows for the six months ended December 31, 2009 and 2008 (unaudited) | 6 |
| Notes to the Consolidated Financial Statements (unaudited) | 7-21 |

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

China Precision Steel, Inc. and Subsidiaries

Consolidated Balance Sheets

| | Notes | (Unaudited) December 31, 2009 | June 30, 2009 |
|---|-------|-------------------------------------|-----------------------|
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents | | \$ 12,752,288 | \$ 13,649,587 |
| Accounts receivable | | | |
| Trade, net of allowances of \$1,006,973 and \$830,127 at December 31 and June 30, 2009, respectively | 5 | 23,524,856 | 25,140,834 |
| Bills receivable | | 317,391 | 6,131,143 |
| Other | | 920,274 | 881,153 |
| Inventories | 6 | 25,149,536 | 16,275,070 |
| Prepaid expenses | | 161,427 | 75,917 |
| Advances to suppliers, net of allowance of \$1,632,442 and \$1,631,557 at December 31 and June 30, 2009, respectively | 7 | 22,491,830 | 21,878,047 |
| Total current assets | | 85,317,602 | 84,031,751 |
| Property, plant and equipment | | | |
| Property, plant and equipment, net | 8 | 72,880,841 | 46,812,484 |
| Deposits for building, plant and machinery | | - | 8,348,496 |
| Construction-in-progress | 9 | 5,656,934 | 22,245,173 |
| | | 78,537,775 | 77,406,153 |
| Intangible assets, net | 10 | 1,852,015 | 1,871,211 |
| Goodwill | | 99,999 | 99,999 |
| Total assets | | \$ 165,807,391 | \$ 163,409,114 |
| Liabilities and Stockholders' Equity | | | |
| Current liabilities | | | |
| Short-term loans | 11 | \$ 25,791,988 | \$ 22,489,031 |
| Accounts payable and accrued liabilities | | 6,346,626 | 7,144,242 |
| Advances from customers | 12 | 2,786,380 | 1,742,944 |
| Other taxes payables | | 2,921,706 | 6,650,668 |
| Current income taxes payable | | 4,978,877 | 4,778,767 |
| Total current liabilities | | 42,825,577 | 42,805,652 |
| Stockholders' equity: | | | |
| Preferred stock: \$0.001 per value, 8,000,000 shares | | | |

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

| | | | |
|---|----|----------------|----------------|
| authorized, no shares outstanding at December 31 and June 30, 2009, respectively | 13 | | |
| Common stock: \$0.001 par value, 62,000,000 shares authorized, 46,562,955 and 46,562,955 issued and outstanding December 31 and June 30, 2009, respectively | 13 | 46,563 | 46,563 |
| Additional paid-in capital | 13 | 75,642,383 | 75,642,383 |
| Accumulated other comprehensive income | | 9,795,611 | 9,731,505 |
| Retained earnings | | 37,497,257 | 35,183,011 |
| Total stockholders' equity | | 122,981,814 | 120,603,462 |
| Total liabilities and stockholders' equity | | \$ 165,807,391 | \$ 163,409,114 |

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 and Six Months Ended December 31, 2009 and 2008
(Unaudited)

| | Notes | Three Months Ended | | Six Months Ended | |
|--|-------|----------------------|-----------------------|----------------------|----------------------|
| | | December 31, 2009 | December 31, 2008 | December 31, 2009 | December 31, 2008 |
| Revenues | | | | | |
| Sales revenues | | \$ 27,013,838 | \$ 17,573,959 | \$ 44,055,827 | \$ 42,924,378 |
| Cost of goods sold | | 23,377,883 | 14,122,622 | 39,716,513 | 35,520,383 |
| Gross profit | | 3,635,955 | 3,451,337 | 4,339,314 | 7,403,995 |
| Operating expenses | | | | | |
| Selling expenses | | 70,605 | 1,122,532 | 102,414 | 1,333,830 |
| Administrative expenses | | 654,041 | 578,105 | 1,232,739 | 1,040,205 |
| Allowance for bad and doubtful debts | | 101,067 | 3,829,462 | 218,184 | 3,829,462 |
| Depreciation and amortization expense | | 36,755 | 33,318 | 80,493 | 59,521 |
| Total operating expenses | | 862,468 | 5,563,417 | 1,633,830 | 6,263,018 |
| Income/(loss) from operations | | 2,773,487 | (2,112,080) | 2,705,484 | 1,140,977 |
| Other income/(expense) | | | | | |
| Other revenues | | 91,041 | 138,998 | 110,963 | 259,701 |
| Interest and finance costs | | (275,091) | (320,777) | (503,434) | (648,182) |
| Total other (expense) | | (184,050) | (181,779) | (392,471) | (388,481) |
| Net income/(loss) from operations before income tax | | 2,589,437 | (2,293,859) | 2,313,013 | 752,496 |
| Provision for/(benefit from) income tax | 15 | | | | |
| Current | | - | (318,878) | (1,233) | (148,257) |
| Deferred | | - | - | - | - |
| Total income tax (benefit) | | - | (318,878) | (1,233) | (148,257) |
| Net income/(loss) | | \$ 2,589,437 | \$ (1,974,981) | \$ 2,314,246 | \$ 900,753 |
| Basic earnings/(loss) per share | | \$ 0.06 | \$ (0.04) | \$ 0.05 | \$ 0.02 |
| | | 46,562,955 | 46,562,955 | 46,562,955 | 46,559,531 |

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

Basic weighted average shares
outstanding

| | | | | | | | | |
|-----------------------------------|----|------|----|--------|----|------|----|------|
| Diluted earnings/(loss) per share | \$ | 0.06 | \$ | (0.04) | \$ | 0.05 | \$ | 0.02 |
|-----------------------------------|----|------|----|--------|----|------|----|------|

Diluted weighted average shares
outstanding

| | | | | |
|--|------------|------------|------------|------------|
| | 46,562,955 | 46,562,955 | 46,562,955 | 46,566,423 |
|--|------------|------------|------------|------------|

The Components of
comprehensive income/(loss):

| | | | | | | | | |
|-------------------|----|-----------|----|-------------|----|-----------|----|---------|
| Net income/(loss) | \$ | 2,589,437 | \$ | (1,974,981) | \$ | 2,314,246 | \$ | 900,753 |
|-------------------|----|-----------|----|-------------|----|-----------|----|---------|

Foreign currency translation
adjustment

| | | | | |
|--|----------|---------|--------|---------|
| | (11,086) | 677,905 | 64,106 | 750,424 |
|--|----------|---------|--------|---------|

| | | | | | | | | |
|-----------------------------|----|-----------|----|-------------|----|-----------|----|-----------|
| Comprehensive income/(loss) | \$ | 2,578,351 | \$ | (1,297,076) | \$ | 2,378,352 | \$ | 1,651,177 |
|-----------------------------|----|-----------|----|-------------|----|-----------|----|-----------|

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

China Precision Steel, Inc. and Subsidiaries
 Consolidated Statements of Changes in Stockholders' Equity
 For the Year Ended June 30, 2009 and the Six Months Ended December 31, 2009

| | Ordinary Shares | | Additional | Accumulated | Retained | Total |
|--|-----------------|-----------|---------------|---------------|---------------|----------------|
| | Share | Amount | Paid-in | Other | Earnings | Stockholders' |
| | | | Capital | Comprehensive | | Equity |
| | | | | Income | | |
| Balance at June 30, 2008 | 46,472,953 | \$ 46,473 | \$ 75,372,488 | \$ 9,295,658 | \$ 35,591,349 | \$ 120,305,968 |
| Transfer agent adjustment | 2 | - | - | - | - | - |
| Exercise of warrants | 90,000 | 90 | 269,895 | - | - | 269,985 |
| Foreign currency translation adjustment | - | - | - | 435,847 | - | 435,847 |
| Net income | - | - | - | - | (408,338) | (408,338) |
| Balance at June 30, 2009 | 46,562,955 | 46,563 | 75,642,383 | 9,731,505 | 35,183,011 | 120,603,462 |
| Foreign currency translation adjustment | - | - | - | 64,106 | - | 64,106 |
| Net income | - | - | - | - | 2,314,246 | 2,314,246 |
| Balance at December 31, 2009 (unaudited) | 46,562,955 | \$ 46,563 | \$ 75,642,383 | \$ 9,795,611 | \$ 37,497,257 | \$ 122,981,814 |

China Precision Steel, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
For the Six Months Ended December 31, 2009 and 2008
(Unaudited)

| | 2009 | 2008 |
|---|----------------------|----------------------|
| Cash flows from operating activities | | |
| Net income | \$ 2,314,246 | \$ 900,753 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 2,181,380 | 1,825,544 |
| Allowance for bad and doubtful debts | 218,184 | 3,829,462 |
| Inventory impairment | 42,534 | - |
| Net changes in assets and liabilities: | | |
| Accounts receivable, net | 7,189,783 | 3,801,518 |
| Inventories | (8,908,192) | (461,094) |
| Prepaid expenses | (85,504) | (50,382) |
| Advances to suppliers | (601,926) | 2,890,245 |
| Accounts payable and accrued expenses | (801,406) | (147,831) |
| Advances from customers | 1,042,492 | (3,006,670) |
| Other taxes payable | (2,236,478) | (426,823) |
| Current income taxes | 197,520 | (491,584) |
| Net cash provided by operating activities | 552,633 | 8,663,138 |
| Cash flows from investing activities | | |
| Purchase of property, plant and equipment including construction in progress | (4,746,139) | (12,954,497) |
| Net cash (used in) investing activities | (4,746,139) | (12,954,497) |
| Cash flows from financing activities | | |
| Exercise of common stock warrants | - | 269,985 |
| Short-term loan proceeds | 3,735,169 | - |
| Repayments of short-term loans | (444,400) | (87,690) |
| Net cash provided by financing activities | 3,290,769 | 182,295 |
| Effect of exchange rate | 5,438 | 303,887 |
| Net (decrease) in cash | (897,299) | (3,805,177) |
| Cash and cash equivalents, beginning of period | 13,649,587 | 18,568,842 |
| Cash and cash equivalents, end of period | \$ 12,752,288 | \$ 14,763,665 |

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

China Precision Steel, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements
(Unaudited)

1. Description of Business

On December 28, 2006, China Precision Steel, Inc. (the “Company” 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 December 31 and June 30, 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 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 Tuorong through PSHL. The sole activity of Tuorong is the ownership of land use rights with respect to facilities utilized by Chengtong. On April 10, 2007, PSHL purchased the entire equity interest in Blessford International, 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 (“USD”) (see Note 3 “Foreign Currencies” below).

