

China Precision Steel, Inc.  
Form 10-K  
October 11, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

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

For the fiscal year ended: June 30, 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 No. 000-23039

**CHINA PRECISION STEEL, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**14-1623047**

(I.R.S. Employer Identification No.)

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

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

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

| <b>Title of each class</b>                | <b>Name of each exchange on which registered</b> |
|---|--|
| Common Stock, par value \$0.001 per share | NASDAQ Capital Market                            |

Securities registered pursuant to Section 12(g) of the Exchange Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

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 registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

As of December 31, 2012 (the last business day of the registrant’s most recently completed second fiscal quarter), the aggregate market value of the shares of the registrant’s common stock held by non-affiliates (based upon the closing sale price of such shares as reported on the NASDAQ Capital Market) was approximately \$5.1 million. Shares of the registrant’s common stock held by each executive officer and director and each by each person who owns 10% or more of the outstanding common stock have been excluded from the calculation in that such persons may be deemed to be affiliates of the registrant. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

There were a total of 3,880,866 shares of the registrant’s common stock outstanding as of September 25, 2013.

**DOCUMENTS INCORPORATED BY REFERENCE**

None.

**CHINA PRECISION STEEL, INC.**

*Annual Report on FORM 10-K*

*For the Fiscal Year Ended June 30, 2013*

---

**TABLE OF CONTENTS**

|   |    |
|---|----|
| Item 1. <u>Business</u>                   | 4  |
| Item 1A. <u>Risk Factors</u>              | 12 |
| Item 1B. <u>Unresolved Staff Comments</u> | 26 |
| Item 2. <u>Properties</u>                 | 26 |
| Item 3. <u>Legal Proceedings</u>          | 26 |
| Item 4. <u>(Removed and Reserved)</u>     | 26 |

**PART II**

|   |    |
|---|----|
| Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 27 |
| Item 6. <u>Selected Financial Data</u>  | 27 |
| Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 28 |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 39 |
| Item 8. <u>Financial Statements and Supplementary Data</u>  | 39 |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | 41 |
| Item 9A. <u>Controls and Procedures</u>   | 41 |
| Item 9B. <u>Other Information</u>   | 41 |

**PART III**

|  |    |
|--|----|
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u>   | 42 |
| Item 11. <u>Executive Compensation</u>   | 45 |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 47 |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>                      | 48 |

Item 14. Principal Accounting Fees and Services

48

**PART IV**

Item 15. Exhibits, Financial Statement Schedules  
Signatures

49

50

- 2 -

## 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. Additional disclosures regarding factors that could cause our results and performance to differ from results or anticipated performance are discussed in Item 1A, “Risk Factors” included herein.

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

## Use of Terms

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

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

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

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

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

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

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

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

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

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

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

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

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

“BVI” are to the British Virgin Islands.

## **PART I**

### **ITEM 1. BUSINESS.**

#### **Overview**

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

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

We conduct our operations principally in China through our wholly-owned operating subsidiaries, Chengtong and Shanghai Blessford, which are wholly owned subsidiaries of our direct subsidiary, PSHL. Most of our sales are made domestically in China; however, we began exporting during fiscal 2007 and our overseas market currently covers Indonesia, Thailand, the Caribbean, Nigeria and Ethiopia. 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 overall profitability and cash flows. These measures include: (1) initiating additional sales and marketing efforts to expand 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) hiring technicians to improve production management and increase quality control; (4) continue to carry out research and development (“R&D”) to improve profitability of existing products and launch new high value-add products; and (5) strengthening efforts of accounts receivables collection and limiting further credit sales. We will also continue to take appropriate actions to perform business and credit reviews of customers and suppliers with the downward pressure in the PRC economy which has caused many difficulties faced by businesses.



