

China Precision Steel, Inc.  
Form 10-Q  
May 15, 2013

**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: March 31, 2013

**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** **14-1623047**  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) 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 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 May 7, 2013 is as follows:

| Class of Securities             | Shares Outstanding |
|---------------------------------|--------------------|
| Common Stock, \$0.001 par value | 3,880,866          |

**CHINA PRECISION STEEL, INC.**

*Quarterly Report on Form 10-Q*

*Three and Nine Months Ended March 31, 2013*

TABLE OF CONTENTS

|   | <b>Pages</b> |
|---|--------------|
| <b><u>PART I</u></b>  |              |
| <b><u>FINANCIAL INFORMATION</u></b>   | 3            |
| ITEM 1. <u>FINANCIAL STATEMENTS.</u>  | 3            |
| ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.</u> | 4            |
| ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.</u>                            | 18           |
| ITEM 4. <u>CONTROLS AND PROCEDURES.</u>   | 18           |
| <b><u>PART II</u></b>   |              |
| <b><u>OTHER INFORMATION</u></b>   |              |
| ITEM 1. <u>LEGAL PROCEEDINGS.</u>   | 19           |
| ITEM 1A. <u>RISK FACTORS.</u>   | 19           |
| ITEM 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.</u>                           | 19           |
| ITEM 3. <u>DEFAULTS UPON SENIOR SECURITIES.</u>   | 19           |
| ITEM 4. <u>MINE SAFETY DISCLOSURES.</u>   | 19           |
| ITEM 5. <u>OTHER INFORMATION.</u>   | 19           |
| ITEM 6. <u>EXHIBITS.</u>  | 20           |
| <u>SIGNATURES</u>   | 21           |

PART I

FINANCIAL INFORMATION

**ITEM 1. FINANCIAL STATEMENTS.**

**CHINA PRECISION STEEL, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2013 AND 2012**

**INDEX TO FINANCIAL STATEMENTS**

|   | <b>Page(s)</b> |
|---|----------------|
| <u>Consolidated Balance Sheets (unaudited)</u>                                    | F-1            |
| <u>Consolidated Statements of Operations and Comprehensive Income (unaudited)</u> | F-2            |
| <u>Consolidated Statements of Changes in Stockholders' Equity (unaudited)</u>     | F-3            |
| <u>Consolidated Statements of Cash Flows (unaudited)</u>                          | F-4            |
| <u>Notes to Consolidated Financial Statements (unaudited)</u>                     | F-5            |

**China Precision Steel, Inc. and Subsidiaries****Consolidated Balance Sheets****(Unaudited)**

|  | Notes | March 31,<br>2013     | June 30, 2012         |
|--|-------|-----------------------|-----------------------|
| <b>Assets</b>  |       |                       |                       |
| <b>Current assets</b>  |       |                       |                       |
| Cash and cash equivalents  |       | \$ 162,273            | \$ 1,602,805          |
| Accounts receivable  |       |                       |                       |
| Trade, net of allowances of \$23,320,482 and \$3,231,613 at March 31, 2013 and June 30, 2012, respectively               |       | 38,473,081            | 59,116,931            |
| Bills receivable   |       | 25,256                | 173,089               |
| Other  |       | 936,795               | 1,117,243             |
| Inventories  | 6     | 20,559,566            | 15,516,220            |
| Prepaid expenses   |       | 582,129               | 668,867               |
| Advances to suppliers, net of allowance of \$4,726,554 and \$4,623,323 at March 31, 2013 and June 30, 2012, respectively | 7     | 37,858,418            | 37,384,684            |
| <b>Total current assets</b>  |       | <b>98,597,518</b>     | <b>115,579,839</b>    |
| <b>Property, plant and equipment</b>   |       |                       |                       |
| Property, plant and equipment, net   | 8     | 62,419,482            | 67,752,991            |
| Construction-in-progress   | 9     | 245,692               | 233,512               |
|  |       | 62,665,174            | 67,986,503            |
| Intangible assets, net   | 10    | 1,890,829             | 1,880,129             |
| Goodwill   |       | 99,999                | 99,999                |
| <b>Total assets</b>  |       | <b>\$ 163,253,520</b> | <b>\$ 185,546,470</b> |
| <b>Liabilities and Stockholders' Equity</b>  |       |                       |                       |
| <b>Current liabilities</b>   |       |                       |                       |
| Short-term loans   | 11    | \$ 27,673,871         | \$ 27,246,477         |
| Long-term loan - current portion   | 12    | 16,200,000            | 16,200,000            |
| Accounts payable and accrued liabilities   |       | 9,989,856             | 6,772,892             |
| Advances from customers  |       | 2,746,107             | 2,253,956             |
| Other taxes payables   |       | 8,088,623             | 8,446,373             |
| Current income taxes payable   |       | 5,917,694             | 5,756,178             |

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

|   |    |                |                |
|---|----|----------------|----------------|
| Total current liabilities   |    | 70,616,151     | 66,675,876     |
| Long-term loans   | 12 | -              | -              |
| Stockholders' equity:   |    |                |                |
| Preferred stock: \$0.001 per value, 8,000,000 shares authorized, no shares outstanding at March 31, 2013 and June 30, 2012, respectively          | 13 | -              | -              |
| Common stock: \$0.001 par value, 62,000,000 shares authorized, 3,880,866 issued and outstanding at March 31, 2013 and June 30, 2012, respectively | 13 | 3,880          | 3,880          |
| Additional paid-in capital  | 13 | 75,685,066     | 75,685,066     |
| Accumulated other comprehensive income  |    | 21,458,253     | 19,097,295     |
| Retained (deficit)/earnings   |    | (4,509,830 )   | 24,084,353     |
| Total stockholders' equity  |    | 92,637,369     | 118,870,594    |
| Total liabilities and stockholders' equity  |    | \$ 163,253,520 | \$ 185,546,470 |

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

**China Precision Steel, Inc. and Subsidiaries****Consolidated Statements of Operations and Comprehensive Income****For the Three and Nine Months Ended March 31, 2013 and 2012****(Unaudited)**

|   | Notes | Three Months Ended |                | Nine Months Ended |                |
|---|-------|--------------------|----------------|-------------------|----------------|
|   |       | 2013               | 2012           | 2013              | 2012           |
| Sales revenues                            |       | \$8,563,497        | \$29,494,865   | \$22,684,524      | \$105,324,043  |
| Cost of goods sold                        |       | 10,938,804         | 30,612,073     | 27,828,738        | 108,178,198    |
| Gross (loss)                              |       | (2,375,307 )       | (1,117,208 )   | (5,144,214 )      | (2,854,155 )   |
| Operating expenses                        |       |                    |                |                   |                |
| Selling expenses                          |       | 31,901             | 63,734         | 86,237            | 172,223        |
| Administrative expenses                   |       | 576,091            | 781,221        | 1,420,503         | 2,007,777      |
| Allowance for bad and doubtful debts      |       | 9,665,828          | 522,118        | 19,825,042        | 522,118        |
| Depreciation and amortization expense     |       | 51,742             | 54,173         | 155,753           | 162,610        |
| Total operating expenses                  |       | 10,325,562         | 1,421,246      | 21,487,535        | 2,864,728      |
| (Loss) from operations                    |       | (12,700,869)       | (2,538,454 )   | (26,631,749)      | (5,718,883 )   |
| Other income/(expense)                    |       |                    |                |                   |                |
| Other revenues                            |       | 70,743             | 20,434         | 678,500           | 89,505         |
| Interest and finance costs                |       | (857,269 )         | (794,895 )     | (2,640,934 )      | (2,273,473 )   |
| Total other (expense)                     |       | (786,526 )         | (774,461 )     | (1,962,434 )      | (2,183,968 )   |
| (Loss) from operations before income tax  |       | (13,487,395)       | (3,312,915 )   | (28,594,183)      | (7,902,851 )   |
| Provision for income tax                  | 14    |                    |                |                   |                |
| Current                                   |       | -                  | 108            | -                 | 27,189         |
| Total income tax expense                  |       | -                  | 108            | -                 | 27,189         |
| Net (loss)                                |       | \$(13,487,395)     | \$(3,313,023 ) | \$(28,594,183)    | \$(7,930,040 ) |
| Basic (loss) per share                    | 15    | \$(3.48 )          | \$(0.85 )      | \$(7.37 )         | \$(2.04 )      |
| Basic weighted average shares outstanding |       | 3,880,866          | 3,880,866      | 3,880,866         | 3,880,866      |
| Diluted (loss) per share                  | 15    | \$(3.48 )          | \$(0.85 )      | \$(7.37 )         | \$(2.04 )      |



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

|   |                |                |                |                |
|---|----------------|----------------|----------------|----------------|
| Diluted weighted average shares outstanding | 3,880,866      | 3,880,866      | 3,880,866      | 3,880,866      |
| Components of comprehensive (loss)/income:  |                |                |                |                |
| Net (loss)                                  | \$(13,487,395) | \$(3,313,023 ) | \$(28,594,183) | \$(7,930,040 ) |
| Other comprehensive income:                 |                |                |                |                |
| Foreign currency translation adjustment     | 168,529        | 185,979        | 2,360,958      | 3,456,634      |
| Comprehensive (loss)                        | \$(13,318,866) | \$(3,127,044 ) | \$(26,233,225) | \$(4,473,406 ) |

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

F-2

**China Precision Steel, Inc. and Subsidiaries****Consolidated Statements of Changes in Stockholders' Equity****For the Nine Months Ended March 31, 2013****(Unaudited)**

|   | Ordinary Shares |          | Additional   | Accumulated   | Retained           | Total          |
|---|-----------------|----------|--------------|---------------|--------------------|----------------|
|   | Share           | Amount   | Paid-in      | Other         | Earnings/(deficit) | Stockholders'  |
|   |                 |          | Capital      | Comprehensive |                    | Equity         |
|   |                 |          |              | Income        |                    |                |
| Balance at June 30, 2012                | 3,880,866       | \$ 3,880 | \$75,685,066 | \$ 19,097,295 | \$ 24,084,353      | \$ 118,870,594 |
| Foreign currency translation adjustment | -               | -        | -            | 2,360,958     | -                  | 2,360,958      |
| Net loss                                | -               | -        | -            | -             | (28,594,183 )      | (28,594,183 )  |
| Balance at March 31, 2013               | 3,880,866       | \$ 3,880 | \$75,685,066 | \$ 21,458,253 | \$ (4,509,830 )    | \$ 92,637,369  |