The accompanying unaudited consolidated financial statements as of December 31 and June 30, 2009 and for the periods ended December 31, 2009 and 2008 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 six months ended December 31, 2009 are not necessarily indicative of the results to be expected for the full year ending June 30, 2010.

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 our quarter ended December 31, 2009. 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 a 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 the longer credit terms to longstanding recurring customers with good payment histories and sizable operations. Accounts receivable are recorded at the time revenue is recognized and is 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 December 31 and June 30, 2009, the Company had \$1,006,973 and

\$830,127 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 December 31, 2009 and 2008 were \$101,067 and \$3,829,462, respectively. The current period 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.

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 the PRC 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 the PRC.

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 don't 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 December 31 and June 30, 2009, the Company had allowances of advances to suppliers of \$1,632,442 and \$1,631,557, 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, plant and equipment are as follows:

| | |
|---------------------|---------------|
| Plant and machinery | 10 years |
| Buildings | 10 years |
| Motor vehicles | 5 years |
| Office equipment | 5 to 10 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 six months ended December 31, 2009 and 2008, the Company capitalized \$260,690 and nil, 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 use 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 - Revenue from the sale of goods or services is recognized at the time that goods are delivered or services are rendered. Receipts in advance for goods to be delivered or services to be rendered in a 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 year 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 graduated rates up to 34%. No provision for current income taxes in the United States has been made as China Precision Steel, Inc. had no taxable income for

the six months ended December 31, 2009 and 2008.

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.

10

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 United States' 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 Old FIEs, Chengtong's tax holiday of a 50% reduction in the 25% statutory rates had expired on December 31, 2008 and is currently subject to the 25% statutory rates since January 1, 2009; Shanghai Blessford's full tax exemption from the enterprise income tax has expired on December 31, 2009, and is adjusted 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 then 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 the PRC.

While current income tax in our consolidated group accounts is provided in accordance with US GAAP and based on income recognized for our financial year ending June 30, actual income tax payments are based on the assessment of taxable income by local tax authority in the PRC where our operating subsidiaries are located and our tax year ends December 31. In the case where the income tax assessed by the local tax authority is different from the amount we have provided in our consolidated group accounts, there will be an impact on our future operating results.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement 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 statement 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 statement 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 by the State. However, the Company cannot reasonably quantify political risk factors and thus must depend on guidance issued by current State officials.

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of December 31, 2009 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 December 31, 2009, 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 pension regulations, Chengtong and Shanghai Blessford contribute to a defined contribution retirement scheme organized by the 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 six months ended December 31, 2009 and 2008, the Company's pension cost charged to the statements of operations under the plan amounted to \$80,263 and \$160,885, 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, accounts payable, accrued expenses, and other payables approximate their fair values as at December 31 and June 30, 2009 because of the relatively short-term maturity of these instruments. For short-term loans, the carrying amount is assumed to approximate fair value based on the current rates at which the Group could borrow funds with similar remaining maturities.

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 six months ended December 31, 2009 and 2008 is as follows:

| Customers | 2009 | % to sales | 2008 | % to sales |
|---------------------------------------|-----------|------------|-----------|------------|
| Shanghai Changshuo Steel Company, Ltd | 8,473,414 | 19 | 4,555,411 | 11 |
| | 6,465,502 | 15 | _* | _* |

Shanghai Shengdejia Metal Products Co.,
Ltd

| | | | | |
|---|----|----|------------|----|
| Salzgitter Mannesmann International GMBH | -* | -* | 13,651,071 | 32 |
|---|----|----|------------|----|

12

The Company's list of suppliers whose sales to us exceeded 10% of our total purchases during the six months ended December 31, 2009 and 2008 is as follows:

| Suppliers | 2009 | % to purchases | 2008 | % to purchases |
|---|-----------|-------------------|------------|-------------------|
| Dachang Huizu Baosheng Steel Products Co., Ltd. | 9,952,219 | 23 | -* | -* |
| Guangzhou Zhujiang Steel Co., Ltd. | 7,973,946 | 19 | -* | -* |
| Wuxi Hangda Trading Co., Ltd. | 7,363,868 | 17 | -* | -* |
| BaoSteel Steel Products Trading Co. Ltd. | -* | -* | 10,756,193 | 35 |
| Shanghai Pinyun Steel Co., Ltd. | -* | -* | 6,877,828 | 22 |

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. We have halted all our direct sales to customers located in the Philippines as we consider the associated credit risk to be relatively high. Based on publicly available reports, such as that issued by A.M. Best, there is a high risk that financial volatility may erupt in that country due to inadequate reporting standards, a weak banking system or asset markets and/or poor regulatory structure. We expect to resume such exports when conditions improve.

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 \$23,524,856 and \$25,140,834 as of December 31 and June 30, 2009, 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 had been relatively accurate in the past and there was 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 its inventory to its net realizable value (average selling price less reasonable costs to convert the inventory into completed form) in the amount of \$42,529 for the six months ended December 31, 2009.

As of December 31 and June 30, 2009, inventories consisted of the following:

| At cost: | December 31, 2009 | June 30, 2009 |
|------------------|----------------------|------------------|
| Raw materials | \$ 16,250,018 | \$ 8,846,663 |
| Work in progress | 4,556,219 | 2,818,832 |
| Finished goods | 1,697,662 | 2,191,341 |

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

| | | |
|------------------|---------------|---------------|
| Consumable items | 2,688,166 | 2,418,234 |
| | 25,192,065 | 16,275,070 |
| Less: impairment | (42,529) | - |
| | \$ 25,149,536 | \$ 16,275,070 |

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 \$7,814,015 were pledged for short-term loans totaling \$25,791,988 as of December 31, 2009.

7. Advances to Suppliers

Cash advances are shown net of allowances of \$1,632,442 and \$1,631,557 as of December 31 and June 30, 2009, respectively.

The majority of our advances to suppliers greater than 180 days as of December 31, 2009 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:

| | December 31, 2009 | June 30, 2009 |
|--------------------------------|----------------------|------------------|
| Plant and machinery | \$ 61,505,494 | \$ 33,331,681 |
| Buildings | 21,818,038 | 21,806,219 |
| Motor vehicles | 562,186 | 534,652 |
| Office equipment | 426,747 | 404,695 |
| | 84,312,465 | 56,077,247 |
| Less: Accumulated depreciation | (11,431,624) | (9,264,763) |
| | \$ 72,880,841 | \$ 46,812,484 |

Depreciation expense related to manufacturing is included as a component of cost of goods sold. During the three and six months ended December 31, 2009, depreciation totaling \$662,517 and \$1,396,252, respectively, was included as a component of cost of goods sold (2008: \$806,621 and \$1,526,548, respectively).

Plant and machinery and buildings amounting to \$42,708,827 (June 30, 2009: \$55,137,900) were pledged for short-term loans totaling \$25,791,988.

9. Construction-In-Progress

As of December 31 and June 30, 2009, construction-in-progress consisted of the following:

| | December 31, 2009 | June 30, 2009 |
|--------------------|----------------------|------------------|
| Construction costs | \$ 5,656,934 | \$ 22,245,173 |

Construction-in-progress represents construction and installations of annealing furnaces and other cold rolling related equipment.

10. Intangible Assets

Land use right amounting to \$1,852,015 (June 30, 2009: \$1,861,093) were pledged for short-term loans totaling \$25,791,988.

The Company acquired land use rights in August 2004 and December 2006 that both expire in December 2056. The land use rights are amortized over a fifty-year term. An amortization amount of approximately \$39,000 is to be recorded each year 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.

11. Short-Term Loans

Short-term loans consisted of the following:

| | December 31, 2009 | June 30, 2009 |
|--|----------------------|------------------|
| Bank loan agreement dated July 7, 2009, due July 31, 2010 with an interest rate of the Singapore Interbank Offered Rate ("SIBOR") plus 3% (3.10% at December 31, 2009) (Note 8) | 5,300,000 | 5,300,000 |
| Bank loan agreement dated July 7, 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 December 31, 2009) (Note 8) | 2,475,290 | 2,915,238 |
| Bank loan agreement dated July 7, 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 December 31, 2009) (Note 6 and 8) | 18,016,698 | 14,273,793 |
| | \$ 25,791,988 | \$ 22,489,031 |

The above bank loans outstanding as at December 31, 2009 carry an interest rate of 1.15 times of the standard market rate set by the People's Bank of China for Renminbi loans and at SIBOR plus 3% for USD 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 and CEO, Mr. Wo Hing Li. In addition, pursuant to a bank loan agreement entered into between the Company and Raiffeisen Zentralbank Österreich 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 as of December 31 and June 30, 2009 was 5.49% and 5.52%, respectively.

12. Advances from Customers

Advances from customers represent advance cash receipts from new customers and for which goods have not been delivered or services have not been rendered as of the balance sheets dates. Advances from customers for goods to be delivered or services to be rendered in the subsequent period are carried forward as deferred revenue.

13. Equity

Pursuant to Section 5.1 of the Stock Purchase Agreement, the Company agreed to reserve for issuance to investors in the private placement an aggregate of 2,000,000 shares of Common Stock if the Company's net income for the fiscal year ended June 30, 2007 was less than US\$10.4 million, as set forth in the Company's audited financial statements as filed with the SEC in the Company's Annual Report on Form 10-K for that fiscal year. As the Company's net income as set forth in its audited financial statements for the year ended June 30, 2007 was less than US\$10.4 million, the Company was required to issue the 2,000,000 shares of Common Stock to such investors. Such issuance was effected on October 15, 2007. No additional consideration was received by the Company in connection with this issuance of shares of Common Stock.

In conjunction with the audit of the Group's financial statements for the year ended June 30, 2007, certain post-closing adjustments were made for Tuorong. In light of such adjustments and consistent with the purposes and intentions of the Debt Reduction Agreement, dated February 13, 2007, as amended on February 20, 2007, it was determined that

771,060 shares of the Company's Common Stock issued to directors pursuant to the Debt Reduction Agreement would be required to be cancelled in order to eliminate the \$2,590,763 reflected on the June 30, 2007 audited financial statements as amounts due from directors. Such cancellation was effected on November 8, 2007.