## **History and Corporate Structure**

We are a Delaware company. We became a public company in May 1997 through a merger with SSI Capital Corporation, a Colorado corporation. We changed our name to OraLabs Holding Corp. and engaged in the production and sale of consumer products relating to oral care and lip care and the distribution of nutritional supplements through our wholly-owned subsidiary, OraLabs, Inc. In December 2006, we merged with PSHL, a BVI company, and its sole subsidiary at the time, Chengtong, a PRC company, renamed ourselves China Precision Steel, Inc. to reflect our continuing operations. In September 2007, we reincorporated to the State of Delaware by merging into China Precision Steel, Inc., a subsidiary that we established in Delaware to effect the reincorporation.

In 2007, we added three indirect subsidiaries to our corporate structure. On April 9, 2007, we purchased Tuorong, a PRC company, through Chengtong. The sole activity of Tuorong is the ownership of a land use right with respect to facilities leased to Chengtong. On April 10, 2007, PSHL purchased Blessford International, a BVI company, for nominal consideration. Blessford International is the holding company for Shanghai Blessford, a wholly-foreign owned enterprise in China, engaged in steel processing.

The following chart reflects our organizational structure as of the date of this report:

Our business is conducted principally through Chengtong and Shanghai Blessford, both of which are Wholly Foreign Owned Enterprises, or WFOEs, under Chinese law.

Our corporate headquarters are located at 18th Floor, Teda Building, 87 Wing Lok Street, Sheung Wan, Hong Kong, and our telephone number is (011) 852-2543-2290. Although we maintain a website at [www.chinaprecisionsteelinc.com](http://www.chinaprecisionsteelinc.com), we do not intend that information available on our website be incorporated into this filing.

### **Current Environment and Our Growth Strategy**

During the year ended June 30, 2013, we saw a substantial reduction in demand for our cold rolled steel products coupled with lower selling prices, which have substantially and adversely impacted our gross margin. Tightened credit, slowing growth in China and overcapacity in the steel sector have caused large losses across the industry during Calendar year 2012. We have also made substantial provisions for our accounts receivable and advances to suppliers for the year ended June 30, 2013 due to slow turnover and risks of recoverability, a trend that is strongly correlated to those of the companies in the coal and steel sectors in China during the past two years.

Despite a difficult time for the Company and China's steel industry at present, we believe our high strength and ultra-thin cold-rolled steel products are niche products in China and our goal is to maintain our position as the leading supplier of these products in China, while we continue to build brand awareness and demand for our products internationally. We have identified three factors critical to the achievement of this goal in the past, and will continue to focus on these factors in the long run:

***Focus on Growing Niche Segments.*** We will continue to focus on niche markets. According to publicly available information, the demand for precision cold-rolled steel products has been growing at an average rate of 16% annually between 2007 and 2011 in China. Despite the slowdown in demand in the past two years and a moderate rather than double-digit growth rate outlook for the Chinese economy in the medium- to long-run, domestic consumption is expected to grow bigger from the current levels and we believe that demand for niche precision steel products such as automobile parts and components, steel roofing, plane friction discs, food packaging materials and microelectronics is expected to continue. Moreover, new applications of steel products are continually being developed. We will focus our R&D efforts on advancing processing techniques and production of high strength and

ultra-thin, cold-rolled precision steel products to enhance our product offerings and expand our market share over time.

**Compete Internationally.** We intend to continue building our brand awareness and expand our exports to compete in the international marketplace. We believe that we have already established our presence in the international market for low carbon precision cold-rolled steel products in the less than 0.1 mm to 0.2 mm used for steel roofing. We will continue to look for other product opportunities and compete on the ones where we believe that we have a competitive advantage.

**Retain Key Personnel.** The Chinese market is highly competitive for experienced and talented executives and we will strive to retain our key executives, including our Board Chairperson and Chief Financial Officer, Ms. Tak Tai Leada Li, our Chief Executive Officer, Mr. Hai Sheng Chen and our Chief Operating Officer, Mr. Zu De Jiang. Their experience in strategic expansions and in steel manufacturing, respectively, is critical to our continued growth and success.

## Overview of the Chinese Steel Industry

The following industry information has been obtained from various publicly available sources. We believe it is the most current information available on this subject, and that it is widely available and reliable.