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

**China Precision Steel, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****For the Nine Months Ended March 31, 2013 and 2012**

|  | 2013           | 2012          |
|--|----------------|---------------|
| Cash flows from operating activities   |                |               |
| Net (loss)   | \$(28,594,183) | \$(7,930,040) |
| Adjustments to reconcile net income to net cash provided by operating activities |                |               |
| Depreciation and amortization  | 6,876,606      | 6,763,799     |
| Gain on disposal of property, plant and equipment                                | -              | (36,945 )     |
| Allowance for bad and doubtful debts   | 19,825,042     | 522,118       |
| Inventory provision  | -              | 636,405       |
| Net changes in assets and liabilities:   |                |               |
| Accounts receivable  | 2,304,215      | (3,448,433)   |
| Inventories  | (4,696,893 )   | (3,416,954)   |
| Prepaid expenses   | 94,093         | (86,378 )     |
| Advances to suppliers  | 412,483        | 2,365,370     |
| Accounts payable and accrued expenses  | 3,071,081      | 3,343,901     |
| Advances from customers  | 441,823        | 4,088,100     |
| Other taxes payable  | (546,344 )     | (144,398 )    |
| Current income taxes   | 32,989         | -             |
| Net cash (used in)/provided by operating activities                              | (779,088 )     | 2,656,545     |
| Cash flows from investing activities   |                |               |
| Purchase of property, plant and equipment, including construction in progress    | (120,079 )     | (365,568 )    |
| Purchases of intangible assets   | (2,724 )       | -             |
| Proceeds from disposal of property, plant and equipment                          | -              | 55,933        |
| Net cash (used in) investing activities  | (122,803 )     | (309,635 )    |
| Cash flows from financing activities   |                |               |
| Repayments of short-term loans   | (542,696 )     | -             |
| Repayments of long-term loan   | -              | (2,874,740)   |
| Net cash (used in) financing activities  | (542,696 )     | (2,874,740)   |
| Effect of exchange rate  | 4,055          | 64,685        |
| Net (decrease) in cash   | (1,440,532 )   | (463,145 )    |
| Cash and cash equivalents, beginning of period                                   | 1,602,805      | 2,707,754     |

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

|  |           |             |
|--|-----------|-------------|
| Cash and cash equivalents, end of period | \$162,273 | \$2,244,609 |
|--|-----------|-------------|

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

F-4

**China Precision Steel, Inc.**

**Notes to the Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

China Precision Steel, Inc. (the “Company,” “CPSL” or “we”) is a steel processing company principally engaged in the manufacture and sale of cold-rolled precision steel products for downstream applications including automobile components and spare parts, kitchen tools, electrical appliances, roofing and food packaging materials. Raw materials, hot-rolled steel coils, will go through certain reduction, heating and cutting processing procedures to give steel coils or plates different thickness and specifications for deliveries in accordance with customers’ requirements. Specialty precision steel offers specific control of thickness, shape, width, surface finish and other special quality features that compliment the need for highly engineered end use applications. Precision steel pertains to the precision of measurements and tolerances of the above factors, especially thickness tolerance.

We have five wholly-owned subsidiaries, Partner Success Holdings Limited (“PSHL”), Blessford International Limited (“Blessford International”), Shanghai Chengtong Precision Strip Company Limited (“Chengtong”), Shanghai Blessford Alloy Company Limited (“Shanghai Blessford”) and Shanghai Tuorong Precision Strip Company Limited (“Tuorong”). The Company’s principal activities are conducted through our two operating subsidiaries, Chengtong and Shanghai Blessford with manufacturing facilities located in Shanghai, the People’s Republic of China (the “PRC”). The sole activity of Tuorong is the ownership of land use rights with respect to facilities utilized by Chengtong and Shanghai Blessford. PSHL and Blessford International are both British Virgin Islands companies with the sole purpose of investment holding.

**2. Basis of Preparation of Financial Statements**

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

In June and July 2012, the Company defaulted on the repayment obligations of its short-term and long-term bank loans totaling \$43,873,871. Each of the banks also have the right to take possession of the collateral (which collectively constitute substantial assets of the Company) granted in connection with their respective loan agreements,

which action would have a material adverse impact on the Company. The Company is currently in discussions with its banks regarding the restructuring of these loans for repayment but has not yet agreed on specific terms. There can be no assurance that the Company will be able to successfully work out a repayment plan or otherwise fulfill its obligations under the loans. The uncertainty surrounding the successful restructuring of our bank loans and our current lack of readily available liquidity provided by other third party sources raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

The accompanying unaudited consolidated financial statements as of March 31, 2013 and for the periods ended March 31, 2013 and 2012 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 nine months ended March 31, 2013 are not necessarily indicative of the results to be expected for the full year ending June 30, 2013.

### **3. Summary of Significant Accounting Policies**

The following is a summary of significant accounting policies:

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

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

**Allowance for Doubtful Accounts** – The Company maintains an allowance for doubtful accounts based on its assessment of the collectability of the accounts receivable. Management determines the collectability of outstanding accounts by maintaining regular communication with such customers and obtaining confirmation of their intent to fulfill their obligations to the Company. Management also considers past collection experience, our relationship with customers and the impact of current economic conditions on our industry and market. However, we note that the continuation or intensification of the current global economic crisis may have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations. To reserve for potentially uncollectible accounts receivable, management has made a 50% provision for all accounts receivable that are over 180 days past due and full provision for all accounts receivable over 1 year past due. From time to time, we will review these credit periods, along with our collection experience and the other factors discussed above, to evaluate the adequacy of our allowance for doubtful accounts, and to make changes to the allowance, if necessary. If our actual collection experience or other conditions change, revisions to our allowances may be required, including a further provision which could adversely affect our operating income, or write back of provision when estimated uncollectible accounts are actually collected. At March 31, 2013 and June 30, 2012, the Company had \$23,320,482 and \$3,231,613 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. There was a provision for accounts receivable bad debts of \$9,665,828 and \$19,825,042 recognized for the three and nine months ended March 31, 2013, respectively. There was a provision for accounts receivable bad debts of \$522,118 recognized for the three and nine months ended March 31, 2012.

**Inventories** – Inventories are stated at the lower of cost or market. Cost is determined using the weighted average method. Cost of inventories comprises all costs of purchases, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Costs of conversion of inventories include fixed and variable production overheads, taking into account the stage of completion.

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

**Advances to Suppliers** – In order to ensure a steady supply of raw materials, the Company is required to regularly 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 when the advance purchase contracts are entered into. Advances to suppliers are shown net of an allowance which represents potentially unrecoverable cash advances at each balance sheet date. Such allowances are based on an analysis of past raw materials receipt experience and the credibility of each supplier according to its size and background. In general, we do not provide allowances against advances paid to those PRC state-owned companies as there is minimal risk of default. Our allowances for advances to suppliers are subjective critical estimates that have a direct impact on reported net earnings, and are reviewed quarterly at a minimum to reflect changes from our historic raw materials receipt experience and to ensure the appropriateness of the allowance in light of the circumstances present at the time of the review. It is reasonably possible that the Company's estimate of the allowance will change, such as in the case when the Company becomes aware of a supplier's inability to deliver the contracted raw materials or meet its financial obligations. As of March 31, 2013 and June 30, 2012, the Company had made allowances of advances to suppliers of \$4,726,554 and \$4,623,323, respectively.



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

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

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

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

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

**Impairment of Long-Lived Assets** – The Company accounts for impairment of property, plant and equipment and amortizable intangible assets in accordance with ASC Topic No. 360 “Property, Plant and Equipment” (“ASC 360”), which requires the Company to evaluate a long-lived asset for recoverability when there is an event or circumstance that indicates the carrying value of the asset may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset or asset group is not recoverable (when carrying amount exceeds the gross, undiscounted cash flows from use and disposition) and is measured as the excess of the carrying amount over the asset’s (or asset group’s) fair value.

**Capitalized Interest** – The Company capitalizes interest cost on borrowings incurred during the new construction or upgrade of qualified assets. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. During the three and nine months ended March 31, 2013 and 2012, the Company capitalized \$nil interest to construction-in-progress.

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

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

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

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

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

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

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

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 calendar year than in the first half of the calendar year and the first quarter of the calendar year is usually the slowest quarter because fewer projects are undertaken during and around the Chinese New Year holidays.

**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 a tax rate of 34%. No provision for income taxes in the United States has been made as China Precision Steel, Inc. had no taxable income in fiscal years 2012 and

2011.

At March 31, 2013 and June 30, 2012, the Company had no unrecognized income tax positions recorded. The Company does not expect its unrecognized tax positions to change significantly in the next twelve months. If unrecognized tax positions existed, the interest and penalties related to the unrecognized tax positions would be recorded as income tax expense in the consolidated statements of operation and comprehensive income.

The Company is subject to United States federal income taxes, as well as income taxes in various states and foreign jurisdictions. The Company's tax years 2010 through 2012 remain open to examination for U.S. federal income taxes. With few exceptions, the Company is no longer subject to state or non-U.S. income tax examinations prior to 2010.

#### 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.

#### PRC

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

F-8

*Enterprise income tax*

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

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

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

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

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

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax benefits as of March 31, 2013 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 March 31, 2013, 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.

F-9

*Value added tax*

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

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

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

**Retirement Benefit Costs** – According to the PRC regulations on pension, Chengtong and Shanghai Blessford contribute to a defined contribution retirement scheme organized by municipal government in the province in which Chengtong and Shanghai Blessford were registered and all qualified employees are eligible to participate in the scheme. Contributions to the scheme are calculated at 37% of the employees' salaries above a fixed threshold amount and the employees contribute 11%, while Chengtong and Shanghai Blessford contribute the balance contribution of 26%. The Group has no other material obligation for the payment of retirement benefits beyond the annual contributions under this scheme.

For the nine months ended March 31, 2013 and 2012, the Company's pension cost charged to the statements of operations under the plan amounted to \$182,303 and \$199,975, respectively, all of which have been paid to the National Social Security Fund.

**Fair Value of Financial Instruments** – The carrying amounts of certain financial instruments, including cash, accounts receivable, other receivables, short-term loans, accounts payable, accrued expenses, and other payables approximate their fair values as at March 31, 2013 and June 30, 2012 because of the relatively short-term maturity of these instruments. The Company considers the carrying amount of long-term loans to approximate their fair values based on the interest rates of the instruments and the current market rate of interest.

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

#### 4. Concentrations of Business and Credit Risk

The Company's list of customers whose purchases from us were 10% or more of total sales during nine months ended March 31, 2013 and 2012 is as follows:

|   | 2013 |            | 2012       |            |
|---|------|------------|------------|------------|
|   | \$   | % of sales | \$         | % of sales |
| a. Customers                                    |      |            |            |            |
| Shanghai Shengdejia Metal Products Co., Ltd.    | - *  | - *        | 14,107,630 | 13         |
| Shanghai Changshuo Steel Co., Ltd.              | - *  | - *        | 12,068,785 | 11         |
| Hangzhou Cogeneration Import & Export Co., Ltd. | - *  | - *        | 11,204,723 | 11         |

*\* Not 10% customers for the relevant periods*



The Company's list of suppliers whose sales to us were 10% or more of total purchases during nine months ended March 31, 2013 and 2012 is as follows:

| b. Suppliers                                    | 2013      |                | 2012         |                |
|---|-----------|----------------|--------------|----------------|
|   | \$        | % of purchases | \$           | % of purchases |
| Wuxi Hangda Trading Co., Ltd.                   | 2,439,776 | 12             | 13,530,357   | 14             |
| Shanghai Tuoda Metal Co., Ltd.                  | 1,998,539 | 11             | -            | * - *          |
| Hebei Nuojin Steel Co., Ltd.                    | -         | * -            | * 22,800,704 | 24             |
| Dachang Huizu Baosheng Steel Products Co., Ltd. | -         | * -            | * 21,403,015 | 23             |
| Shanghai Piyun Steel Co., Ltd.                  | -         | * -            | * 11,142,163 | 12             |

\* Not 10% suppliers for the relevant periods

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

## 5. Accounts Receivable

The Company provides credit in the normal course of business. The Company performs ongoing credit evaluations of its domestic and international customers and clients and maintains allowances for bad and doubtful accounts based on factors surrounding the credit risk of specific customers and clients, historical trends, and other information. Trade accounts receivable, net totaled \$38,473,081 and \$59,116,931 as of March 31, 2013 and June 30, 2012, respectively.