Pursuant to the Subscription Agreement dated November 1, 2007 (the "Subscription Agreement"), on November 6, 2007, the Company agreed to issue and sell in a registered direct offering (the "Offering") an aggregate of 7,100,000 shares of its common stock at a price of \$6.75 per share (the "Purchase Price") and an aggregate of 1,420,000 warrants to purchase shares of its Common Stock ("Warrants" and, together with the Common Stock, the "Securities"). The Warrants have an exercise price of \$8.45 per share. The Warrants were not be exercised prior to May 6, 2008. The Securities are registered under the Securities Act of 1933, as amended (the "Act"), pursuant to the Company's existing effective shelf Registration Statement on Form S-3. In connection with the offer and sale of the Securities, the Company filed on November 1, 2007, a Registration Statement on Form S-3 pursuant to Rule 462(b) promulgated under the Act to register an additional \$10 million of its securities relating to its shelf Registration Statement.

The Company closed the Offering on November 6, 2007 (the “Closing Date”). The net proceeds of the offering were approximately \$44 million, after deducting underwriting commissions and discounts and other fees and expenses relating to the offering. The warrants were valued at \$5.3 million and the net proceeds were recorded to additional paid-in capital. The intended usage of the net proceeds was for repayment of certain bank debt, capital expenditure, and general corporate purposes. During the year ended June 30, 2008, long-term bank loans of \$13,042,159 were paid off, and a progress payment of \$7,016,729 was made in relation to the construction of the third cold rolling mill. During the year ended June 30, 2009, we invested an additional \$13,423,016 in construction in progress and property, production plants and equipment in relation to the third cold rolling mill and expansion of the Shanghai Blessford production facilities.

On the Closing Date, pursuant to a Placement Agency Agreement entered into between the Company and Roth Capital Partners LLC on October 31, 2007, Roth Capital received an amount in cash equal to 7.0% of the gross proceeds of the Offering and warrants to purchase an amount of Common Stock equal to 3.0% of the total number of shares of Common Stock sold in the Offering (the “Placement Warrants”), or 225,600 shares of Common Stock valued at \$887,504, and this amount was recorded as syndication fees offsetting additional paid-in capital. Such Placement Warrants have an exercise price per share of 120% of the closing price per share of the Company’s Common Stock on the Closing Date, or \$7.38, and were not exercisable prior to May 6, 2008. Thereafter, the Placement Warrants are exercisable at any time until the third anniversary of the date of issue.

14. 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 have been 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.

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, 2009 | Granted | Expired or Exercised | Outstanding December 31, 2009 | Expiration Date |
|----------------|---------------------------|---------|----------------------|-------------------------------|-------------------|
| \$ 3.60 | 100,000 | -0- | -0- | 100,000 | February 22, 2010 |
| \$ 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 |

15. 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.

16

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

The tax holiday resulted in tax savings as follows:

| | Six months ended December 31, | |
|-------------------|----------------------------------|------------|
| | 2009 | 2008 |
| Tax savings | \$ 675,840 | \$ 411,977 |
| Benefit per share | | |
| Basic | \$ 0.01 | \$ 0.01 |
| Diluted | \$ 0.01 | \$ 0.01 |

Significant components of the Group's deferred tax assets as of December 31 and June 30, 2009 are as follows:

| Deferred tax assets: | December 31, 2009 | June 30, 2009 |
|---|----------------------|------------------|
| Net operating loss carried forward | \$ 1,911,287 | \$ 1,823,487 |
| Temporary differences resulting from allowances | 1,905,901 | 1,850,921 |
| Total deferred income tax assets | \$ 3,817,188 | \$ 3,674,408 |
| Valuation allowance | (3,817,188) | (3,674,408) |
| | \$ — | \$ — |

The Company has not recognized a deferred tax liability in respect of the undistributed earnings of its foreign subsidiaries of approximately \$14,636,382 as of December 31, 2009 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 U.S. federal income tax rate to income tax expense per books is as follows.

| | Six months ended December 31, | |
|---|-------------------------------|--------------|
| | 2009 | 2008 |
| Computed tax (benefit)/expense at the federal statutory rate of 34% | \$ 786,843 | \$ 255,849 |
| Adjustments for PRC entities taxed at different rates | (252,963) | (106,772) |
| Valuation allowance | 142,289 | (32,867) |
| Income not subject to tax | (329) | 147,510 |
| Overprovision in prior year | (1,233) | - |
| Benefit of tax holiday | (675,840) | (411,977) |
| Income tax (benefit) per books | \$ (1,233) | \$ (148,257) |

Income tax expense consists of:

| | Six months ended December 31, | |
|---|-------------------------------|--------------|
| | 2009 | 2008 |
| Income tax (benefit) for the year - PRC | \$ (1,233) | \$ (148,257) |

| | | |
|-----------------------------------|------------|--------------|
| Deferred income tax benefit – PRC | - | - |
| Income tax (benefit) per books | \$ (1,233) | \$ (148,257) |

16. 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.

17

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

For the three and six months ended December 31, 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.

For the six months ended December 31, 2008, dilutive shares include outstanding warrants to purchase 358,392 shares of common stock at an exercise price of \$3.00 and warrants to purchase 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.

For the three months ended December 31, 2008, 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 (Numerator) | Shares (Denominator) | Per Share Amount |
|--|-----------------------|-------------------------|---------------------|
| For the three months ended December 31, 2009: | | | |
| Net income | \$ 2,589,437 | | |
| Basic EPS income available to common shareholders | \$ 2,589,437 | 46,562,955 | \$ 0.06 |
| Effect of dilutive securities: | | - | |
| Diluted EPS income available to common shareholders | \$ 2,589,437 | 46,562,955 | \$ 0.06 |
| For the three months ended December 31, 2008: | | | |
| Net loss | \$ (1,974,981) | | |
| Basic EPS (loss) available to common shareholders | \$ (1,974,981) | 46,562,955 | \$ (0.04) |
| Effect of dilutive securities: | | - | |
| Diluted EPS (loss) available to common shareholders | \$ (1,974,981) | 46,562,955 | \$ (0.04) |
| | Income (Numerator) | Shares (Denominator) | Per Share Amount |
| For the six months ended December 31, 2009: | | | |
| Net income | \$ 2,314,246 | | |
| Basic EPS income available to common shareholders | \$ 2,314,246 | 46,562,955 | \$ 0.05 |
| Effect of dilutive securities: | | - | |
| Diluted EPS income available to common shareholders | \$ 2,314,246 | 46,562,955 | \$ 0.05 |
| For the six months ended December 31, 2008: | | | |
| Net income | \$ 900,753 | | |
| Basic EPS income available to common shareholders | \$ 900,753 | 46,559,531 | \$ 0.02 |
| Effect of dilutive securities: | | | |
| Warrants | | 6,892 | |
| Diluted EPS income available to common shareholders | \$ 900,753 | 46,566,423 | \$ 0.02 |

17. Capital Commitments

As of December 31, 2009, the Company had contractual commitments of \$916,069 (June 30, 2009: \$2,496,669) for the construction of a cold rolling mill.

18. 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.

18

The recent decline in market cap and stock price has triggered an impairment test under ASC 360, an impairment test was performed for the quarter ended December 31, 2009 and no impairment charges were recognized for the relevant period. As of December 31, 2009, the Company expects these assets to be fully recoverable based on the result of the impairment test. Goodwill amounting to \$99,999 as at December 31, 2009 was considered immaterial and not tested for impairment in accordance with ASC 350.

19. Impact of Recent Accounting Pronouncements

In December 2007, the FASB issued guidance now codified as FASB ASC 805, “Business Combinations” (“ASC 805”). ASC 805 will change the accounting for business combinations. Under ASC 805, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. ASC 805 will change the accounting treatment and disclosure for certain specific items in a business combination. ASC 805 applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. ASC 805 will impact the Company in the event of any future acquisition.

In December 2007, the FASB issued guidance now codified as ASC 810, “Non-controlling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51”. ASC 810 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. ASC 810 is effective for fiscal years beginning on or after December 15, 2008. The Company does not believe that ASC 810 will have a material impact on its consolidated financial statements.

In April 2008, the FASB issued guidance now codified as ASC 350-30, “Determination of the Useful Life of Intangible Assets” (“ASC 350-30”), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under ASC 350, “Goodwill and Other Intangible Assets” (“ASC 350”). The intent of this guidance is to improve the consistency between the useful life of a recognized intangible asset under ASC 350 and the period of expected cash flows used to measure the fair value of the asset under ASC 805, “Business Combinations,” and other U.S. generally accepted accounting principles. This guidance is effective for fiscal years beginning after December 15, 2008 (the Company’s fiscal year 2010), and interim periods within those fiscal years. The Company does not believe the adoption of ASC 350-30 will have a material impact on the Company’s consolidated financial position, results of operations and cash flows.

In May 2008, the FASB issued guidance now codified as ASC 944-20, “Accounting for Financial Guarantee Insurance Contracts” (“ASC 944-20”). The new standard clarifies how FASB Statement No. 60, now codified as ASC 944-20, “Accounting and Reporting by Insurance Enterprises”, applies to financial guarantee insurance contracts issued by insurance enterprises, including the recognition and measurement of premium revenue and claim liabilities. It also requires expanded disclosures about financial guarantee insurance contracts. ASC 944-20 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years, except for disclosures about the insurance enterprise’s risk-management activities, which are effective the first period (including interim periods) beginning after May 23, 2008. Except for the required disclosures, earlier application is not permitted. The standard is not applicable to this Company.

In October 2008, the FASB issued guidance now codified as ASC 820-10, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active” (“ASC 820-10”). This guidance clarifies the application of FASB Statement No. 157, now codified as ASC 820-10, “Fair Value Measurements”, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. ASC 820-10 was effective upon issuance. The adoption of ASC 820-10 will not impact our consolidated financial statements in any material respect.

In December 2008, the FASB issued guidance now codified as ASC 715-20-65, “Employers’ Disclosures about Postretirement Benefit Plan Assets, an amendment of FASB Statement No. 132” (revised 2003), now codified as ASC 715-20-65. It provides guidance on an employer’s disclosures about plan assets, including: how investment allocation decisions are made and factors that are pertinent to an understanding of investment policies and strategies; the major categories of plan assets; the inputs and valuation techniques used to measure the fair value of plan assets; the effect of fair value measurements using significant unobservable inputs (level 3) on changes in plan assets for the period, and significant concentrations of risks within plan assets. ASC 715-20-65 is effective for fiscal years ending after December 15, 2009. We are currently assessing the potential impact that adoption of this standard may have on our financial statements.

In April 2009, the FASB issued guidance now codified as ASC 825, “Interim Disclosures about Fair Value of Financial Instruments”. It requires the fair value for all financial instruments within the scope of SFAS No. 107, now codified as ASC 825, “Disclosures about Fair Value of Financial Instruments”, to be disclosed in the interim periods as well as in annual financial statements. This standard is effective for the quarter ending after June 15, 2009. The adoption of ASC 825 will not impact our consolidated financial statements in any material respect.