According to the World Steel Association, China is the largest steel producing country. During calendar year 2012, China's share of world crude steel production increased to 46.3% from 45.4% in 2011, with a total production of 716.5 million tons. According to the China Iron and Steel Association, or CISA, while China's steel production accounts for almost half of the global steel output, it is currently the least profitable of the country's 39 industrial sectors. Economic slowdown and rising prices for imported iron ore have aggravated operating difficulties. During the first half of calendar year 2013, 35 out of 86 CISA members reported losses.

Steel products can be categorized as low-end (long products such as pipes, tubes, wires and rods) and high end (flat products such as hot-rolled steel or cold-rolled steel strips). Based upon information we obtained from the China Metallurgical Industry Planning and Research Institute, or CMI, we believe that approximately 65% of China's steel production are low-end long products and approximately 35% are high-end high value cold-rolled steel strips. The Company operates in the high-end category of this market with its niche precision steel processing and produces and sells high precision cold-rolled steel products.

The Chinese government has historically provided a subsidy by means of a value added tax, or VAT, rebate to exporters of steel products. This rebate was reduced in April 2007 in response to international pressure on China to curb its exports. The subsidy has been eliminated for 83 products, including hot-rolled, thin plate, steel wire, section, bar and H-beam, despite which, a 4% tax rebate currently applies to the cold-rolled steel products the Company produces.

We expect that the Chinese government will continue to impose additional controls on domestic steel producers in order to reduce pollution and ensure steel mills operate under the same rules and standards, with the aim of making competition fairer across regions. For more information on Chinese regulations, see "Regulation" below.

## Our Products

Cold-rolled specialty precision steel is a relatively new industry in China. Manufacturers of products that use specialty precision steel products have traditionally imported precision steel products from Japan, Korea, the European Union and the United States. We believe that generally, to date, the average quality and standards of China's high precision

steel industry lag behind the international norm. Over the last ten years of operation, we believe that we have begun to develop and establish a nationally recognized brand in China. We have also exported to various countries and regions including South East Asia, Africa and the Caribbean. Although we have been exporting the low-carbon ultra thin roofing materials for a number of years now, we are not yet an internationally known brand for cold-rolled precision steel products.

For the year ended June 30, 2013, we sold 56,232 tons of precision steel products. We currently produce cold-rolled precision steel coils and sheets with thickness ranging from 7.5 mm to 0.03 mm. We also provide heat treatment and cutting and slitting of steel strips not exceeding 7.5 mm thickness. Our precision steel products and services can be categorized into four major categories:

| <b>Categories</b>                           | <b>Uses</b>   | <b>Thickness</b> |
|---|---|------------------|
| Low carbon steel (cold-rolled, hard-rolled) | Steel roofing, food packaging, dry batteries, electronic devices, kitchen tools | 0.03-6.0mm       |
| High carbon steel (cold-rolled, hot-rolled) | Automobile parts and components, grinding pieces, saw blades, weaving needles   | 0.5-7.5mm        |
| Steel processing                            | Tailor made cold rolled steel products according to customer specifications     | 0.03-7.5mm       |
| Steel services                              | Heat treatment; cutting and slitting  |                  |

We produce our cold-rolled precision steel strips using a process that utilizes our proprietary know-how and certain patented technology. The finished products have a reduced thickness ranging from 7.5 mm to 0.03 mm, and a width of between 1000 mm and 1450 mm. We also provide heat treatment and cutting and slitting services for steel coils with thicknesses not exceeding 7.5 mm. We are not aware of any other company in China that currently manufactures high carbon high strength cold-rolled steel with a width of or exceeding 1400 mm.