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

**6. Inventories**

ASC 330-10-35, "Adjustments to Lower of Cost or Market", requires us to reduce the carrying value of inventory when there is evidence that the utility of goods will be less than cost, whether due to physical deterioration, obsolescence, changes in price levels or other causes. The Company recorded inventory write-downs in the amounts of \$nil and \$642,884 for the nine months ended March 31, 2013 and 2012, respectively. These amounts were recognized as a loss in each respective period.

As of March 31, 2013 and June 30, 2012, inventories consisted of the following:

| At cost:         | March 31,<br>2013 | June 30,<br>2012 |
|------------------|-------------------|------------------|
| Raw materials    | \$2,992,788       | \$1,711,735      |
| Work in progress | 2,138,399         | 1,064,229        |
| Finished goods   | 9,355,802         | 6,409,395        |
| Consumable items | 6,477,749         | 6,727,183        |
|                  | 20,964,738        | 15,912,542       |
| Less: provision  | (405,172 )        | (396,322 )       |
|                  | \$20,559,566      | \$15,516,220     |

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 \$7,029,769 (June 30, 2012: \$6,299,566) were pledged for short-term loans totaling \$19,605,714 at March 31, 2013 (June 30, 2012: \$19,354,534).

## 7. Advances to Suppliers

Cash advances are shown net of allowances of \$4,726,554 and \$4,623,323 at March 31, 2013 and June 30, 2012, respectively.

## 8. Property, Plant and Equipment

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

|                                | March 31,<br>2013 | June 30, 2012 |
|--------------------------------|-------------------|---------------|
| Plant and machinery            | \$78,848,255      | \$77,064,727  |
| Buildings                      | 23,961,479        | 23,438,143    |
| Motor vehicles                 | 666,144           | 651,595       |
| Office equipment               | 551,368           | 539,416       |
|                                | 104,027,246       | 101,693,881   |
| Less: Accumulated depreciation | (41,607,764 )     | (33,940,890 ) |
|                                | \$62,419,482      | \$67,752,991  |

Depreciation expense related to manufacturing is included as a component of cost of goods sold. During the nine months ended March 31, 2013 and 2012, depreciation totaling \$4,663,500 and \$4,543,995, respectively, was included as a component of cost of goods sold.

Plant and machinery amounting to \$31,818,925 (June 30, 2012: \$34,533,411) and \$17,956,101 (June 30, 2012: \$19,514,340) were pledged for short-term loans totaling \$27,673,871 and long-term loans including current portion totaling \$16,200,000, respectively, at March 31, 2013 (June 30, 2012: \$27,246,477 and \$16,200,000, respectively).

## 9. Construction-In-Progress

As of March 31, 2013 and June 30, 2012, construction-in-progress consisted of the following:

|                    | March<br>31, 2013 | June 30,<br>2012 |
|--------------------|-------------------|------------------|
| Construction costs | \$245,692         | \$233,512        |

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

## 10. Intangible Assets

Land use rights amounting to \$1,887,457 (June 30, 2012: \$1,877,363) were pledged for short-term loans totaling \$27,673,871 at March 31, 2013 (June 30, 2012: \$27,246,477).

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

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

## 11. Short-Term Loans

Short-term loans consisted of the following:

|  | March 31,<br>2013 | June 30,<br>2012 |
|--|-------------------|------------------|
| Loan dated June 29, 2011, due July 31, 2012, with an interest rate at 115% of the standard market rate set by the People's Bank of China ("PBOC") (6.9% at March 31, 2013) per annum (Notes 6 and 8) | \$8,068,157       | \$7,891,943      |
| Bank loan dated June 29, 2011, due July 31, 2012 with an interest rate at 115% of the standard market rate set by PBOC (6.9% at March 31, 2013) per annum (Notes 6, 8 and 10)                        | 19,605,714        | 19,354,534       |
|  | \$27,673,871      | \$27,246,477     |

The above bank loans outstanding at March 31, 2013 are Renminbi ("RMB") loans, carry an interest rate of 1.15 times the standard market rate set by the PBOC, and are secured by inventories, land use rights, buildings and plant and machinery, and guaranteed by PSHL and our former Chairman, Mr. Wo Hing Li. In addition, pursuant to a bank loan agreement entered into between the Company and Raiffeisen Zentralbank Osterreich AG ("RZB"), Mr. Li undertakes to maintain a shareholding percentage in the Company of not less than 33.4% unless otherwise agreed to with RZB.

The weighted-average interest rate on short-term loans at March 31, 2013 and 2012 was 6.9% and 7.54%, respectively. Principal and interest under the short-term loans totaling \$27,610,356 with RZB were to be repaid in full on July 31, 2012, but the Company has defaulted on this repayment obligation. The Company is currently in discussions with RZB regarding the restructuring of the loans for repayment but has not yet agreed on specific terms. Any restructuring will be subject to approval by RZB's governing bodies, and to the Company's ability to meet certain conditions and requirements that may be imposed by the Bank. RZB also has the right to take possession of the collateral granted in connection with their respective loan agreements, which action would have a material adverse impact on the Company.

As part of the ongoing discussions with RZB to potentially restructure our short-term loans, we have implemented and will continue to implement a series of measures to remain viable and improve overall profitability including expanding our customer base to increase total demand, strategizing our product mix to re-focus on our competitive advantage and niche capabilities including the ultra-thin low-carbon and high strength high-carbon products and, improve our production management and increase quality control, and continuing to carry out research and development ("R&D") to improve profitability of existing products and launch new high value-add products. The Company also made a partial repayment for its short-term loan from the deposit account held with RZB during the nine months ended March 31, 2013.

**12. Long-Term Loan – Current Portion**

|   | March 31,<br>2013 | June 30,<br>2012 |
|---|-------------------|------------------|
| Bank loan dated June 29, 2010, due June 15, 2016 with an interest rate of the London Interbank Offered Rate (“LIBOR”) plus 4.5% (4.96% at March 31, 2013) per annum (Noted 8) | \$16,200,000      | \$16,200,000     |

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

In June 2012, the Company has defaulted on its semi-annual principal and interest repayment obligation. The Company is currently in discussions with DEG regarding the restructuring of the loans for repayment but has not yet agreed on specific terms. Until such agreement is reached, DEG has the right to cancel the total outstanding commitment of the loan, demand immediate repayment of all or part of the loan with accrued interest, and/or terminate the loan agreement. DEG also has the right to take possession of the collateral granted in connection with its respective loan agreements, which action would have a material adverse impact on the Company.

### 13. Stockholders' Equity

#### *Reverse Stock Split*

In June 2012, the stockholders of the Company approved the authority of the Company's Board of Directors to effect a one-for-twelve reverse stock split of the Company's outstanding common stock. The reverse stock split became effective on August 27, 2012 and as a result of the reverse stock split, the issued and outstanding shares of the Company's common stock decreased to 3,880,866 shares, without any change in the par value of such shares. These consolidated financial statements and accompanying notes to the consolidated financial statements give retroactive effect to the reverse stock split for all periods presented.

#### *Stock Warrants*

On November 6, 2007, in connection with the Subscription Agreement, the Company issued to certain institutional accredited investors warrants to purchase 118,333 shares of Common Stock valued at \$5,374,748, and Roth Capital Partners, LLC, as placement agent, received warrants to purchase 18,800 shares of Common Stock valued at \$887,504. These amounts were recorded as syndication fees offsetting additional paid-in capital. Warrants issued to Roth Capital were not exercised and expired on November 5, 2010.

Information with respect to stock warrants outstanding is as follows:

| Exercise Price | Outstanding June 30, 2012 | Granted | Expired or Exercised | Outstanding March 31, 2013 | Expiration Date |
|----------------|---------------------------|---------|----------------------|----------------------------|-----------------|
| \$101.40       | 118,333                   | -0-     | -0-                  | 118,333                    | May 5, 2013     |

**14. Income Taxes**

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

The tax holiday resulted in tax savings as follows:

|                   | Nine months<br>ended<br>March 31 |        |
|-------------------|----------------------------------|--------|
|                   | 2013                             | 2012   |
| Tax savings       | \$-                              | \$-    |
| Benefit per share |                                  |        |
| Basic             | \$0.00                           | \$0.00 |
| Diluted           | \$0.00                           | \$0.00 |

Significant components of the Group's deferred tax assets and liabilities as of March 31, 2013 and June 30, 2012 are as follows:

| Deferred tax assets and liabilities:            | March 31,<br>2013 | June 30,<br>2012 |
|---|-------------------|------------------|
| Net operating loss carried forward              | \$6,847,443       | \$6,668,613      |
| Temporary differences resulting from allowances | 7,101,308         | 2,051,326        |
| Net deferred income tax asset                   | 13,948,751        | 8,719,939        |
| Valuation allowance                             | (13,948,751)      | (8,719,939)      |
|   | \$-               | \$-              |



The Company has not recognized a deferred tax liability as its foreign subsidiaries do not have any undistributed earnings as of March 31, 2013. A deferred tax liability will be recognized when the Company has undistributed earnings and no longer plans to permanently reinvest undistributed earnings.

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

|   | Nine months ended |               |
|---|-------------------|---------------|
|   | March 31          |               |
|   | 2013              | 2012          |
| Computed tax at the PRC statutory rate of 25% | \$(7,280,149)     | \$(2,018,204) |
| Valuation allowance                           | 2,230,154         | 2,018,190     |
| Expenses not deductible for tax               | 5,049,995         | 14            |
| Overprovision                                 | -                 | 27,189        |
| Income tax expense per books                  | \$-               | 27,189        |

Income tax expense consists of:

|   | Nine     |          |
|---|----------|----------|
|   | months   |          |
|   | ended    |          |
|   | March 31 |          |
|   | 2013     | 2012     |
|   |          |          |
| Income tax expense for the period – PRC | \$-      | \$27,189 |
| Deferred income tax benefit – PRC       | -        | -        |
| Income tax expense per books            | \$-      | \$27,189 |

## 15. (Loss) Per Share

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

For the three and nine months ended March 31, 2013, warrants to purchase 118,333 shares at an exercise price of \$101.40 were not included as their effect would have been anti-dilutive, however, securities represented by the 118,333 warrants still outstanding could potentially dilute basic earnings per share in the future.