In April 2009, the FASB issued guidance now codified as ASC 820-10, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly”. It clarifies the objective and method of fair value measurement even when there has been a significant decrease in market activity for the asset being measured. This standard is effective for the quarter ending after June 15, 2009. The adoption of ASC 825 will not impact our consolidated financial statements in any material respect.

In April 2009, the FASB issued guidance now codified as ASC 320, “Recognition and Presentation of Other-Than-Temporary Impairments”. The objective of an other-than-temporary impairment analysis under existing U.S. GAAP is to determine whether the holder of an investment in a debt or equity security for which changes in fair value are not regularly recognized in earnings (such as securities classified as held-to-maturity or available-for-sale) should recognize a loss in earnings when the investment is impaired. An investment is impaired if the fair value of the investment is less than its amortized cost basis. This guidance amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. We are currently assessing the potential impact that adoption of this standard may have on our financial statements.

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. The Company is currently evaluating whether this standard will have an impact on the Company consolidated 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 are currently evaluating the impact on our financial statements of adopting these amendments to ASC 605 and cannot estimate the impact of adoption at this time.

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 are currently evaluating the impact on our financial statements of adopting the amendments in ASU 2009-15 and cannot estimate the impact of adoption at this time.

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 are 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. 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. The Company is currently evaluating whether this standard will have an impact on the Company consolidated 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.

20. Subsequent Events

On January 29, 2010, Shanghai Blessford has 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 half annually over five years starting on December 15, 2011 and secured on a mortgage of the new cold rolling line and annealing furnaces at Shanghai Blessford's facilities.

Management has evaluated subsequent events from January 1, 2010 to February 12, 2010, the date which our financial statements have been issued and were available to be issued, and has concluded that other than disclosed above, no material subsequent events have occurred since December 31, 2009 that required recognition or disclosure in our current period financial statements. Subsequent events that may occur after February 12, 2010 have not been evaluated.

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

Special Note Regarding Forward Looking Statements

This quarterly report contains forward-looking statements relating to us that are based on the beliefs of our management as well as assumptions made by, and information currently available to, our management. When used in this Report, the words "anticipate," "believe," "estimate," "expect," "intend," "plan" and similar expressions, as they relate to our management, are intended to identify forward-looking statements. These statements reflect management's current view of us concerning future events and are subject to certain risks, uncertainties and assumptions, including among many others: 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 produce and sell cold-rolled precision steel products at high margins; 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; changes in our relationships with customers and suppliers; and other risks and uncertainties. Should any of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this Report as anticipated, estimated or expected. We undertake no obligation to publicly release any revisions to the forward-looking statements after the date of this document. 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, 2009.

The following discussion should be read in conjunction with our unaudited consolidated financial statements and the related notes that appear in Part I, Item 1, "Financial Statements," of this quarterly report. Our unaudited consolidated financial statements are stated in United States Dollars and are prepared in accordance with United States Generally Accepted Accounting Principles. The following discussion and analysis covers the Company's consolidated financial condition at December 31, 2009 (unaudited) and June 30, 2009, the end of its prior fiscal year, and its unaudited consolidated results of operation for the three and six month periods ended December 31, 2009 and 2008.

Use of Terms

Except as otherwise indicated by the context, all references in this Quarterly Report to (i) the "Group," the "Company," "we," "us" or "our" are to China Precision Steel, Inc., a Delaware corporation, and its direct and indirect subsidiaries; (ii) "PSHL" are to our subsidiary Partner Success Holdings Limited, a BVI company; (iii) "Blessford International" are to PSHL's subsidiary Blessford International Limited, a BVI company; (iv) "Shanghai Blessford" are to Blessford International's subsidiary Shanghai Blessford Alloy Company Limited, a PRC company; (v) "Chengtong" are to PSHL's subsidiary Shanghai Chengtong Precision Strip Company Limited, a PRC company; (vi) "Tuorong" are to PSHL's subsidiary Shanghai Tuorong Precision Strip Company Limited, a PRC company; (vii) "SEC" are to the United States Securities and Exchange Commission; (viii) "Securities Act" are to the Securities Act of 1933, as amended; (ix) "Exchange Act" are to the Securities Exchange Act of 1934, as amended; (x) "RMB" are to Renminbi, the legal currency of China; (xi) "U.S. dollar," "USD," "US\$" and "\$" are to the legal currency of the United States; (xii) "China," "Chinese" "PRC" are to the People's Republic of China; and (xiii) "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 the PRC through our wholly-owned operating subsidiaries, Chengtong and Shanghai Blessford, which are wholly owned subsidiaries of our direct subsidiary, PSHL. Our products are sold domestically in the PRC as well as in overseas markets such as Thailand, Nigeria and Ethiopia. We intend to further expand into additional overseas markets in the future, subject to suitable market conditions and favorable regulatory controls.

Second Quarter Financial Performance Highlights

During the second fiscal quarter of 2010, we saw robust growth in demand for our cold rolled steel products as market sentiment gradually improved towards the end of calendar year 2009, but at the same time we continued to see lower average selling prices compared to same period a year ago. We have seen gradually increasing demand and orders from existing customers, especially in the low-carbon cold-rolled steel segment and the high-carbon cold-rolled steel segment, due to favorable policies and 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. Our two cold-rolling mills are currently operating at approximately 70% utilization rate due to reduced orders on hand. As of December 31, 2009, we have completed the construction of our 3rd cold rolling mill which will commence production during the third fiscal quarter of 2010.

During the three months ended December 31, 2009, we sold a total of 35,588 tons of products, an increase of 20,726 tons from 14,862 tons during the same period a year ago, due to increase in demand in a gradually improving market. We believe that such increase was mainly caused by increases in demand from the auto and home appliance products due to government subsidies to encourage consumer spending in these segments during the period ended December 31, 2009. Increased volume and sales have led to a gross profit of \$3,635,955 and a net profit of \$2,589,437 for the three months ended December 31, 2009.

Due to the nature of our niche segment and high-end products, we have been able to keep quality customers and negotiate new contracts with a total of 3 new customers during the current period. Management continues to be in talks with potential customers whose past orders we had been unable to fill due to full capacity. If these talks are successful, we could see additional sales from a broadened customer base which would mitigate the impact of the global slowdown on our business and results of operations. Total company backlog as of December 31, 2009 was \$23,907,238.

We also continue to take appropriate actions to perform business and credit reviews of customers and suppliers and reduce exposure by avoiding entry into contracts with countries or 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 across all product segments, and adverse impacts on our gross margins due to lower steel prices 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 R&D and expand to new segments, customers and markets.

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

- **Revenues:** Our revenues were approximately \$27.0 million for the second quarter, an increase of 53.7% from last year.

- Gross Margin: Gross margin was 13.5% for the second quarter, as compared to 19.6% last year.
- Income/(loss) from operations before tax: Income from operations before tax was approximately \$2.6 million for the second quarter, as compared to loss from operations before tax of \$2.3 million last year.
- Net Income/(loss): Net income was approximately \$2.6 million for the second quarter, as compared to a net loss of approximately \$2.0 million last year.

- Fully diluted Income/(loss) per share: Fully diluted income per share was \$0.06 for the second quarter compared to a fully diluted loss per share of \$0.04 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 December 31, | | | | Six Months Ended December 31, | | | |
|--|---------------------------------|---------------|----------------|---------------|-------------------------------|---------------|---------------|---------------|
| | 2009 | | 2008 | | 2009 | | 2008 | |
| | Amount | % of Revenues | Amount | % of Revenues | Amount | % of Revenues | Amount | % of Revenues |
| Revenues | \$ 27,013,838 | 100.0 | \$ 17,573,959 | 100.0 | \$ 44,055,827 | 100.0 | \$ 42,924,378 | 100.0 |
| Cost of sales (including depreciation and amortization) | 23,377,883 | 86.5 | 14,122,622 | 80.4 | 39,716,513 | 90.2 | 35,520,383 | 82.8 |
| Gross profit | 3,635,955 | 13.5 | 3,451,337 | 19.6 | 4,339,314 | 9.8 | 7,403,995 | 17.2 |
| Selling and marketing expenses | 70,605 | 0.3 | 1,122,532 | 6.4 | 102,414 | 0.2 | 1,333,830 | 3.1 |
| Administrative expenses | 654,041 | 2.4 | 578,105 | 3.3 | 1,232,739 | 2.8 | 1,040,205 | 2.4 |
| Allowance for bad and doubtful debts | 101,067 | 0.4 | 3,829,462 | 21.8 | 218,184 | 0.5 | 3,829,462 | 8.9 |
| Depreciation and amortization expense | 36,755 | 0.1 | 33,318 | 0.2 | 80,493 | 0.2 | 59,521 | 0.1 |
| Total operating expenses | 862,468 | 3.2 | 5,563,417 | 31.7 | 1,633,830 | 3.7 | 6,263,018 | 14.6 |
| Income/(loss) from operations | 2,773,487 | 10.3 | (2,112,080) | (12.0) | 2,705,484 | 6.1 | 1,140,977 | 2.7 |
| Other revenues | 91,041 | 0.3 | 138,998 | 0.8 | 110,963 | 0.3 | 259,701 | 0.6 |
| Interest and finance costs | (275,091) | (1.0) | (320,777) | (1.8) | (503,434) | (1.1) | (648,182) | (1.5) |
| Total other (expense) | (184,050) | (0.7) | (181,779) | (1.0) | (392,471) | (0.9) | (388,481) | (0.9) |
| Income/(loss) before income taxes | 2,589,437 | 9.6 | (2,293,859) | (13.1) | 2,313,013 | 5.3 | 752,496 | 1.8 |
| Income tax (benefit) | - | - | (318,878) | (0.2) | (1,233) | <(0.1) | (148,257) | (0.3) |
| Net income/(loss) | \$ 2,589,437 | 9.6 | \$ (1,974,981) | (11.0) | \$ 2,314,246 | 5.3 | \$ 900,753 | 2.1 |
| Basic earnings/(loss) per share | \$ 0.06 | | \$ (0.04) | | \$ 0.05 | | \$ 0.02 | |
| | \$ 0.06 | | \$ (0.04) | | \$ 0.05 | | \$ 0.02 | |