Our low carbon products have a carbon content of less than 0.1%. Low carbon steel is a very versatile and useful material with good mechanical properties. It is easily machined and worked into complex shapes, and is low in cost. Our high carbon products have a carbon content of 0.3% and are typically engineered steel products. Hard-rolled or cold-rolled steel with high carbon has a carbon content of 0.8% or more. This precision steel product is very hard and quite brittle and is much less ductile than low carbon steel. High carbon steel has good wear resistance and is used for railways as well as for cutting tools. Acid wash steel is also known as acid pickling and refers to the process of using liquid acids, for example hydrochloric acid, to remove rust or oxides from the surface of steel. Removing rust prepares the surface for a protective coating.

Cold-rolled steel products are manufactured from hot-rolled de-scaled (pickled) steel coils which are processed by cold reduction through a cold-rolling mill to customer specified thicknesses. The process does not involve heating and the primary feature of cold reduction is to reduce the thickness of the steel coils. However, because the cold reduction operation induces very high strains (work hardening) into the steel sheet, the precision steel sheet not only becomes thinner, but also becomes much harder, less ductile and very difficult to form. In order to make the cold-reduced steel products soft and formable, they are annealed, or heated to high temperatures. Cold-rolled sheet products are used in a wide variety of end applications, such as home appliances (refrigerators, washers, dryers, and other small appliances), automobiles (exposed as well as unexposed parts), steel roofing, electric motors, microelectronics and food packaging.

## **Production Facilities**

### ***Cold Rolling Mills***

Due to different processing times and product specifications, the capacity of our mills varies depending on the types of products we use them to produce. As of June 30, 2013, we had an annual production capacity of approximately 200,000 tons based on our targeted product structure, comprised of:

one 1100 mm 12-high cold rolling mill, with a current operating capacity of 80,000 tons;

one 1400 mm 12-high cold rolling mill, with a current operation capacity of 60,000 tons; and

one 1450 mm 4-high cold rolling mill, with a current operation capacity of 60,000 tons.

Our first rolling mill primarily manufactures low carbon precision cold-rolled steel products. The second and third mills focus on the production of high carbon, high strength cold-rolled steel products and the production of more complex and higher strength precision steel products that cannot be manufactured in our first rolling mill.

### ***Hydrogen Annealing Furnace***

Our annealing furnaces automatically control the complete annealing process. The furnace uses pure hydrogen as protective gas to make the steel surface clean and smooth with no carbon-off post-annealing. The furnace also includes an oxygen station. In addition to the cold-rolling mills and annealing furnaces, we also have a 1250 mm cleaning line, a 1000 mm cutting and slitting line and a 1200 mm tension leveller.

**Raw Materials and Suppliers**

We are not dependent on any one single supplier for supply of hot-rolled coils. Several Chinese steelmakers supply hot-rolled coils to us. Our largest supplier for the year ended June 30, 2013 was Maoxun Trading Co., Ltd.

Below is a list of our principal suppliers during the years ended June 30, 2013 and 2012:

| Suppliers                                       | 2013      |                | 2012         |                |
|---|-----------|----------------|--------------|----------------|
|   | \$        | % to Purchases | \$           | % to purchases |
| Maoxun Trading Co., Ltd.                        | 4,640,101 | 14             | -*           | - *            |
| Changshu Jiacheng Steel Plate Co., Ltd.         | 3,122,782 | 10             | -*           | - *            |
| Dachang Huizu Baosheng Steel Products Co., Ltd. | -         | * -            | * 31,035,606 | 26             |
| Hebei Nuojin Trading Co., Ltd.                  | -         | * -            | * 28,581,403 | 24             |
| Wuxi Hangda Trading Co., Ltd.                   | -         | * -            | * 14,389,057 | 12             |

*\* Not major suppliers for the relevant years*

The price of steel coils is competitive, volatile and dependent on supply and demand. We have seen both sharp increases in our raw material prices over the past years caused by inflation and temporary shortage and sharp decreases in steel prices due to oversupply and weak demand. In order to secure sufficient supply of raw material for necessary production, we have made bulk purchases in the past after taking into account customers' orders on hand and steel supply at the time. As steel coils have a long shelf-life, obsolescence is not a major concern. However, due to steel price volatilities, the advance contracted prices of these purchases could adversely impact our margins during a downward trend in steel prices.