For the three and nine months ended March 31, 2012, warrants to purchase 118,333 shares at an exercise price of \$101.40 were not included as their effect would have been anti-dilutive.

The following reconciles the components of the EPS computation:

|   | Income         | Shares        | Per<br>Share |
|---|----------------|---------------|--------------|
|   | (Numerator)    | (Denominator) | Amount       |
| For the three months ended March 31, 2013:        |                |               |              |
| Net loss  | \$(13,487,395) |               |              |
| Basic EPS loss available to common shareholders   | \$(13,487,395) | 3,880,866     | \$ (3.48 )   |
| Effect of dilutive securities:                    |                |               |              |
| Warrants  |                | -             |              |
| Diluted EPS loss available to common shareholders | \$(13,487,395) | 3,880,866     | \$ (3.48 )   |
| For the three months ended March 31, 2012:        |                |               |              |
| Net loss  | \$(3,313,023 ) |               |              |
| Basic EPS loss available to common shareholders   | \$(3,313,023 ) | 3,880,866     | \$ (0.85 )   |
| Effect of dilutive securities:                    |                |               |              |
| Warrants  |                | -             |              |
| Diluted EPS loss available to common shareholders | \$(3,313,023 ) | 3,880,866     | \$ (0.85 )   |

|   | Income<br>(Numerator) | Shares<br>(Denominator) | Per<br>Share<br>Amount |
|---|-----------------------|-------------------------|------------------------|
| For the nine months ended March 31, 2013:           |                       |                         |                        |
| Net loss  | \$(28,594,183)        |                         |                        |
| Basic EPS loss available to common shareholders     | \$(28,594,183)        | 3,880,866               | \$ (7.37 )             |
| Effect of dilutive securities:                      |                       |                         |                        |
| Warrants  |                       | -                       |                        |
| Diluted EPS loss available to common shareholders   | \$(28,594,183)        | 3,880,866               | \$ (7.37 )             |
| For the nine months ended March 31, 2012:           |                       |                         |                        |
| Net loss  | \$(7,930,040 )        |                         |                        |
| Basic EPS income available to common shareholders   | \$(7,930,040 )        | 3,880,866               | \$ (2.04 )             |
| Effect of dilutive securities:                      |                       |                         |                        |
| Warrants  |                       | -                       |                        |
| Diluted EPS income available to common shareholders | \$(7,930,040 )        | 3,880,866               | \$ (2.04 )             |

## 16. Contingencies and Commitments

### *Legal Proceedings*

The Company is subject to various legal proceedings and claims that have arisen in the ordinary course of business.

On March 15, 2012, the Company received notice of a complaint filed by a Mr. Haining Zhang and China Venture Partners, Inc. in the U.S. Southern District Court of New York on March 9, 2012, against several defendants, including the Company, as successor to OraLabs Holding Corp. In the complaint Mr. Zhang is alleging, among other things, breach of contract by the Company and certain of our former officers, directors and control persons, in connection with our December 2006 acquisition of Partner Success Holdings Limited. Among other things, Mr. Zhang alleges that the defendants breached an agreement to compensate him for services he allegedly performed in connection with seeking out a merger candidate for the Company. The Company believes that the suit is without merit and intends to vigorously defend its interests in the case. The Company was granted court permission to file a motion to dismiss the action as against it. Prior to filing the motion to dismiss, plaintiffs amended their complaint. Accordingly, the Company filed a motion to dismiss the amended complaint. On March 13, 2013, the Company's motions to dismiss were granted by the Court. The Plaintiff had the right to appeal within 30 days of the court decision, and a notice of appeal was filed on April 17, 2013. The Plaintiff has the obligation to prepare the record on appeal and have the same submitted to the Court of Appeals. We intend to file a notice to oppose such appeal. Although an estimate of any potential loss cannot be made at this time, the Company does not believe that its business or financial condition is materially adversely affected.

### *Capital Commitments*

As of March 31, 2013, the Company did not have any capital commitments (June 30, 2012: \$nil).

## **17. Impairment**

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

The assets are subject to impairment consideration under ASC 360-10-35-17 if events or circumstances indicate that their carrying amounts might not be recoverable. In accordance with ASC 360, as of March 31, 2013, as the Company's market capitalization was lower than the carrying value of its assets, management performed an impairment test pursuant to the guidance outlined in ASC 360-10-35-21 and no impairment charges were recognized for the relevant year. As of March 31, 2013, the Company expects these assets to be fully recoverable based on the result of the impairment test. Goodwill amounting to \$99,999 as at March 31, 2013 was considered immaterial and not tested for impairment in accordance with ASC 350.

## 18. Recent Accounting Pronouncements

In December 2011, the FASB issued ASU No. 2011-11, *Disclosures About Offsetting Assets and Liabilities*, (“ASU 2011-11”). The amendments in ASU 2011-11 require entities to disclose information about offsetting and related arrangements to enable users of financial statements to understand the effect of those arrangements on an entity’s financial position. The amendments require enhanced disclosures by requiring improved information about financial instruments and derivative instruments that are either (i) offset in accordance with current literature or (ii) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with current literature. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. This standard will become effective for the Company beginning July 1, 2013. The Company does not believe adoption of this new guidance will have a significant impact on its consolidated financial statements.

In July 2012, the FASB issued ASU No. 2012-02, *Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* (“ASU 2012-02”). ASU 2012-02 amends Topic 350 by establishing an optional two-step analysis for impairment testing of indefinite-lived intangibles other than goodwill. This update allows an entity the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. Under that option, an entity no longer would be required to calculate the fair value of the intangible asset unless the entity determines, based on that qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption is permitted. This standard will become effective for the Company beginning July 1, 2013. The Company does not believe adoption of this new guidance will have a significant impact on its consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, “Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income” (ASU No. 2013-02). Under ASU No. 2013-02, an entity is required to provide information about the amounts reclassified out of accumulated other comprehensive income (“AOCI”) by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU No. 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 became effective from January 1, 2013 and the new guidance did not have any material impact on the Company’s unaudited consolidated financial statements.

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

**Special Note Regarding Forward Looking Statements**

In addition to historical information, this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We use words such as “believe,” “expect,” “anticipate,” “project,” “target,” “plan,” “optimistic,” “intend,” “aim,” “will” or similar expressions which are intended to identify forward-looking statements. Such statements include, among others, those concerning market and industry segment growth and demand and acceptance of new and existing products; any projections of sales, earnings, revenue, margins or other financial items; any statements of the plans, strategies and objectives of management for future operations; and any statements regarding future economic conditions or performance, as well as all assumptions, expectations, predictions, intentions or beliefs about future events. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, as well as assumptions, which, if they were to ever materialize or prove incorrect, could cause the results of the Company to differ materially from those expressed or implied by such forward-looking statements. Potential risks and uncertainties include, among other things, factors such as: plans to expand our exports outside of China; plans to increase our production capacity and the anticipated dates that such facilities may commence operations; our ability to obtain additional funding for our continuing operations and to fund our expansion; our ability to meet our financial projections for any financial year; our ability to retain our key executives and to hire additional senior management; continued growth of the Chinese economy and industries demanding our products; our ability to secure at acceptable prices the raw materials we need to produce our products; political changes in China that may impact our ability to produce and sell our products in our target markets; general business conditions and competitive factors, including pricing pressures and product development; and changes in our relationships with customers and suppliers. You should carefully review the risk factors described in other documents we file from time to time with the U.S. Securities and Exchange Commission, including our Annual Report on Form 10-K for our fiscal year ended June 30, 2012.

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 unaudited consolidated financial condition at March 31, 2013 and June 30, 2012, the end of its prior fiscal year, and its unaudited consolidated results of operation for the three and nine months ended March 31, 2013 and 2012.

**Use of Terms**

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

“CPSL,” “Company,” “Group,” “we,” “us” or “our” are to China Precision Steel, Inc., a Delaware corporation, and its direct and indirect subsidiaries;

“PSHL” are to our subsidiary Partner Success Holdings Limited, a BVI company;

“Blessford International” are to our subsidiary Blessford International Limited, a BVI company;

“Shanghai Blessford” are to our subsidiary Shanghai Blessford Alloy Company Limited, a PRC company;

“Chengtong” are to our subsidiary Shanghai Chengtong Precision Strip Company Limited, a PRC company;

“Tuorong” are to our subsidiary Shanghai Tuorong Precision Strip Company Limited, a PRC company;

“China” and “PRC” are to the People’s Republic of China;

“BVI” are to the British Virgin Islands;

“SEC” are to the United States Securities and Exchange Commission;

“Securities Act” are to the Securities Act of 1933, as amended;

“Exchange Act” are to the Securities Exchange Act of 1934, as amended;

“RMB” are to Renminbi, the legal currency of China; and

“U.S. dollar,” “USD,” “US\$” and “\$” are to the legal currency of the United States.

## **Overview of the Company’s Business**

We are a 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 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 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 micro electronics.

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

To remodel our business to make it sustainable, we have implemented and will continue to implement a series of measures to remain viable and improve profitability. These measures include: (1) initiating additional sales and marketing efforts to expand our customer base and increase total demand; (2) strategizing our product mix to re-focus on our niche capabilities including the ultra-thin low-carbon and high-strength high-carbon products; (3) improve production management and increase quality control; (4) continuing to carry out R&D to improve profitability of existing products and launch new high value-add products; and (5) improving working capital efficiency by increasing turnovers of advances to suppliers and accounts receivables. We will also continue to take appropriate actions to perform business and credit reviews of customers and suppliers with the downward pressure in the Chinese economy and credit crunch which have caused many difficulties faced by businesses.

### **Third Quarter Financial Performance Highlights**

During the three months ended March 31, 2013, consistent with the two prior fiscal quarters, we largely reduced our overall production volume of the low-carbon products as part of our strategy to streamline production and reposition the Company in its product offerings. However, as we work towards that, tightened credit and slowing growth in China continued to cause a slow turnover of our accounts receivable for the three months ended March 31, 2013, a trend that is strongly correlated to the experience of other companies in the coal and steel sectors in China during the past year.

During the three months ended March 31, 2013, we sold a total of 10,264 tons of products, a decrease of 28,634 tons from 38,898 tons a year ago, largely due to the decrease in sales of low-carbon cold-rolled steel products mentioned above. Our average cost per unit sold increased 35.5% while average selling prices increased 10.0% period-on-period, mainly due to increases in factory overhead and direct labor per unit sold as a result of the substantially reduced units sold. Decreased sales volume coupled with a large provision for accounts receivable bad debts of \$9,665,828 led to a

gross loss of \$2,375,307 and a net loss of \$13,487,395 for the three months ended March 31, 2013. Total company backlog as of March 31, 2013 was \$6,376,456.