Diluted
earnings/(loss)
per share

Comparison of Three Months Ended December 31, 2009 and December 31, 2008

Sales Revenues

Sales volume increased by 20,726 tons, or 139%, period-on-period to 35,588 tons for the three months ended December 31, 2009 from 14,862 tons for the three months ended December 31, 2008 and, as a result, sales revenues increased by \$9,439,879, or 54%, period-on-period to \$27,013,838 for the three months ended December 31, 2009 from \$17,573,959 for the three months ended December 31, 2008. The increase in sales revenues during the three months ended December 31, 2009 is mainly attributable to increase in demand for high-carbon cold-rolled products used in automobile components production as well as increase in demand for low-carbon cold-rolled products used in home appliances production both 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 December 31, 2009 and 2008 is as follows:

| Product Category | Quantity (tons) | Three Months Ended December 31, 2009 | | 2008 | | Period-on- period Qty. Variance | |
|----------------------------|--------------------|---|---------------|---------------|-------------------|---------------------------------------|---------------|
| | | \$ Amount | % of Sales | \$ Amount | % of Sales | | |
| Low carbon hard rolled | 4,453 | 3,520,889 | 13 | 11,755 | 13,238,537 | 75 | (7,302) |
| Low carbon cold-rolled | 16,627 | 11,303,581 | 42 | 1,834 | 2,107,484 | 12 | 14,793 |
| High-carbon hot-rolled | 1,440 | 1,236,831 | 5 | 861 | 903,754 | 5 | 579 |
| High-carbon cold-rolled | 7,167 | 7,402,355 | 27 | 196 | 168,782 | 1 | 6,971 |
| Subcontracting income | 5,901 | 3,256,866 | 12 | 216 | 49,110 | <1 | 5,685 |
| Sales of scrap metal | - | 293,316 | 1 | — | 1,106,292 | 6 | - |
| Total | 35,588 | 27,013,838 | 100 | 14,862 | 17,573,959 | 100 | 20,726 |

There were different trends of demand across various product categories during the three months ended December 31, 2009. High-carbon cold-rolled steel products accounted for 27% of the current sales mix at an average selling price of \$1,033 per ton for the three months ended December 31, 2009, compared to 1% of the sales mix at an average selling price per ton of \$861 for the three months ended December 31, 2008. The products in this category are mainly used in the automobile industry and the increase in sales volume period-on-period was a result of the Chinese government's automobile stimulus policies. Low-carbon cold-rolled steel products accounted for 42% of the current sales mix at an average selling price of \$680 per ton for the three months ended December 31, 2009, compared to 12% of the sales mix at an average selling price per ton of \$1,149 for the three months ended December 31, 2008. The robust increase in demand in this category during the period was a direct result of increased orders of steel used in the production of home appliances due to subsidies granted by the Chinese government to encourage consumer spending. Low-carbon hard-rolled steel products accounted for 13% of the current sales mix at an average selling price of \$791 per ton for the three months ended December 31, 2009, compared to 75% of the sales mix at an average selling price per ton of \$1,126 for the three months ended December 31, 2008, due to a sharp decrease in demand and volatilities in pricing in the international market period-on-period, as a result of the global slowdown and favorable currency movements for competitors' products. Subcontracting income revenues increased to \$3,256,866, or 12%, of the sales mix for the three months ended December 31, 2009, as compared to \$49,110, or less than 1%, of the sales mix for the three months ended December 31, 2008.

| Average Selling Prices | Three Months Ended December 31, | | Variance | |
|-------------------------|---------------------------------|--------------|----------|------|
| | 2009 (\$) | 2008 (\$) | (\$) | (%) |
| Low-carbon hard rolled | 791 | 1,126 | (335) | (30) |
| Low-carbon cold-rolled | 680 | 1,149 | (469) | (41) |
| High-carbon hot-rolled | 859 | 1,050 | (191) | (18) |
| High-carbon cold-rolled | 1,033 | 861 | 172 | 20 |
| Subcontracting income | 552 | 227 | 325 | 143 |

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

The average selling price per ton decreased to \$759 for the three months ended December 31, 2009, compared to the corresponding period in 2008 of \$1,182, representing a decrease of \$423, or 36%, period-on-period. This decrease was mainly due to decreases in general steel prices and therefore selling prices due to volatilities in the industry. Other than for high-carbon cold rolled steel products and subcontracting work, there were decreases in average selling prices across all product categories during the period.

Sales Breakdown by Major Customer

| Customers | Three Months Ended December 31, | | 2008 | |
|--|---------------------------------|------------|------------|------------|
| | 2009 | 2009 | 2008 | 2008 |
| | \$ | % of Sales | \$ | % of Sales |
| Shanghai Shengdejia Metal Products Co., Ltd. | 6,468,783 | 24 | * | * |
| Shanghai Changshuo Stainless Steel Co., Ltd. | 4,626,449 | 17 | 1,140,227 | 7 |
| Hangzhou Cogeneration Co., Ltd. | 1,906,610 | 7 | * | * |
| Shaoxing Wancheng Metal Plate Co., Ltd. | 1,819,561 | 7 | * | * |
| Marubeni-Itochu Steel Inc. | 1,126,107 | 4 | 1,626,006 | 9 |
| Salzgitter Mannesmann International GMBH | * | * | 11,257,852 | 64 |
| Zhangjiagang Gangxing Innovative Construction Material Co., Ltd. | * | * | 336,980 | 2 |
| Coutinho and Ferrostaal GMBH | * | * | 351,887 | 2 |
| | 15,947,510 | 59 | 14,712,952 | 84 |
| Others | 11,066,328 | 41 | 2,861,007 | 16 |
| Total | 27,013,838 | 100 | 17,573,959 | 100 |

* Not major customers for the relevant periods

Sales revenues generated from our top five major customers as a percentage of total sales decreased to 59% for the three months ended December 31, 2009, compared to 84% for the three months ended December 31, 2008. Sales to three new major customers, Shanghai Shengdejia Metal Products Co., Ltd., Hangzhou Cogeneration Co., Ltd., and Shaoxing Wancheng Metal Plate Co, Ltd. accounted for 38% of our sales revenues for the three months. 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 \$9,255,261, or 65.5%, period-on-period to \$23,377,883 for the three months ended December 31, 2009, from \$14,122,622 for the three months ended December 31, 2008. Cost of sales represented 86.5% of sales revenues for the three months ended December 31, 2009, compared to 80.4% for the three months ended December 31, 2008. Average cost per unit sold decreased to \$657 for the three months ended December 31, 2009, compared to an average cost per unit sold of \$950 for the three months ended December 31, 2008, representing an decrease of \$293 per ton, or 30.9%, period-on-period.

| | Three Months Ended December 31, | | | |
|-------------------------------------|---------------------------------|------------|-----------|--------|
| | 2009 | 2008 | Variance | |
| | (\$) | (\$) | (\$) | (%) |
| Cost of goods sold | | | | |
| - Raw materials | 20,501,079 | 11,339,712 | 9,161,367 | 80.8 |
| - Direct labor | 161,579 | 261,110 | (99,531) | (38.1) |
| - Manufacturing overhead | 2,715,225 | 2,521,800 | 193,425 | 7.7 |
| | 23,377,883 | 14,122,622 | 9,255,261 | 65.5 |
| Cost per unit sold | | | | |
| Total units sold (tons) | 35,588 | 14,862 | 20,726 | 139 |
| Average cost per unit sold (\$/ton) | 657 | 950 | (293) | (30.9) |

The decrease in average per unit cost of sales is represented by the combined effect of:

- a decrease in cost of raw materials per unit sold of \$187, or 24.5%, from \$763 for the three months ended December 31, 2008 compared to \$576 for the three months ended December 31, 2009;
- a decrease in direct labor per unit sold of \$13, or 72.2%, from \$18 for the three months ended December 31, 2008 compared to \$5 for the three months ended December 31, 2009;
- a decrease in factory overhead per unit sold of \$94, or 55.3%, from \$170 for the three months ended December 31, 2008 compared to \$76 for the three months ended December 31, 2009.

The cost of raw materials consumed increased by \$9,161,367, or 80.8%, period-on-period, to \$20,501,079 for the three months ended December 31, 2009 from \$11,339,712 for the three months ended December 31, 2008. This increase was a direct result of increased number of units sold offset by decrease in average raw material cost per unit sold.

Direct labor costs decreased by \$99,531, or 38.1%, period-on-period, to \$161,579 for the three months ended December 31, 2009, from \$261,110 for the three months ended December 31, 2008. The decrease was a result of effective labor management and decreased overtime payments during the period.

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

Manufacturing overhead costs increased by \$193,425, or 7.7%, period-on-period, to \$2,715,225 for the three months ended December 31, 2009, from \$2,521,800 for the three months ended December 31, 2008. The increase was mainly attributable to the combined effect of an increase in utilities of \$328,409, or 67.6%, period-on-period to \$814,525 for the three months ended December 31, 2009, from \$486,116 for the three months ended December 31, 2008, and a decrease in low consumables by \$139,117, or 23.9%, period-on-period to \$442,797 for the three months ended December 31, 2009, from \$581,914 for the three months ended December 31, 2008.

Gross Profit

Gross profit in absolute terms increased by \$184,618, or 5.3%, period-on-period, to \$3,635,955 for the three months ended December 31, 2009, from \$3,451,337 for the three months ended December 31, 2008, while gross profit margin decreased to 13.5% for the three months ended December 31, 2009, from 19.6% for the three months ended December 31, 2008. The decrease in gross profit margin is mainly attributable to a 35.8% period-on-period decrease in average selling prices, offset by a decrease in average cost per unit sold of 30.9% period-on-period.

Selling Expenses

Selling expenses decreased by \$1,051,927, or 93.7%, period-on-period, to \$70,605 for the three months ended December 31, 2009 compared to the corresponding period in 2008 of \$1,122,532. The decrease was a direct result of decreased export sales period-on-period and therefore less selling commission costs associated.

Administrative Expenses

Administrative expenses increased by \$75,936, or 13.1%, period-on-period, to \$654,041 for the three months ended December 31, 2009 compared to \$578,105 for the three months ended December 31, 2008. This was chiefly due to an increase in salaries and wages due to the increased average number of staff at the Group companies, as well as an increase in stock and listing fees and travelling expenses during the three months ended December 31, 2009.

Allowance for Bad and Doubtful Debts

Allowance for bad and doubtful debts decreased by \$3,728,395, or 97.4%, period-on-period. The prior period charge reflects a provision for uncollectible accounts receivable amounting to \$3,829,462 due to a dispute regarding a special stainless steel product as disclosed in our Form 10-K filed for the financial year ended June 30, 2009. Allowance recognized for the current period was in the amount of \$101,067 in accordance with our policy for allowance for bad and doubtful debts set forth under the "Critical Accounting Policies and Estimates" heading in this report.