## Customers

We currently have approximately 230 customers, with domestic customers primarily located in East China and overseas sales reaching Thailand, Nigeria, Ethiopia and the Caribbean. Our location in Shanghai with a well developed transport network is particularly advantageous for meeting with customers from inside and outside of China for product design discussions and customer service. We have reconnected with a few customers in the automotive components segment during the year ended June 30, 2013, and intend to increase our customer base by further expanding into North China, where the automotive industries are concentrated.

Below is a list of our principal customers during the years ended June 30, 2013 and 2012:

| Customers                               | 2013      |            | 2012         |            |
|---|-----------|------------|--------------|------------|
|   | \$        | % to sales | \$           | % to sales |
| Shanghai Hongyu Metal Co., Ltd.         | 6,290,377 | 17         | -*           | - *        |
| Changshu Jiacheng Steel Plate Co., Ltd. | 5,278,035 | 15         | -*           | - *        |
| Shanghai Shengdejia Metal Co., Ltd.     | -         | *          | * 17,829,967 | 12         |
| Shanghai Changshuo Steel Co., Ltd.      | -         | *          | * 14,842,069 | 11         |

*\* Not major customers for the relevant years*

## Sales and Marketing

Our high precision steel products are sold both to components manufactures and directly to the end-users in various parts of China and international marketplace such as Indonesia, Thailand, the Caribbean, Nigeria, Ethiopia and Turkey. Majority of new orders come from customers reducing imports and adding further capacity in China. We have strengthened our sales and marketing efforts during the year ended June 30, 2013 by actively reestablishing connection with old customers whom we lost during the years as a result of our product focus shift and potential customers whom our products would be fit for.

## Competition



Our business is concentrated in the niche segments of low carbon ultra-thin cold-rolled steel and high-carbon high strength cold-rolled steel. We are not in direct competition with large Chinese steelmakers such as Baosteel Group Corporation and Magang Group. China's large steelmakers concentrate on the production of crude steel and hot-rolled steel from imported iron ore mainly imported from Brazil and Australia. Hot-rolled steel coils produced by these steelmakers are supplied as raw materials to down stream steel processors, such as us, for cold reduction processing to the desired thickness for various applications. Cold-rolled steel products are then sold to manufacturers and other customers in industries such as automobile and food packaging.

Our business has become increasingly competitive and capital intensive in recent years due to tightened credit, rising operating costs in China, and a continuously appreciating RMB against USD which has made the prices of imports more competitive. Some of our competitors have financial resources, staff and facilities substantially greater than ours and we may be at a competitive disadvantage compared with larger companies, particularly the state owned enterprises. Our domestic competition in China's ultra-thin cold-rolled precision steel segment comes from a few manufacturers scattered around different parts of China. However, we understand that these manufacturers mainly produce cold-rolled steel with widths of 400 mm or less, whereas our products have a width between 1000 mm to 1450 mm. Consequently, their products are sold in a different market segment than ours and are not considered to be direct competition. In the high carbon cold-rolled steel products segment, we mainly compete with imports from Shinwha Steel Co., Ltd. in Korea. Further, there are potential competitors who are currently constructing mills that are expected to produce precision and specialty steel products both in China and internationally.

Although there is intense competition in China's steel industry, this affects mostly the low-carbon product segment. We believe we are still currently one of the leading suppliers of high carbon, high strength cold-rolled steel products with a thickness up to 7.5 mm in China. We are not aware of any other Chinese manufacturer processing high carbon cold-rolled steel products with this specification. In addition, the low carbon precision cold-rolled steel products in the thickness range between 0.1 to 0.2 mm are also where we have our technological expertise and competitive strength. Since fiscal 2007 we have been exporting low carbon products in this range and we are not aware of any other Chinese manufacturer currently competing in this specific low carbon segment in the global market.