In June and July 2012, we defaulted on the repayment obligations of our short-term and long-term bank loans totaling \$43,873,871. We are currently in discussions with our banks regarding the restructuring of these loans for repayment but have not yet agreed on specific terms. Any restructuring will be subject to approval by the banks' governing bodies, and to our ability to meet certain conditions and requirements that may be imposed by the banks. There can be no assurance that the Company will be able to successfully work out a repayment plan or otherwise fulfill its obligations under the loans. Each of the banks also have the right to take possession of the collateral (which collectively constitute substantial assets of the Company) granted in connection with their respective loan agreements, which action would have a material adverse impact on the Company. We have implemented and will continue to implement a series of measures, discussed above, to remodel our business to make it sustainable, and as part of the ongoing discussions with banks to potentially restructure our bank loans.

The Company has suffered a very significant loss in the period ended March 31, 2013. Operating cash flows have also been significantly adversely impacted by the slow turnover of our accounts receivable and although the Company has been renegotiating with its major suppliers to get a partial refund of our advances to suppliers, to date we have yet to receive any substantial refund due to the credit crunch in the Chinese steel industry. There can be no assurance that the Company will be able to generate sufficient positive cash flow from operations to address all of its cash flow needs, and to continue as a going concern.

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

**Revenues:** Our revenues were approximately \$8.6 million for the quarter, a decrease of 71.0% from last year.

**Gross Margin:** Gross margin was (27.7%) for the quarter, compared to (3.8%) last year.

**Loss from operations before tax:** Loss from operations before tax was approximately \$12.7 million for the quarter, compared to a loss of approximately \$2.5 million last year.

**Net loss:** Net loss was approximately \$13.5 million for the quarter, compared to a net loss of approximately \$3.3 million last year.

**Fully diluted loss per share:** Fully diluted loss per share was \$3.48 for the quarter, compared to a loss per share of \$0.85 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.

### Comparison of Three and nine months Ended March 31, 2013 and 2012

| Three Months Ended March 31,<br>2013 |                  | 2012   |                  | Nine months Ended March 31,<br>2013 |                  | 2012   |                  |                  |
|--------------------------------------|------------------|--------|------------------|-------------------------------------|------------------|--------|------------------|------------------|
| Amount                               | % of<br>Revenues | Amount | % of<br>Revenues | Amount                              | % of<br>Revenues | Amount | % of<br>Revenues | % of<br>Revenues |

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

|  |                |          |                |         |                |          |                |        |
|--|----------------|----------|----------------|---------|----------------|----------|----------------|--------|
| Revenues   | \$8,563,497    | 100.0    | \$29,494,865   | 100.0   | \$22,684,524   | 100.0    | \$105,324,043  | 100.0  |
| Cost of sales<br>(including<br>depreciation and<br>amortization) | 10,938,804     | 127.7    | 30,612,073     | 103.8   | 27,828,738     | 122.7    | 108,178,198    | 102.7  |
| Gross (loss)   | (2,375,307 )   | (27.7 )  | (1,117,208 )   | (3.8 )  | (5,144,214 )   | (22.7 )  | (2,854,155 )   | (2.7 ) |
| Selling and<br>marketing<br>expenses                             | 31,901         | 0.4      | 63,734         | 0.2     | 86,237         | 0.4      | 172,223        | 0.2    |
| Administrative<br>expenses                                       | 576,091        | 6.7      | 781,221        | 2.6     | 1,420,503      | 6.3      | 2,007,777      | 1.9    |
| Allowance for<br>bad and doubtful<br>debts                       | 9,665,828      | 112.9    | 522,118        | 1.8     | 19,825,042     | 87.4     | 522,118        | 0.5    |
| Depreciation and<br>amortization<br>expense                      | 51,742         | 0.6      | 54,173         | 0.2     | 155,753        | 0.7      | 162,610        | 0.2    |
| Total operating<br>expenses                                      | 10,325,562     | 120.6    | 1,421,246      | 4.8     | 21,487,535     | 94.7     | 2,864,728      | 2.7    |
| (Loss) from<br>operations  | (12,700,869)   | (148.3 ) | (2,538,454 )   | (8.6 )  | (26,631,749)   | (117.4 ) | (5,718,883 )   | (5.4 ) |
| Other revenues   | 70,743         | 0.8      | 20,434         | 0.1     | 678,500        | 3.0      | 89,505         | 0.1    |
| Interest and<br>finance costs                                    | (857,269 )     | (10.0 )  | (794,895 )     | (2.7 )  | (2,640,934 )   | (11.6 )  | (2,273,473 )   | (2.2 ) |
| Total other<br>(expense)   | (786,526 )     | (9.2 )   | (774,461 )     | (2.6 )  | (1,962,434 )   | (8.7 )   | (2,183,968 )   | (2.1 ) |
| (Loss) before<br>income taxes                                    | (13,487,395)   | (157.5 ) | (3,312,915 )   | (11.2 ) | (28,594,183)   | (126.1 ) | (7,902,851 )   | (7.5 ) |
| Income tax<br>(benefit)/expense                                  | -              | -        | 108            | <0.1    | -              | -        | 27,189         | <0.1   |
| Net (loss)   | \$(13,487,395) | (157.5 ) | \$(3,313,023 ) | (11.2 ) | \$(28,594,183) | (126.1 ) | \$(7,930,040 ) | (7.5 ) |
| Basic (loss) per<br>share  | \$(3.48 )      |          | \$(0.85 )      |         | \$(7.37 )      |          | \$(2.04 )      |        |
| Diluted (loss) per<br>share                                      | \$(3.48 )      |          | \$(0.85 )      |         | \$(7.37 )      |          | \$(2.04 )      |        |

**Sales Revenues.**

Sales volume decreased by 28,634 tons, or 73.6%, period-on-period, to 10,264 tons for the three months ended March 31, 2013, from 38,898 tons for the three months ended March 31, 2012 and as a result, sales revenues decreased by \$20,931,368, or 71.0%, period-on-period, to \$8,563,497 for the three months ended March 31, 2013, from \$29,494,865 for the three months ended March 31, 2012. The decrease in sales revenues period-on-period is mainly attributable to the decrease in production and sales of our low-carbon cold-rolled products in an effort to reduce the sales of these loss-making products and restructure our product offerings.

Sales by Product Line

A break-down of our sales by product line for the three months ended March 31, 2013 and 2012 is as follows:

| Product Category        | Three Months ended March 31,<br>2013 |           |               | 2012               |            |               | Period-on-<br>Period Qty.<br>Variance |
|-------------------------|--------------------------------------|-----------|---------------|--------------------|------------|---------------|---------------------------------------|
|                         | Quantity<br>(tons)                   | \$ Amount | % of<br>Sales | Quantity<br>(tons) | \$ Amount  | % of<br>Sales |                                       |
| Low-carbon hard-rolled  | 1,061                                | 722,340   | 9             | 2,245              | 1,597,893  | 5             | (1,184 )                              |
| Low-carbon cold-rolled  | 4,136                                | 3,437,778 | 40            | 32,971             | 23,828,512 | 81            | (28,835 )                             |
| High-carbon hot-rolled  | 270                                  | 206,840   | 2             | 144                | 133,371    | <1            | 126                                   |
| High-carbon cold-rolled | 3,990                                | 3,279,644 | 38            | 3,464              | 3,384,305  | 11            | 526                                   |
| Subcontracting income   | 807                                  | 42,228    | 1             | 74                 | 10,374     | <1            | 733                                   |
| Sales of scrap metal    | -                                    | 874,667   | 10            | -                  | 540,410    | 2             | -                                     |
| Total                   | 10,264                               | 8,563,497 | 100           | 38,898             | 29,494,865 | 100           | (28,634 )                             |

During the three months ended March 31, 2013, domestic sales were stable in all product categories except low-carbon products. Low-carbon cold-rolled steel products accounted for 40% of the current sales mix at an average selling price of \$831 per ton for the three months ended March 31, 2013, compared to 81% of the sales mix at an average selling price per ton of \$723 for the three months ended March 31, 2012. The decrease in sales in this category during the quarter was mainly due to streamlined production to reduce the sales of these loss-making products. Low-carbon hard-rolled steel products accounted for 9% of the current sales mix at an average selling price of \$681 per ton for the three months ended March 31, 2013, compared to 5% of the sales mix at an average selling price per ton of \$712 for the three months ended March 31, 2012, due to a decrease in demand in the export market during the period. High-carbon cold-rolled steel products accounted for 38% of the current sales mix at an average selling price of \$822 per ton for the three months ended March 31, 2013, compared to 11% of the sales mix at an average selling price of \$977 for the three months ended March 31, 2012. The products in this category are mainly used in the automobile industry and we intend to dedicate further sales and marketing efforts in this category as this is where we differentiate our products from other domestic manufacturers. Subcontracting income revenues accounted for \$42,228 or 1% of the sales mix for the three months ended March 31, 2013, an increase from \$10,374 for the three months ended March 31, 2012.

|                        | Three<br>Months<br>ended<br>March 31,<br>2013 |      |      | 2012 |       | Variance |      |
|------------------------|---|------|------|------|-------|----------|------|
|                        | (\$)  | (\$) | (\$) | (\$) | (%)   | (%)      | (%)  |
| Average Selling Prices | 681   | 712  | 831  | 723  | (31)  | (4)      | (4)  |
| Low-carbon hard-rolled | 681   | 712  | 831  | 723  | (31)  | (4)      | (4)  |
| Low-carbon cold-rolled | 831   | 723  | 831  | 723  | 108   | 15       | 15   |
| High-carbon hot-rolled | 766   | 926  | 766  | 926  | (160) | (17)     | (17) |

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

|                         |     |     |       |      |
|-------------------------|-----|-----|-------|------|
| High-carbon cold-rolled | 822 | 977 | (155) | (16) |
| Subcontracting income   | 52  | 140 | (88 ) | (63) |

The average selling price per ton increased to \$834 for the three months ended March 31, 2013, compared to \$758 last year, representing an increase of \$76, or 10.0%, period-on-period. This increase was mainly due to a change in product mix and concentration period-on-period. Average selling prices decreased across all product categories, except for low-carbon cold-rolled products, during the three months ended March 31, 2013.