Income/(loss) from Operations

Income from operations before income tax increased by \$4,885,567, or 231.3%, period-on-period to income of \$2,773,487 for the three months ended December 31, 2009 from a loss of \$2,112,080 for the three months ended December 31, 2008, as a result of all the factors discussed above.

Other Income

Our other income decreased \$47,957, or 34.5%, to \$91,041 for the three months ended December 31, 2009 from \$138,998 for the three months ended December 31, 2008 due to lower interest rates period-on-period. As a percentage of revenues, other income decreased to 0.3% for the three months ended December 31, 2009 from 0.8% for the three months ended December 31, 2008 due to higher revenue and lower interest income during the current period.

Interest Expense

Total interest expense decreased \$45,686, or 14.2%, to \$275,091 for the three months ended December 31, 2009, from \$320,777 for the three months ended December 31, 2008 due to a lower weighted average interest rate offset by increase in loan balances period-on-period, as well as interest amounting to \$137,140 being capitalized to construction-in-progress for the period.

Income Tax

For the three months ended December 31, 2009, we recognized an income tax expense of nil, compared to an income tax benefit of \$318,878 for the three months ended December 31, 2008 as Chengtong had tax losses carried forward from prior periods and Shanghai Blessford was exempted from income tax as of December 31, 2009.

Net Income/(loss)

Net income increased by \$4,564,418, or 231.1%, period-on-period, to a net income of \$2,589,437 for the three months ended December 31, 2009 from net loss of \$1,974,981 for the three months ended December 31, 2008. The increase in net income is attributable to a combination of factors discussed above, including increase in tons sold due to strengthening in demand offset by a decrease in average selling prices due to lower steel prices.

Comparison of Six Months Ended December 31, 2009 and December 31, 2008

Sales Revenues

Sales volume increased by 18,804 tons, or 48.1%, period-on-period to 57,881 tons for the six months ended December 31, 2009 from 39,077 tons for the six months ended December 31, 2008 and as a result, sales revenues increased by \$1,131,449, or 2.6%, period-on-period to \$44,055,827 for the six months ended December 31, 2009 from \$42,924,378 for the six months ended December 31, 2008. The increase in sales revenues period-on-period is mainly attributable to an increase in demand for high-carbon cold-rolled products used in automobile components production as well as increase in demand for low-carbon cold-rolled products used in home appliances production both 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 six months ended December 31, 2009 and 2008 is as follows:

| Product Category | Quantity (tons) | Six Months Ended December 31, | | Quantity (tons) | 2008 | | Period-on- period Qty. Variance |
|----------------------------|--------------------|-------------------------------|---------------|--------------------|-------------------|---------------|---------------------------------------|
| | | 2009 \$ Amount | % of Sales | | \$ Amount | % of Sales | |
| Low carbon hard rolled | 9,012 | 6,584,452 | 15.0 | 15,376 | 17,388,885 | 40.5 | (6,364) |
| Low carbon cold-rolled | 27,260 | 17,660,685 | 40.1 | 12,642 | 13,092,059 | 30.5 | 14,618 |
| High-carbon hot-rolled | 3,422 | 2,793,319 | 6.3 | 2,273 | 2,822,122 | 6.6 | 1,149 |
| High-carbon cold-rolled | 9,664 | 11,721,415 | 26.6 | 2,795 | 3,614,759 | 8.4 | 6,869 |
| Subcontracting income | 8,523 | 4,904,501 | 11.1 | 5,991 | 4,728,603 | 11.0 | 2,532 |
| Sales of scrap metal | - | 391,455 | 0.9 | — | 1,277,950 | 3.0 | - |
| Total | 57,881 | 44,055,827 | 100 | 39,077 | 42,924,378 | 100 | 18,804 |

There were different trends of demand across various product categories during the six months ended December 31, 2009. High-carbon cold-rolled steel products accounted for 26.6% of the current sales mix at an average selling price of \$1,213 per ton for the six months ended December 31, 2009, compared to 8.4% of the sales mix at an average selling price per ton of \$1,293 for the six months ended December 31, 2008. The products in this category are mainly used in the automobile industry and the increase in sales volume period-on-period was a result of the Chinese government's automobile stimulus policies, which increased demand. Low-carbon cold-rolled steel products accounted for 40.1% of the current sales mix at an average selling price of \$648 per ton for the six months ended December 31, 2009, compared to 30.5% of the sales mix at an average selling price per ton of \$1,036 for the six months ended

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

December 31, 2008. The increase in demand in this category during the period was a result of increased orders of steel used in the production of home appliances due to subsidies granted by the Chinese government to encourage consumer spending. Low-carbon hard-rolled steel products accounted for 15.0% of the current sales mix at an average selling price of \$731 per ton for the six months ended December 31, 2009, compared to 40.5% of the sales mix at an average selling price per ton of \$1,131 for the six months ended December 31, 2008, due to a sharp decrease in demand and volatilities in pricing in the international market period-on-period, as a result of the global slowdown and favorable currency movements for competitors' products. Subcontracting income revenues was at a similar level of \$4,904,501, or 11.1% of the sales mix for the six months ended December 31, 2009 as compared to \$4,728,603, or 11.0%, of the sales mix for the six months ended December 31, 2008.

| Average Selling Prices | Six Months Ended December 31, | | | |
|-------------------------|-------------------------------|--------------|------------------|--------|
| | 2009 (\$) | 2008 (\$) | Variance (\$) | (%) |
| Low-carbon hard rolled | 731 | 1,131 | (400) | (35.4) |
| Low-carbon cold-rolled | 648 | 1,036 | (388) | (37.5) |
| High-carbon hot-rolled | 816 | 1,242 | (426) | (34.3) |
| High-carbon cold-rolled | 1,213 | 1,293 | (80) | (6.2) |
| Subcontracting income | 575 | 789 | (214) | (27.1) |

The average selling price per ton decreased to \$761 for the six months ended December 31, 2009, compared to the corresponding period in 2008 of \$1,098, representing a decrease of \$337, or 30.7%, period-on-period. This decrease was mainly due to decreases in steel prices and therefore selling prices due to volatilities in the industry. There were decreases in average selling prices across all product categories during the period.

Sales Breakdown by Major Customer

| Customers | Six Months Ended December 31, | | 2008 | |
|--|-------------------------------|------------|------------|------------|
| | 2009 | 2009 | 2008 | 2008 |
| | \$ | % of Sales | \$ | % of Sales |
| Shanghai Changshuo Stainless Steel Co., Ltd. | 8,473,414 | 19 | 4,555,411 | 11 |
| Shanghai Shengdejia Metal Products Co., Ltd. | 6,465,502 | 15 | * | * |
| Shaoxing Wancheng Metal Plate Co., Ltd. | 3,587,461 | 8 | * | * |
| Zhangjiagang Gangxing Innovative Construction Material Co., Ltd. | 2,857,042 | 6 | 1,864,414 | 4 |
| Hangzhou Cogeneration Co., Ltd. | 2,269,786 | 5 | * | * |
| Salzgitter Mannesmann International GMBH | * | * | 13,651,071 | 32 |
| Jiangsu Sumec International Trading Co., Ltd. | * | * | 3,217,647 | 7 |
| Shanghai Bayou Industrial Co., Ltd. | * | * | 2,961,644 | 7 |
| | 23,653,205 | 53 | 26,250,187 | 61 |
| Others | 20,402,622 | 47 | 16,674,191 | 39 |
| Total | 44,055,827 | 100 | 42,924,378 | 100 |

* Not major customers for the relevant periods

Sales revenues generated from our top five major customers as a percentage of total sales decreased to 53% for the six months ended December 31, 2009, compared to 61% for the six months ended December 31, 2008. Sales to two new major customers, Shaoxing Wancheng Metal Plate Co, Ltd. and Shanghai Shengdejia Metal Products Co., Ltd., for the six months accounted for 23% 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 \$4,196,130, or 11.8%, period-on-period to \$39,716,513 for the six months ended December 31, 2009, from \$35,520,383 for the six months ended December 31, 2008. Cost of sales represented 90.2% of sales revenues for the six months ended December 31, 2009, compared to 82.8% for the six months ended December 31, 2008. Average cost per unit sold decreased to \$686 for the six months ended December 31, 2009, compared to an average cost per unit sold of \$909 for the six months ended December 31, 2008, representing an decrease of \$223 per ton, or 24.5%, period-on-period.

| | Six Months Ended December 31, | | | |
|--------------------------|-------------------------------|------------|-----------|--------|
| | 2009 | 2008 | Variance | |
| | (\$) | (\$) | (\$) | (%) |
| Cost of goods sold | | | | |
| - Raw materials | 34,807,381 | 30,597,181 | 4,210,200 | 13.8 |
| - Direct labor | 212,473 | 380,350 | (167,877) | (44.1) |
| - Manufacturing overhead | 4,696,659 | 4,542,852 | 153,807 | 3.4 |
| | 39,716,513 | 35,520,383 | 4,196,130 | 11.8 |

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

| | | | | |
|-------------------------------------|--------|--------|--------|------|
| Cost per unit sold | | | | |
| Total units sold (tons) | 57,881 | 39,077 | 18,804 | 48.1 |
| Average cost per unit sold (\$/ton) | 686 | 909 | (223) | (25) |

The decrease in average per unit cost of sales is represented by the combined effect of:

29

- a decrease in cost of raw materials per unit sold of \$182, or 23.2%, from \$783 for the six months ended December 31, 2008 compared to \$601 for the six months ended December 31, 2009;
- a decrease in direct labor per unit sold of \$6, or 60.0%, from \$10 for the six months ended December 31, 2008 compared to \$4 for the six months ended December 31, 2009;
- a decrease in factory overhead per unit sold of \$35, or 30.2%, from \$116 for the six months ended December 31, 2008 compared to \$81 for the six months ended December 31, 2009.

The cost of raw materials consumed increased by \$4,210,200, or 13.8%, period-on-period, to \$34,807,381 for the six months ended December 31, 2009 from \$30,597,181 for the six months ended December 31, 2008. This increase was mainly due to increase in total units sold offset by decrease in average raw material cost per unit sold.

Direct labor costs decreased by \$167,877 or 44.1%, period-on-period, to \$212,473 for the six months ended December 31, 2009, from \$380,350 for the six months ended December 31, 2008. The decrease was due to effective labor management and thus a decrease in direct labor cost per unit sold of \$6.