Sales Breakdown by Major Customer

| Customers                                    | 2013      |            | 2012       |            |
|--|-----------|------------|------------|------------|
|  | \$        | % of Sales | \$         | % of Sales |
| Hangzhou Pugang Steel Materials Co., Ltd.    | 841,618   | 10         | -          | * - *      |
| Shanghai Changshuo Steel Co., Ltd.           | 823,983   | 10         | -          | * - *      |
| Shanghai Yanmao Trading Co., Ltd.            | 544,708   | 6          | -          | * - *      |
| Unimax & Far                                 | 541,374   | 6          | -          | * - *      |
| Changshu Jiacheng Steel Plating Co., Ltd.    | 522,640   | 6          | 3,661,289  | 12         |
| Shanghai Bayou Co., Ltd.                     | -         | * - *      | 13,708,730 | 46         |
| Jiangsu Sumec Group Corporation              | -         | * - *      | 3,495,647  | 12         |
| Shanghai Shengdejia Metal Products Co., Ltd. | -         | * - *      | 2,353,098  | 8          |
| Zhejiang Yejin Materials Co., Ltd.           | -         | * - *      | 2,687,696  | 9          |
|  | 3,274,323 | 38         | 25,906,460 | 87         |
| Others                                       | 5,289,174 | 62         | 3,588,405  | 13         |
| Total  | 8,563,497 | 100        | 29,494,865 | 100        |

\* Not major customers for the relevant periods

Sales revenue generated from our top five major customers as a percentage of total sales was 38% for the three months ended March 31, 2013, as compared to 87% in 2012. 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 decreased by \$19,673,269, or 64.3%, period-on-period, to \$10,938,804 for the three months ended March 31, 2013, from \$30,612,073 for the three months ended March 31, 2012. Cost of sales represented 127.7% of sales revenues for the three months ended March 31, 2013, compared to 103.8% for the three months ended March 31, 2012. Average cost per unit sold increased to \$1,066 for the three months ended March 31, 2013, compared to \$787 for the three months ended March 31, 2012, representing an increase of \$279 per ton, or 35.5%, period-on-period.

|                    | 2013      | 2012       | Variance     |        |
|--------------------|-----------|------------|--------------|--------|
|                    | (\$)      | (\$)       | (\$)         | (%)    |
| Cost of goods sold |           |            |              |        |
| - Raw materials    | 8,572,999 | 28,139,271 | (19,566,272) | (69.5) |

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

|                          |            |            |              |        |
|--------------------------|------------|------------|--------------|--------|
| - Direct labor           | 120,271    | 132,304    | (12,033 )    | (9.1 ) |
| - Manufacturing overhead | 2,245,534  | 2,340,498  | (94,964 )    | (4.1 ) |
|                          | 10,938,804 | 30,612,073 | (19,673,269) | (64.3) |

Cost per unit sold

|                                     |        |        |           |        |
|-------------------------------------|--------|--------|-----------|--------|
| Total units sold (tons)             | 10,264 | 38,898 | (28,634 ) | (73.6) |
| Average cost per unit sold (\$/ton) | 1,066  | 787    | 279       | 35.5   |

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

an increase in factory overhead per unit sold of \$159, or 265.0%, from \$60 for the three months ended March 31, 2012, to \$219 for the three months ended March 31, 2013;

an increase in direct labor per unit sold of \$9, or 300.0%, from \$3 for the three months ended March 31, 2012, to \$12 for the three months ended March 31, 2013, and;

an increase in cost of raw materials per unit sold of \$112, or 15.5%, from \$723 for the three months ended March 31, 2012, to \$835 for the three months ended March 31, 2013.



The cost of raw materials consumed decreased by \$19,566,272, or 69.5%, period-on-period, to \$8,572,999 for the three months ended March 31, 2013, from \$28,139,271 for the three months ended March 31, 2012. This decrease was mainly due to a substantial decrease in total units sold during the three months ended March 31, 2013.

Direct labor costs decreased by \$12,033, or 9.1%, period-on-period, to \$120,271 for the three months ended March 31, 2013, from \$132,304 for the three months ended March 31, 2012. Manufacturing overhead costs decreased by \$94,964, or 4.1%, period-on-period, to \$2,245,534 for the three months ended March 31, 2013, from \$2,340,498 for the three months ended March 31, 2012. The decrease was mainly attributable to the combined effect of a decrease in utilities of \$247,047, or 41.5%, period-on-period, to \$347,699 for the three months ended March 31, 2013, from \$594,746 for the three months ended March 31, 2012, and partially offset by an increase in depreciation of \$219,695 or 16.5%, period-on-period, to \$1,549,594 for the three months ended March 31, 2013, from \$1,329,899 for the three months ended March 31, 2012.

### ***Gross Profit***

Gross profit in absolute terms decreased by \$1,258,099 or 112.6%, period-on-period, to a gross loss of \$2,375,307 for the three months ended March 31, 2013, from a gross loss of \$1,117,208 for the three months ended March 31, 2012. Gross profit margin decreased to (27.7%) for the three months ended March 31, 2013, from (3.8%) for the three months ended March 31, 2012. The decrease in gross profit margin is mainly attributable to a 35.5% period-on-period increase in average cost per unit sold.

### ***Selling Expenses***

Selling expenses decreased by \$31,833, or 49.9%, period-on-period, to \$31,901 for the three months ended March 31, 2013, from \$63,734 for the three months ended March 31, 2012. The decrease was mainly attributable to lower transportation costs period-on-period.

### ***Administrative Expenses***

Administrative expenses decreased by \$205,130 or 26.3%, period-on-period, to \$576,091 for the three months ended March 31, 2013, compared to \$781,221 for the three months ended March 31, 2012. This was mainly due to decreases in traveling expenses and professional fees period-on-period.

***Allowance for Bad and Doubtful Debts***

Allowance for bad and doubtful debts increased by \$9,143,710, or 1,751.3%, period-on-period. Allowance recognized for the three months ended March 31, 2013 was in the amount of \$9,665,828 in accordance with our policy for allowance for doubtful accounts.

***Loss from Operations***

Loss from operations increased by \$10,162,415, or 400.3%, period-on-period, to a loss of \$12,700,869 for the three months ended March 31, 2013, from \$2,538,454 for the three months ended March 31, 2012, as a result of the factors discussed above.

***Other Income***

Other income increased by \$50,309, or 246.2%, to \$70,743 for the three months ended March 31, 2013, from \$20,434 for the three months ended March 31, 2012.

***Interest Expense***

Total interest expense increased by \$62,374, or 7.8%, to \$857,269 for the three months ended March 31, 2013, from \$794,895 for the three months ended March 31, 2012, due to the accrued late payment penalty interest as a result of the loan default.

***Income Tax***

For the three months ended March 31, 2013, we recognized no income tax expense, compared to an income tax expense of \$108 for the three months ended March 31, 2012. The decrease of \$108, or 100.0%, in income tax expense was a result of the net loss for the three months ended March 31, 2013.

***Net Loss***

Net loss increased by \$10,174,372, or 307.1%, period-on-period, to \$13,487,395 for the three months ended March 31, 2013, from \$3,313,023 for the three months ended March 31, 2012. The increase in net loss is attributable to a combination of all the factors discussed above, principally the negative gross margin and the large increase in allowance for bad and doubtful debts.

***Comparison of Nine months Ended March 31, 2013 and 2012***

***Sales Revenues.***

Sales volume decreased by 95,631 tons, or 76.9%, period-on-period, to 28,722 tons for the nine months ended March 31, 2013, from 124,353 tons for the nine months ended March 31, 2012 and as a result, sales revenues decreased by \$82,639,519, or 78.5%, period-on-period, to \$22,684,524 for the nine months ended March 31, 2013, from \$105,324,043 for the nine months ended March 31, 2012. The decrease in sales revenues period-on-period is mainly attributable to the decrease in production and sales of our low-carbon cold-rolled products in an effort to reduce the sales of these loss-making products.

Sales by Product Line

A break-down of our sales by product line for the nine months ended March 31, 2013 and 2012 is as follows:

| Product Category        | Nine months ended March 31,<br>2013 |            |               | 2012               |             |               | Period-on-<br>Period Qty.<br>Variance |
|-------------------------|-------------------------------------|------------|---------------|--------------------|-------------|---------------|---------------------------------------|
|                         | Quantity<br>(tons)                  | \$ Amount  | % of<br>Sales | Quantity<br>(tons) | \$ Amount   | % of<br>Sales |                                       |
| Low-carbon hard-rolled  | 3,733                               | 2,698,860  | 12            | 8,998              | 6,605,610   | 6             | (5,265 )                              |
| Low-carbon cold-rolled  | 13,489                              | 9,999,064  | 44            | 96,702             | 78,339,578  | 74            | (83,213 )                             |
| High-carbon hot-rolled  | 449                                 | 324,509    | 1             | 3,321              | 3,659,608   | 4             | (2,872 )                              |
| High-carbon cold-rolled | 9,737                               | 8,368,887  | 37            | 13,316             | 13,788,270  | 13            | (3,579 )                              |
| Subcontracting income   | 1,314                               | 83,020     | 1             | 2,016              | 1,076,389   | 1             | (702 )                                |
| Sales of scrap metal    | -                                   | 1,210,184  | 5             | -                  | 1,854,588   | 2             | -                                     |
| Total                   | 28,722                              | 22,684,524 | 100           | 124,353            | 105,324,043 | 100           | (95,631 )                             |

During the nine months ended March 31, 2013, sales decreased across all product categories. Low-carbon cold-rolled steel products accounted for 44% of the current sales mix at an average selling price of \$741 per ton for the nine months ended March 31, 2013, compared to 74% of the sales mix at an average selling price per ton of \$810 for the nine months ended March 31, 2012. The decrease in sales in this category during the nine months was mainly due to streamlined production to reduce the sales of these loss-making products. Low-carbon hard-rolled steel products accounted for 12% of the current sales mix at an average selling price of \$723 per ton for the nine months ended March 31, 2013, compared to 6% of the sales mix at an average selling price per ton of \$734 for the nine months ended March 31, 2012, due to a decrease in demand in the export market during the period. High-carbon cold-rolled steel products accounted for 37% of the current sales mix at an average selling price of \$859 per ton for the nine months ended March 31, 2013, compared to 13% of the sales mix at an average selling price of \$1,035 for the nine months ended March 31, 2012. The products in this category are mainly used in the automobile industry and the decrease in sales volume was a result of the slowing demand during the period. Subcontracting income revenues accounted for \$83,020, or 1% of the sales mix for the nine months ended March 31, 2013, a decrease from \$1,076,389 for the nine months ended March 31, 2012, due to reduced demand.

|                         | Nine months<br>ended March<br>31, |       |            |
|-------------------------|-----------------------------------|-------|------------|
|                         | 2013                              | 2012  | Variance   |
| Average Selling Prices  | (\$)                              | (\$)  | (\$) (%)   |
| Low-carbon hard-rolled  | 723                               | 734   | (11 ) (2 ) |
| Low-carbon cold-rolled  | 741                               | 810   | (69 ) (9 ) |
| High-carbon hot-rolled  | 723                               | 1,102 | (379) (34) |
| High-carbon cold-rolled | 859                               | 1,035 | (176) (17) |
| Subcontracting income   | 63                                | 534   | (471) (88) |

The average selling price per ton decreased to \$790 for the nine months ended March 31, 2013, compared to \$847 last year, representing a decrease of \$57, or 6.7%, period-on-period. This decrease was mainly due to decreases in general steel prices and therefore our selling prices during the nine months. Average selling prices decreased across all product categories during the nine months ended March 31, 2013.

#### Sales Breakdown by Major Customer

| Customers                                       | 2013       |            | 2012         |            |
|---|------------|------------|--------------|------------|
|   | \$         | % of Sales | \$           | % of Sales |
| Changshu Jiacheng Steel Plating Co., Ltd.       | 2,077,276  | 9          | 8,112,915    | 8          |
| Unimax & Far Corporation                        | 1,611,074  | 7          | -            | * - *      |
| Shanghai Wozi Jintian Blade Co., Ltd.           | 1,620,098  | 7          | -            | * - *      |
| Hangzhou Pugang Steel Materials Co., Ltd.       | 1,348,424  | 6          | -            | * - *      |
| Shanghai Bayou Co., Ltd.                        | 967,558    | 4          | -            | * - *      |
| Shanghai Shengdejia Metal Products Co., Ltd.    | -          | * -        | * 14,107,630 | 13         |
| Shanghai Changshuo Steel Co., Ltd.              | -          | * -        | * 12,068,785 | 11         |
| Hangzhou Cogeneration Import & Export Co., Ltd. | -          | * -        | * 11,204,723 | 11         |
| Zhejiang Yongfeng Steel Co., Ltd.               | -          | * -        | * 7,957,124  | 8          |
|   | 7,624,430  | 33         | 53,451,177   | 51         |
| Others  | 15,060,094 | 67         | 51,872,866   | 49         |
| Total   | 22,684,524 | 100        | 105,324,043  | 100        |

\* Not major customers for the relevant periods

Sales revenue generated from our top five major customers as a percentage of total sales was 33% for the nine months ended March 31, 2013, as compared to 51% in 2012. 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 decreased by \$80,349,460, or 74.3%, period-on-period, to \$27,828,738 for the nine months ended March 31, 2013, from \$108,178,198 for the nine months ended March 31, 2012. Cost of sales represented 122.7% of sales revenues for the nine months ended March 31, 2013, compared to 102.7% for the nine months ended March 31, 2012. Average cost per unit sold increased to \$969 for the nine months ended March 31, 2013, compared to \$870 for the nine months ended March 31, 2012, representing an increase of \$99 per ton, or 11.4%, period-on-period.

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

|                                     | 2013<br>(\$) | 2012<br>(\$) | Variance<br>(\$) | (%)    |
|-------------------------------------|--------------|--------------|------------------|--------|
| Cost of goods sold                  |              |              |                  |        |
| - Raw materials                     | 20,446,881   | 98,982,682   | (78,535,801)     | (79.3) |
| - Direct labor                      | 367,234      | 428,154      | (60,920)         | (14.2) |
| - Manufacturing overhead            | 7,014,623    | 8,767,362    | (1,752,739)      | (20.0) |
|                                     | 27,828,738   | 108,178,198  | (80,349,460)     | (74.3) |
| Cost per unit sold                  |              |              |                  |        |
| Total units sold (tons)             | 28,722       | 124,353      | (95,631)         | (76.9) |
| Average cost per unit sold (\$/ton) | 969          | 870          | 99               | 11.4   |

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

an increase in factory overhead per unit sold of \$173, or 243.7%, from \$71 for the nine months ended March 31, 2012, to \$244 for the nine months ended March 31, 2013;

an increase in direct labor per unit sold of \$10 or 333.3%, from \$3 for the nine months ended March 31, 2012, to \$13 for the nine months ended March 31, 2013, offset by;

a decrease in cost of raw materials per unit sold of \$84, or 10.6%, from \$796 for the nine months ended March 31, 2012, to \$712 for the nine months ended March 31, 2013.

The cost of raw materials consumed decreased by \$78,535,801, or 79.3%, period-on-period, to \$20,446,881 for the nine months ended March 31, 2013, from \$98,982,682 for the nine months ended March 31, 2012. This decrease was mainly due to a substantial decrease in total units sold during the nine months ended March 31, 2013.

Direct labor costs decreased by \$60,920, or 14.2%, period-on-period, to \$367,234 for the nine months ended March 31, 2013, from \$428,154 for the nine months ended March 31, 2012. Manufacturing overhead costs decreased by \$1,752,739, or 20.0%, period-on-period, to \$7,014,623 for the nine months ended March 31, 2013, from \$8,767,362 for the nine months ended March 31, 2012. The decrease was mainly attributable to the combined effect of a decrease in utilities of \$1,133,103, or 48.4%, period-on-period, to \$1,205,683 for the nine months ended March 31, 2013, from \$2,338,786 for the nine months ended March 31, 2012, and a decrease in consumables of \$389,579, or 32.6%, period-on-period, to \$804,217 for the nine months ended March 31, 2013, from \$1,193,796 for the nine months ended March 31, 2012.

**Gross Profit**

Gross profit in absolute terms decreased by \$2,290,059 or 80.2%, period-on-period, to a gross loss of \$5,144,214 for the nine months ended March 31, 2013, from a gross loss of \$2,854,155 for the nine months ended March 31, 2012. Gross profit margin decreased to (22.7%) for the nine months ended March 31, 2013, from (2.7%) for the nine months ended March 31, 2012. The decrease in gross profit margin is mainly attributable to a 11.4% period-on-period increase in average cost per unit sold.

### *Selling Expenses*

Selling expenses decreased by \$85,986, or 49.9%, period-on-period, to \$86,237 for the nine months ended March 31, 2013, from \$172,223 for the nine months ended March 31, 2012. The decrease was mainly attributable to lower transportation costs period-on-period.

### *Administrative Expenses*

Administrative expenses decreased by \$587,274 or 29.2%, period-on-period, to \$1,420,503 for the nine months ended March 31, 2013, compared to \$2,007,777 for the nine months ended March 31, 2012. This was mainly due to a decrease in traveling expenses and legal and professional fees period-on-period.



***Allowance for Bad and Doubtful Debts***

Allowance for bad and doubtful debts increased by \$19,302,924, or 3,697.0%, period-on-period. Allowance recognized for the nine months ended March 31, 2013 was in the amount of \$19,825,042 in accordance with our policy for allowance for doubtful accounts.

***Loss from Operations***

Loss from operations increased by \$20,912,866, or 365.7%, period-on-period, to a loss of \$26,631,749 for the nine months ended March 31, 2013, from \$5,718,883 for the nine months ended March 31, 2012, as a result of the factors discussed above.

***Other Income***

Other income increased by \$588,995, or 658.1%, to \$678,500 for the nine months ended March 31, 2013, from \$89,505 for the nine months ended March 31, 2012.

***Interest Expense***

Total interest expense increased by \$367,461, or 16.2%, to \$2,640,934 for the nine months ended March 31, 2013, from \$2,273,473 for the nine months ended March 31, 2012, due to the accrued late payment penalty interest as a result of the loan default.

***Income Tax***

For the nine months ended March 31, 2013, we recognized no income tax expense, compared to an income tax expense of \$27,189 for the nine months ended March 31, 2012. The decrease of \$27,189, or 100.0%, in income tax expense was a result of the net loss for the nine months ended March 31, 2013.

**Net Loss**

Net loss increased by \$20,664,143, or 260.6%, period-on-period, to \$28,594,183 for the nine months ended March 31, 2013, from \$7,930,040 for the nine months ended March 31, 2012. The increase in net loss is attributable to a combination of all the factors discussed above, principally the negative gross margin and the large increase in allowance for bad and doubtful debts.

**Liquidity and Capital Resources**

Our business is capital intensive and requires substantial expenditures for, among other things, the purchase and maintenance of 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 March 31, 2013, we had cash and cash equivalents of approximately \$0.2 million.

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

**CASH FLOWS**

|   | Nine months Ended |             |
|---|-------------------|-------------|
|   | March 31          |             |
|   | 2013              | 2012        |
| Net cash (used in)/provided by operating activities | \$(779,088 )      | \$2,656,545 |
| Net cash (used in) investing activities             | (122,803 )        | (309,635 )  |
| Net cash (used in) financing activities             | (542,696 )        | (2,847,740) |
| Net cash flow                                       | (1,440,532)       | (463,145 )  |

### ***Operating Activities***

Net cash flows used in operating activities for the nine months ended March 31, 2013 were \$779,088, as compared to \$2,656,545 provided by operating activities for the nine months ended March 31, 2012, resulting in a net decrease of \$3,435,633. This decrease was mainly due to an increase in cash outflows for inventories of \$1,279,939 and a decrease in cash inflows from advances to suppliers of \$1,952,887 during the nine months ended March 31, 2013.

For the nine months ended March 31, 2013, sales revenues generated from the top five major customers as a percentage of total sales was 33%, as compared to 51% in the prior period. 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 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 uses of cash for investing activities during the three months ended March 31, 2013 were for the purchase of additional property, plant and equipment to complement our existing production facilities.

Net cash flows used in investing activities for the nine months ended March 31, 2013 were \$122,803, as compared with \$309,635 for the nine months ended March 31, 2012. Cash flows used in investing activities decreased period-on-period as majority of the construction of the additional annealing furnaces have been completed.

We forecast lower capital expenditures in the coming years as the Company has already completed most of its major expansion plans.

### ***Financing Activities***

Net cash flows used in financing activities for the nine months ended March 31, 2013 were \$542,696, as compared to \$2,874,740 for the nine months ended March 31, 2012, for a net decrease of \$2,332,044. The Company made a partial repayment for its short-term loan from the deposit account held with Raiffeisen Zentral bank Österreich AG (“RZB”) during the nine months ended March 31, 2013 and did not make any repayment for its long-term loan as it did during the nine months ended March 31, 2012.

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 continuing 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. In June and July 2012, we defaulted on the repayment obligations of our short-term and long-term bank loans totaling \$43,873,871. We are currently in discussions with our banks regarding the restructuring of these loans for repayment but have not yet agreed on specific terms. There can be no assurance that the Company will be able to successfully work out a repayment plan or otherwise fulfill its obligations under the loans. Further, each of these lenders has the right to take possession of the collateral (which collectively constitute substantial assets of the Company) granted in connection with their respective loan agreements. The unavailability of debt financing as a result of economic pressures on the credit and equity markets could have a material adverse effect on our business operations.

### ***Going Concern***

Historically, we have funded our operations and expansion expenditures from cash generated by operating activities, bank borrowings and issuance of common stock. As discussed above, the Company defaulted on the repayment obligations of its bank loans and the restructuring of these loans has not yet been agreed on. We also expect the tightened credit and slowing growth in China to continue to cause a slow turnover of our accounts receivable and have a negative impact on our operating cash flows in the next nine months. The uncertainty surrounding the successful restructuring of our bank loans and our current lack of readily available liquidity provided by other third party sources raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

### ***Current Assets***

Current assets decreased by \$16,982,321, or 14.7%, period-on-period, to \$98,597,518 as of March 31, 2013, from \$115,579,839 as of June 30, 2012, principally as a result of a decrease in accounts receivable of \$20,643,850, or 34.9%, period-on-period, offset by an increase in inventories of \$5,043,346, or 32.5%, period-on-period.

Accounts receivable, representing 39.0% of total current assets as of March 31, 2013, 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 principally 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 longer credit terms to long-standing recurring customers with good payment histories and sizable operations.

Our management determines the collectability of outstanding accounts by maintaining at least 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 nine months ended March 31, 2013, 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.

We expect the tightened credit and slowing growth in China to continue to cause a slow turnover of our accounts receivable in the next twelve months.