Manufacturing overhead costs increased by \$153,807, or 3.4%, period-on-period, to \$4,696,659 for the six months ended December 31, 2009, from \$4,542,852 for the six months ended December 31, 2008. The increase was mainly attributable to the combined effect of an increase in packaging materials of \$681,629, or 419.7%, period-on-period to \$844,027 for the six months ended December 31, 2009, from \$162,398 for the six months ended December 31, 2008 offset by a decrease in low consumables by \$525,421, or 42.5%, period-on-period to \$709,565 for the six months ended December 31, 2009, from \$1,234,986 for the six months ended December 31, 2008.

Gross Profit

Gross profit in absolute terms decreased by \$3,064,681, or 41.4%, period-on-period, to \$4,339,314 for the six months ended December 31, 2009, from \$7,403,995 for the six months ended December 31, 2008, while gross profit margin decreased to 9.8% for the six months ended December 31, 2009, from 17.2% for the six months ended December 31, 2008. The decrease in gross profit margin is mainly attributable to a 30.7% period-on-period decrease in average selling prices, offset by a decrease in average cost per unit sold of 24.5% period-on-period.

Selling Expenses

Selling expenses decreased by \$1,231,416, or 92.3%, period-on-period, to \$102,414 for the six months ended December 31, 2009 compared to the corresponding period in 2008 of \$1,333,830. The decrease was mainly attributable to less selling commission costs associated with largely reduced export sales period-on-period.

Administrative Expenses

Administrative expenses increased by \$192,534, or 18.5%, period-on-period, to \$1,232,739 for the six months ended December 31, 2009 compared to \$1,040,205 for the six months ended December 31, 2008. This was chiefly due to an increase in salaries and wages due to the increased average number of staff at the Group companies, as well as an increase in insurance, stock and listing fees and travelling expenses during the six months ended December 31, 2009.

Allowance for Bad and Doubtful Debts

Allowance for bad and doubtful debts decreased by \$3,611,278, or 94.3%, period-on-period. The prior period charge reflects a provision for uncollectible accounts receivable amounting to \$3,829,462 due to a dispute regarding a special

stainless steel product as disclosed in our Form 10-K filed for the financial year ended June 30, 2009. Allowance recognized for the current period was in the amount of \$218,184 in accordance with our policy for allowance for bad and doubtful debts set forth under the “Critical Accounting Policies and Estimates” heading in this report.

Income from Operations

Income from operations before income tax increased by \$1,564,507, or 137.1%, period-on-period to income of \$2,705,484 for the six months ended December 31, 2009 from income of \$1,140,977 for the six months ended December 31, 2008, as a result of all the factors discussed above.

Other Income

Our other income decreased \$148,738, or 57.3%, to \$110,963 for the six months ended December 31, 2009 from \$259,701 for the six months ended December 31, 2008. As a percentage of revenues, other income decreased to 0.3% for the six months ended December 31, 2009 from 0.6% for the six months ended December 31, 2008. Such percentage decrease in other income was primarily due to lower interest rates period-on-period.

Interest Expense

Total interest expense decreased \$144,748, or 22.3%, to \$503,434 for the six months ended December 31, 2009, from \$648,182 for the six months ended December 31, 2008 due to an increase in loan balances offset by a lower weighted average interest rate period-on-period, as well as interest amounting to \$260,690 being capitalized to construction-in-progress for the period.

Income Tax

For the six months ended December 31, 2009, we recognized an income tax benefit of \$1,233, compared to \$148,257 for the six months ended December 31, 2008. The income tax benefit in the amount of \$1,233 was carried forward from the three months ended September 30, 2009. No additional income tax expenses were recognized for the current period as Chengtong had tax losses carried forward from prior periods and Shanghai Blessford was exempted from income taxes as of December 31, 2009.

Net Income

Net income increased by \$1,413,493, or 156.9%, period-on-period, to net income of \$2,314,246 for the six months ended December 31, 2009 compared to net income of \$900,753 for the six months ended December 31, 2008. The increase in net income is attributable to a combination of factors discussed above, including an increase in tons sold due to strengthening demand offset by a decrease in average selling prices due to lower steel 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 December 31, 2009, we had cash and cash equivalents of approximately \$13 million.

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

CASH FLOW

Six Months Ended December 31,

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

| | 2009 | 2008 |
|---|-------------|--------------|
| Net cash provided by operating activities | \$ 552,633 | \$ 8,663,138 |
| Net cash (used in) investing activities | (4,746,139) | (12,954,497) |
| Net cash provided by financing activities | 3,290,769 | 182,295 |
| Net cash flow | (897,299) | (3,805,177) |

31

Operating Activities

Net cash flows provided by operating activities for the six months ended December 31, 2009 was \$552,633 as compared with \$8,663,138 provided by operating activities for the six months ended December 31, 2008, for a net decrease of \$8,110,505. This decrease was mainly due to increase in cash outflow for inventories of \$8,447,098, increase in cash outflow for advances to suppliers of \$3,492,171 and increase in cash outflow for other taxes payable of \$1,809,655 resulting from the payment of VAT offset by increase in cash inflow from accounts receivable of \$3,388,265 during the period ended December 31, 2009. The cash outflow for inventories and advances to suppliers was in line with our revenue growth and increased orders on hand during the six months ended December 31, 2009.

For the six months ended December 31, 2009, sales revenues generated from the top five major customers as a percentage of total sales decreased to 53% as compared to 61% for the six months ended December 31, 2008. 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 worldwide economic crisis 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 six months ended December 31, 2009 were for the purchase of property, plant and equipment related to the addition of a new cold rolling mill and annealing furnaces at our Shanghai Blessford facilities. We believe these capital investments increase our capacity, expand product line, improve product qualities and create synergies with our existing production facilities, thereby creating opportunities to grow sales, enter new markets and further strengthen our leading position in the niche cold rolling segment that we operate in.

Net cash flows used in investing activities for the six months ended December 31, 2009 was \$4,746,139 as compared with \$12,954,497 for the six months ended December 31, 2008. Cash flows used in investing activities decreased as we worked towards the completion of construction related to the new 1450mm cold rolling mill and annealing furnaces and there was no additional material construction project during the period.

As of December 31, 2009, the Company had \$916,069 in commitments for capital expenditures for construction projects mentioned above. Management believes that we currently have sufficient capital resources to meet these contractual commitments. We have completed the installation of the new mill and expect to complete trial production by February 2010. We also forecast lower capital expenditures in the coming years as the Company has already completed most of its major expansion plans and the majority of the construction costs relating to our third cold rolling mill have been paid for as at December 31, 2009.

Financing Activities

Net cash flows provided by financing activities for the six months ended December 31, 2009 was \$3,290,769 as compared to \$182,295 for the six months ended December 31, 2008. During the six months ended December 31, 2009, the Company received short-term loan proceeds of \$3,735,169, which was partially offset by repayment of short-term loans in the amount of \$444,400.

On December 30, 2008, we filed a universal shelf registration statement with the SEC, which was declared effective on December 10, 2009. The shelf registration will permit us to issue securities valued at up to an aggregate of \$40 million. Now that the registration statement is effective, we will have 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 current bank debt that is due in July 2010, 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 increased by \$1,285,851, or 1.5%, period-on-period to \$85,317,602 as of December 31, 2009, from \$84,031,751 as of June 30, 2009, principally as a result of an increase in inventories of \$8,874,466, or 54.5%, and advances to suppliers of \$613,783, or 2.8%, period-on-period, offset by a decrease in bills receivable of \$5,813,752, or 94.8%, period-on-period and accounts receivable of \$1,615,978 or 6.4%, period-on-period.

Accounts receivable, representing 27.6% of total current assets as of December 31, 2009, 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 December 31, 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 based on due date as of December 31, 2009 and June 30, 2009:

| | | | December 31, 2009 | | | | |
|--------------|-------------------|-------------------|-------------------|------------------|------------------|-----------------|----------------|
| US\$ | Total | Current | 1 to 30 days | 31 to 90 days | 91 to 180 days | 181 to 360 days | over 1 year |
| TOTAL | 24,531,828 | 13,558,568 | 2,336,292 | 2,313,955 | 5,210,379 | 209,989 | 902,645 |
| % | 100 | 55 | 10 | 9 | 21 | 1 | 4 |
| | | | June 30, 2009 | | | | |
| US\$ | Total | Current | 1 to 30 days | 31 to 90 days | 91 to 180 days | 181 to 360 days | over 1 year |

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

| | | | | | | | |
|-------|------------|------------|---------|-----------|-----------|-----------|---------|
| TOTAL | 25,970,961 | 14,497,258 | 405,769 | 1,639,027 | 7,061,774 | 2,168,481 | 198,652 |
| % | 100 | 56 | 2 | 6 | 27 | 8 | 1 |

33

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. For example, we have halted all our sales transactions directly with customers in the Philippines as we consider the associated credit risk to be relatively high. Based on publicly available reports, such as that issued by A.M. Best, there is a high risk that financial volatility may erupt in that country due to inadequate reporting standards, a weak banking system or asset markets and/or poor regulatory structure. We expect to resume such exports when conditions improve. Management is also of the opinion that we do not currently have any high risk receivables on our accounts.

Current Liabilities

Current liabilities increased by \$19,925, or 0.05%, period-on-period, to \$42,825,577 as of December 31, 2009, from \$42,805,652 as of June 30, 2009. The increase was mainly attributable to an increase in short-term loans of \$3,302,957, or 14.7%, period-on-period, as well as an increase in advances from customers of \$1,043,436, or 59.9%, period-on-period, offset by a decrease in other taxes payable of \$3,728,962, or 56.1%, period-on-period.

As of December 31, 2009, we had \$25,791,988 in short-term loans. These short-term loans were renewed in July 2009 for one year and will be due on July 31, 2010. 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 six months ended December 31, 2009, we invested \$4,746,139 in purchases of property, plant and equipment, and construction projects in relation to the new cold-rolling mill and annealing furnaces.

Loan Facilities

The following table illustrates our credit facilities as of December 31, 2009, providing the name of the lender, the amount of the facility, the date of issuance and the maturity date:

| Lender | Date of Loan | Maturity Date | Duration | Interest Rate | Principal Amount |
|--|--------------|---------------|----------|--|--|
| Raiffeisen Zentralbank Österreich AG (“RZB”) | July 7, 2009 | July 31, 2010 | 1 year | USD: SIBOR + 3%; RMB: 1.15 times of the PBOC rate | \$5,300,000; \$2,475,290 (RMB17,000,000) |
| Raiffeisen Zentralbank Österreich AG | July 7, 2009 | July 31, 2010 | 1 year | 1.15 times of the PBOC rate | \$18,016,698 (RMB123,000,000) |
| Total | | | | | \$ 25,791,988 |

As of December 31, 2009, we had \$25,791,988 in short-term loans as illustrated in the above table. The above loans carry an interest rate of 1.15 times of the standard market rate set by the People’s Bank of China, or PBOC, for Renminbi loans and at SIBOR plus 3% for USD loans, and are secured by land use rights, buildings, plant and machineries, and guaranteed by PSHL and our Chairman, Mr. Li Wo Hing.