The following table reflects the aging of our accounts receivable based on due date as of March 31, 2013 and June 30, 2012:

**March 31, 2013**

| US\$         | Total      | Current | 1 to 30 days | 31 to 90 days | 91 to 180 days | 181 to 360 days | over 1 year |
|--------------|------------|---------|--------------|---------------|----------------|-----------------|-------------|
| <b>TOTAL</b> | 61,793,564 | 994,214 | 898,261      | 6,787,833     | 7,750,226      | 44,082,793      | 1,280,237   |
| <b>%</b>     | 100        | 2       | 1            | 11            | 13             | 71              | 2           |

**June 30, 2012**

| US\$         | Total      | Current    | 1 to 30 days | 31 to 90 days | 91 to 180 days | 181 to 360 days | over 1 year |
|--------------|------------|------------|--------------|---------------|----------------|-----------------|-------------|
| <b>TOTAL</b> | 62,348,544 | 24,573,802 | 4,167,802    | 9,451,142     | 18,940,851     | 3,964,416       | 1,250,531   |
| <b>%</b>     | 100        | 40         | 7            | 15            | 30             | 6               | 2           |

Management continues to take actions to perform business and credit reviews of our existing and new customers 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. Currently we are also not extending credit on sales in any substantial amount to limit further exposures in accounts receivable.

***Current Liabilities***

Current liabilities increased by \$3,940,274, or 5.9%, period-on-period, to \$70,616,150 as of March 31, 2013, from \$66,675,876 as of June 30, 2012. The increase was mainly attributable to an increase in accounts payable and accrued expenses of \$3,216,964, or 47.5%, period-on-period.

As of March 31, 2013, we had \$27,673,871 in short-term loans. Principal and interest under the loans were to be repaid in full on July 31, 2012, but the Company has defaulted on this repayment obligation. The Company is currently in discussion with its bank regarding the restructuring of these loans but there can be no assurance that the Company will be able to successfully work out a repayment plan or otherwise fulfill its obligations under the loan.

***Capital Expenditures***

During the nine months ended March 31, 2013, we invested \$122,803 in purchases of additional property, plant and equipment.

***Loan Facilities***

The following table illustrates our credit facilities as of March 31, 2013, providing the name of the lender, the amount of the facility, the date of issuance and the maturity date:

All amounts in U.S. dollars

| Lender | Date of Loan | Duration | Interest Rate |
|--------|--------------|----------|---------------|
|--------|--------------|----------|---------------|

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

|                                   |               | Maturity<br>Date |         |                | Principal<br>Amount |
|-----------------------------------|---------------|------------------|---------|----------------|---------------------|
| Raiffeisen                        | June 29, 2011 | July 31, 2012    | 1 year  | 1.15 times     | \$ 8,068,157        |
| Zentralbank Österreich AG (“RZB”) |               |                  |         | the PBOC rate  | RMB(50,154,084)     |
| Raiffeisen                        | June 29, 2011 | July 31, 2012    | 1 year  | 1.15 times the | \$19,605,714        |
| Zentralbank Österreich AG         |               |                  |         | PBOC rate      | RMB(121,875,000)    |
| DEG – Deutsche Investitions – und | June 29, 2010 | June 15, 2016    | 6 years | 6 month USD    | \$ 16,200,000       |
| Entwicklungsgesellschaft mbH      |               |                  |         | LIBOR + 4.5%   | RMB(100,704,060)    |
| Total                             |               |                  |         |                | \$ 43,873,871       |

On January 29, 2010, Shanghai Blessford entered into a Senior Loan Agreement with DEG -Deutsche Investitions-Und Entwicklungsgesellschaft Mbh, or “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 secured by a mortgage on the new cold rolling line and annealing furnaces at Shanghai Blessford’s facilities and guaranteed by the Company. The loan was to have been repaid semi-annually over five years starting on December 15, 2011, but the Company has defaulted on this repayment obligation since the June 15, 2012 installment. The Company is currently in discussions with DEG regarding the restructuring of the loans for repayment but has not yet agreed on specific terms. Until such agreement is reached, DEG has the right to cancel the total outstanding commitment of the loan, demand immediate repayment of the loan or any part thereof together with accrued interest, and/or terminate the loan agreement. DEG may also take possession of the collateral granted in connection with their respective loan agreements, which would have a material adverse impact on the Company. There can be no assurance that the Company will be able to successfully work out a repayment plan with DEG or otherwise fulfill its obligations under the loan.



On June 29, 2011, the Company entered into two short-term loan agreements with Raiffeisen Zentralbank Osterreich AG, or “RZB”, pursuant to which the Company borrowed an aggregate of \$27,610,356 at an annual interest rate of 1.15 times the standard market rate set by the People’s Bank of China. The loans are secured by inventories, land use rights, buildings and plant and machinery, and is guaranteed by PSHL and our former Chairman, Mr. Wo Hing Li. Mr. Li also undertook to maintain a shareholding percentage in the Company of not less than 33.4% unless otherwise agreed to with RZB. Principal and interest under the loans were to be repaid in full on July 31, 2012, but the Company has defaulted on this repayment obligation. The Company is currently in discussions with RZB regarding the restructuring of the loans for repayment but has not yet agreed on specific terms. Any restructuring will be subject to approval by RZB’s governing bodies, and to the Company’s ability to meet certain conditions and requirements that may be imposed by the Bank. Until such agreement is reached, RZB has the right to take possession of the collateral granted in connection with the loan agreement, which action would have a material adverse impact on the Company. There can be no assurance that the Company will be able to successfully work out a repayment plan with RZB or otherwise fulfill its obligations under the loan.

### ***Obligations under Material Contracts***

Below is a table setting forth our material contractual obligations as of March 31, 2013, debt obligations include principal repayments and interest payments:

| Contractual obligations:                      | Payments Due By Year |                     |                             |                             |  |
|---|----------------------|---------------------|-----------------------------|-----------------------------|--|
|   | Total                | Fiscal Year<br>2013 | Fiscal<br>Year<br>2014-2015 | Fiscal<br>Year<br>2016-2017 | Fiscal<br>Years<br>2018<br>and<br>Beyond |
| Short-term debt obligations                   | \$29,583,368         | \$29,583,368        | \$ -                        | \$ -                        | \$ -                                     |
| Current portion of long-term debt obligations | \$17,003,520         | \$17,003,520        | \$ -                        | \$ -                        | \$ -                                     |
|   | \$46,586,888         | \$46,586,888        | \$ -                        | \$ -                        | \$ -                                     |

### **Recent Accounting Pronouncements**

In December 2011, the FASB issued ASU No. 2011-11, *Disclosures About Offsetting Assets and Liabilities*, (“ASU 2011-11”). The amendments in ASU 2011-11 require entities to disclose information about offsetting and related arrangements to enable users of financial statements to understand the effect of those arrangements on an entity’s financial position. The amendments require enhanced disclosures by requiring improved information about financial instruments and derivative instruments that are either (i) offset in accordance with current literature or (ii) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with current literature. ASU 2011-11 is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. This standard will become effective for the Company beginning July 1, 2013. The Company

does not believe adoption of this new guidance will have a significant impact on its consolidated financial statements.

In July 2012, the FASB issued ASU No. 2012-02, *Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* (“ASU 2012-02”). ASU 2012-02 amends Topic 350 by establishing an optional two-step analysis for impairment testing of indefinite-lived intangibles other than goodwill. This update allows an entity the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. Under that option, an entity no longer would be required to calculate the fair value of the intangible asset unless the entity determines, based on that qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption is permitted. This standard will become effective for the Company beginning July 1, 2013. The Company does not believe adoption of this new guidance will have a significant impact on its consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income" (ASU No. 2013-02). Under ASU No. 2013-02, an entity is required to provide information about the amounts reclassified out of accumulated other comprehensive income ("AOCI") by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU No. 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 became effective from January 1, 2013 and the new guidance did not have any material impact on the Company's unaudited consolidated 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 calendar year than in the first half of the calendar year and the first quarter of the calendar year is usually the slowest quarter because fewer projects are undertaken during and around the Chinese New Year holidays.

### **Off-Balance Sheet Arrangements**

For the nine months ended March 31, 2013, 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. Hai Sheng Chen, and Chief Financial Officer, Ms. Leada Tak Tai Li, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2013. Based upon, and as of the date of this evaluation, Mr. Chen and Ms. Li, determined that because of the material weaknesses described below, as of March 31, 2013 our disclosure controls and procedures were not effective.

During its review of our consolidated financial statements for the fiscal quarter ended March 31, 2013, our management concluded that our accounting staff lacked sufficient accounting skills and experience necessary to fulfill our public reporting obligations according to U.S. GAAP and the SEC's rules and regulations.

Management is currently seeking for and plans to appoint qualified personnel as soon as practicable to remediate this material weakness. Our management does not believe that this material weakness had a material effect on our financial condition or results of operations or caused our financial statements as of and for the fiscal quarter ended March 31, 2013, such as to contain a material misstatement.

#### **Changes in Internal Controls over Financial Reporting**

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

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

## PART II

### OTHER INFORMATION

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

From time to time, we may become involved in various lawsuits and legal proceedings, which arise, in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these, or other matters, may arise from time to time that may harm our business.

On March 15, 2012, the Company received notice of a complaint filed by Mr. Haining Zhang and China Venture Partners, Inc. in the U.S. Southern District Court of New York on March 9, 2012, against several defendants, including the Company, as successor to OraLabs Holding Corp. In the complaint Mr. Zhang is alleging, among other things, breach of contract by the Company and certain of our former officers, directors and control persons, in connection with our December 2006 acquisition of Partner Success Holdings Limited. Among other things, Mr. Zhang alleges that the defendants breached an agreement to compensate him for services he allegedly performed in connection with seeking out a merger candidate for the Company. The Company believes that the suit is without merit and intends to vigorously defend its interests in the case. The Company was granted court permission to file a motion to dismiss the action as against it. Prior to filing the motion to dismiss, plaintiffs amended their complaint. Accordingly, the Company filed a motion to dismiss the amended complaint. On March 13, 2013, the Company's motions to dismiss were granted by the Court. The Plaintiff had the right to appeal within 30 days of the court decision, and a notice of appeal was filed on April 17, 2013. The Plaintiff has the obligation to prepare the record on appeal and have the same submitted to the Court of Appeals. We intend to file a notice to oppose such appeal. An estimate of any potential loss cannot be made at this time.

Except with respect to the foregoing proceeding, 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. MINE SAFETY DISCLOSURES.**

Not applicable.

**ITEM 5. OTHER INFORMATION.**

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

**ITEM 6. EXHIBITS.**

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

**Exhibit No. Description**

31.1\* Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  
31.2\* Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  
32.1\* Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  
32.2\* Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS\* XBRL Instance Document  
101.SCH\* XBRL Taxonomy Extension Schema Document  
101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document  
101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document  
101.LAB\* XBRL Taxonomy Extension Label Linkbase Document  
101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed Herewith.

## 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: May 15, 2013 **CHINA PRECISION STEEL, INC.**

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

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