We are not aware of any existing issues that may lead to a withdrawal of these loans that are due and renewable in July 2010. Our inability to renew, and the unavailability of debt financing due to credit market conditions 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 December 31, 2009, the Company also had \$916,069 in contractual commitments for capital expenditures related to the expansion of our production facilities. 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 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 December 31, 2009, short-term debt obligations include one year projected interest at weighted average interest rate:

| | Total | Payments Due by Period | | | |
|-----------------------------|----------------------|------------------------|------------------------|------------------------|-----------------------------|
| | | Fiscal Year 2010 | Fiscal Years 2011-2012 | Fiscal Years 2012-2013 | Fiscal Year 2014 and Beyond |
| Contractual obligations | | | | | |
| Short-Term Debt Obligations | \$ 27,207,968 | \$ 27,207,968 | \$ - | \$ - | \$ - |
| Construction Commitments | 916,069 | 916,069 | - | - | - |
| TOTAL | \$ 28,124,037 | \$ 28,124,037 | \$ - | \$ - | \$ - |

Recent Accounting Pronouncements

In December 2007, the FASB issued guidance now codified as FASB ASC 805, “Business Combinations” (“ASC 805”). ASC 805 will change the accounting for business combinations. Under ASC 805, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. ASC 805 will change the accounting treatment and disclosure for certain specific items in a business combination. ASC 805 applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. ASC 805 will impact the Company in the event of any future acquisition.

In December 2007, the FASB issued guidance now codified as ASC 810, “Non-controlling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51”. ASC 810 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. ASC 810 is effective for fiscal years beginning on or after December 15, 2008. The Company does not believe that ASC 810 will have a material impact on its consolidated financial statements.

In April 2008, the FASB issued guidance now codified as ASC 350-30, “Determination of the Useful Life of Intangible Assets” (“ASC 350-30”), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under ASC 350, “Goodwill and Other Intangible Assets” (“ASC 350”). The intent of this guidance is to improve the consistency between the useful life of a recognized intangible asset under ASC 350 and the period of expected cash flows used to measure the fair value of the asset under ASC 805, “Business Combinations,” and other U.S. generally accepted accounting principles. This guidance is effective for fiscal years beginning after December 15, 2008 (the Company’s fiscal year 2010), and interim periods within those fiscal years. The Company does not believe the adoption of ASC 350-30 will have a material impact on the Company’s consolidated financial position, results of operations and cash flows.

In May 2008, the FASB issued guidance now codified as ASC 944-20, “Accounting for Financial Guarantee Insurance Contracts” (“ASC 944-20”). The new standard clarifies how FASB Statement No. 60, now codified as ASC 944-20, “Accounting and Reporting by Insurance Enterprises”, applies to financial guarantee insurance contracts issued by insurance enterprises, including the recognition and measurement of premium revenue and claim liabilities. It also requires expanded disclosures about financial guarantee insurance contracts. ASC 944-20 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years, except for disclosures about the insurance enterprise’s risk-management activities, which are effective the first period (including interim periods) beginning after May 23, 2008. Except for the required disclosures, earlier application is not permitted. The standard is not applicable to this Company.

In October 2008, the FASB issued guidance now codified as ASC 820-10, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active” (“ASC 820-10”). This guidance clarifies the application of FASB Statement No. 157, now codified as ASC 820-10, “Fair Value Measurements”, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. ASC 820-10 was effective upon issuance. The adoption of ASC 820-10 will not impact our consolidated financial statements in any material respect.

In December 2008, the FASB issued guidance now codified as ASC 715-20-65, “Employers’ Disclosures about Postretirement Benefit Plan Assets, an amendment of FASB Statement No. 132” (revised 2003), now codified as ASC 715-20-65. It provides guidance on an employer’s disclosures about plan assets, including: how investment allocation decisions are made and factors that are pertinent to an understanding of investment policies and strategies; the major categories of plan assets; the inputs and valuation techniques used to measure the fair value of plan assets; the effect of fair value measurements using significant unobservable inputs (level 3) on changes in plan assets for the period, and significant concentrations of risks within plan assets. ASC 715-20-65 is effective for fiscal years ending after December 15, 2009. We are currently assessing the potential impact that adoption of this standard may have on our financial statements.

In April 2009, the FASB issued guidance now codified as ASC 825, “Interim Disclosures about Fair Value of Financial Instruments”. It requires the fair value for all financial instruments within the scope of SFAS No. 107, now codified as ASC 825, “Disclosures about Fair Value of Financial Instruments”, to be disclosed in the interim periods as well as in annual financial statements. This standard is effective for the quarter ending after June 15, 2009. The adoption of ASC 825 will not impact our consolidated financial statements in any material respect.

In April 2009, the FASB issued guidance now codified as ASC 820-10, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly”. It clarifies the objective and method of fair value measurement even when there has been a significant decrease in market activity for the asset being measured. This standard is effective for the quarter ending after June 15, 2009. The adoption of ASC 825 will not impact our consolidated financial statements in any material respect.

In April 2009, the FASB issued guidance now codified as ASC 320, “Recognition and Presentation of Other-Than-Temporary Impairments”. The objective of an other-than-temporary impairment analysis under existing U.S. GAAP is to determine whether the holder of an investment in a debt or equity security for which changes in fair value are not regularly recognized in earnings (such as securities classified as held-to-maturity or available-for-sale) should recognize a loss in earnings when the investment is impaired. An investment is impaired if the fair value of the investment is less than its amortized cost basis. This guidance amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. We are currently assessing the potential impact that adoption of this standard may have on our financial statements.

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. The Company is currently evaluating whether this standard will have an impact on the Company consolidated 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 are currently evaluating the impact on our financial statements of adopting these amendments to ASC 605 and cannot estimate the impact of adoption at this time.

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 are currently evaluating the impact on our financial statements of adopting the amendments in ASU 2009-15 and cannot estimate the impact of adoption at this time.

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 are 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. 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. The Company is currently evaluating whether this standard will have an impact on the Company consolidated 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.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires our management to make assumptions, estimates and judgments that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. We consider our critical accounting policies to be those that require the more significant judgments and estimates in the preparation of financial statements, including the following:

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 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.

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.

Accounts Receivable

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 end product manufacturers. The business cycle is relatively long, as well as 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.

Accounts receivable is recorded at the time revenue is recognized and is stated net of 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. At December 31, 2009, approximately 13% of our accounts receivable were past due over 180 days. To reserve for potentially uncollectible accounts receivable, for the period ended December 31, 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. At December 31 and June 30, 2009, the Company had \$1,006,973 and \$830,127 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 periods ended December 31, 2009 and 2008 were \$218,184 and \$3,829,462, respectively. The current period 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.

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 don't provide allowances against advances paid to 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 material 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. At December 31 and June 30, 2009, the

Company had allowances for advances to suppliers of \$1,632,442 and \$1,631,557, respectively.

The majority of our advances to suppliers of over 180 days is attributable to our advances to a subsidiary of a state-owned company in China, whose risk of default is minimal. At December 31, 2009, this supplier has confirmed to our management that it is committed to delivering the contracted raw materials as and when those are needed by the Company.

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 for the suppliers to deliver the contracted raw materials or refund the cash advances. To date we have not written off any advances to suppliers.

Inventory

Inventory is 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.

Intangible Assets

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. The Company acquired land use rights in August 2004 and December 2006 that both expire in December 2056. The land use rights are amortized over a fifty-year term. Intangible assets of the Company are reviewed for impairment if 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. An impairment test was performed as of December 31, 2009 and no impairment charges were recognized for the relevant periods. As of December 31, 2009, the Company expects these assets to be fully recoverable.

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:

| | |
|---------------------|---------------|
| Buildings | 10 years |
| Plant and machinery | 10 years |
| Motor vehicles | 5 years |
| Office equipment | 5 to 10 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.

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. We determine such impairment by measuring the estimated undiscounted future cash flow generated by the assets, comparing the result to the asset carrying value and adjusting the asset to the lower of its carrying value or fair value and charging current operations for the measured impairment. Where the recoverable amount of any property, plant and equipment is determined to have declined below its carrying amount, the carrying amount is reduced to reflect the decline in value. We performed an impairment test as of December 31, 2009, using a normal and a worse-case scenario, and assessed fair value based on average tons sold, selling price per ton, gross margin, and other cash inflows and outflows for the next ten years where our mills are expected to remain in operation. No impairment charges were recognized for the relevant year. Assumptions and estimates used in our impairment test provide the general direction of major factors expected to affect our business and cash flows, and are subject to risks and uncertainties such as changes in interest rates, industry cyclicality, and factors surrounding the general Chinese and global economies. Those estimates will be reassessed for their reasonableness at each impairment test.

Other Policies

Other accounting policies used by the Company are set forth in the notes accompanying our financial statements.

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 third quarter is usually the slowest quarter because fewer projects are undertaken during and around the Chinese New Year holidays.

Off-Balance Sheet Arrangements

For the period ended December 31, 2009, we did not have any off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of 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. Wo Hing Li, 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 December 31, 2009. Based on our assessment, Mr. Li and Ms. Li determined that, as of December 31, 2009, 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 Control Over Financial Reporting

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.

SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of security holders during the period covered by this report, through the solicitation of proxies or otherwise.

40

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 |
|-------------|---|
| 10.1 | Senior Loan Agreement, dated January 29, 2010, between Shanghai Blessford Alloy Co., Ltd. and DEG – Deutsche Investitions und Entwicklungsgesellschaft MBH. |
| 31.1 | Certifications of Principal Executive Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 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. |

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: February 16, 2010

CHINA PRECISION STEEL, INC.

By: /s/ Wo Hing Li
Wo Hing Li, 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)

EXHIBIT INDEX

| Exhibit No. | Description |
|-------------|---|
| 10.1 | Senior Loan Agreement, dated January 29, 2010, between Shanghai Blessford Alloy Co., Ltd. and DEG – Deutsche Investitions und Entwicklungsgesellschaft MBH. |
| 31.1 | Certifications of Principal Executive Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 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. |