## **Research and Development**

As of June 30, 2013, we had 2 experienced engineers and technicians in the Research and Development Department. The Research and Development Department focuses on new product development, and the advancement and improvement in quality and manufacturing technique of ultra-thin and high-strength cold-rolled steel strip. In addition to the traditional research and development activities, our engineers frequently interact with customers to detect changes in "patterns" and customers' specifications arising from constantly changing industry needs.

Further, we are working on research and development projects involving coiled springs for automotive seat belts and steel for igniters in automotive air bag inflation devices. We have budgeted 0.5% of revenues to be spent for research and development activities for fiscal 2014.

## **Quality Control**

Following the accreditation of the International Organization for Standardization, or ISO, on October 8, 2004, we implemented the Quality Handbook in October 2004. This Quality Handbook was prepared on the basis and standards of the ISO/TS16949 specifications, which ISO Technical Specifications are compatible with existing American (QS-9000), German (VDA6.1), French (EAQF) and Italian (AVSQ) automotive quality systems standards within the global automotive industry. Together with ISO 9001:2000, ISO/TS 16949 specifies the quality system requirements for the design, development, production, installation and servicing of automotive related products.

## **Intellectual Property**

On December 8, 2004, the State Intellectual Property Office in China granted a ten-year patent right to the “Environment-Conscious Mill Bearing with Inner Circulation Lubricant” to Chengtong and Shanghai Te’an-Yikai Bearing Co., Limited, or Te’an-Yikai. The patented bearing is installed in our existing cold-roll mill and, together with our internal know-how complementary to the patented bearing, we believe we address a number of issues associated with the bearing lubrication in cold-rolling and ensure smooth and effective operation of the cold-roll mill. There is no direct or indirect affiliation between us and Te’an-Yikai. We and Te’an-Yikai jointly developed the environment-conscious mill bearing with inner circular lubrication Te’an-Yikai retains the proprietary right to the technology while we have the exclusive right to the application of the technology.

We have elected not to register any other patents and internally developed know-how because of the uncertainty over the ability to enforce intellectual property rights in China. We also protect our internally developed know-how and production process (such as system pressure, cleanliness of the lubrication, temperature control, appropriate allocation of oil supply and retrieving which are vital in providing a radical solution to the difficulties associated with lubricating rolling mills’ backing bearing) by requiring all key personnel (production engineers and management staff members) to sign non-disclosure and confidentiality contracts.

There can be no assurance that third parties will not assert infringement or other claims against us with respect to any of our existing or future products or processes. There can be no assurance that licenses would be available if any of our technology was successfully challenged by a third party, or if it became desirable to use any third-party technology to enhance our products. Litigation to protect our proprietary information or to determine the validity of any third-party claims could result in a significant expense and divert the efforts of our technical and management

personnel, whether or not such litigation is determined in our favor.

While we have no knowledge that we are infringing upon the proprietary rights of any third party, there can be no assurance that such claims will not be asserted in the future with respect to existing or future products or processes. Any such assertion by a third party could require us to pay royalties, to participate in costly litigation and defend licensees in any such suit pursuant to indemnification agreements, or to refrain from selling an alleged infringing product.

## Employees

As of June 30, 2013, we employed a total of 231 full-time employees. The following table sets forth the number of our employees by function.

| Function                        | Number of Employees |
|---------------------------------|---------------------|
| Senior Management               | 9                   |
| Equipment & Maintenance         | 30                  |
| Production                      | 123                 |
| Sales and Marketing             | 12                  |
| Logistics                       | 30                  |
| Quality Control                 | 8                   |
| Research & Development          | 2                   |
| Human Resource & Administration | 12                  |
| Accounting                      | 5                   |
| Total                           | 231                 |

Each employee must enter into multiple employment contracts, including a non-competition agreement, which are then filed with the municipal government. All employees receive a base monthly salary. Executive employees are also eligible for a discretionary year-end bonus based upon our overall performance results, seniority and individual performance and contribution to the Company. Production employees are entitled to a monthly bonus calculated on the basis of the quality of the products produced, and their respective contribution to volume, safe production, correct use of equipment and energy saving. Our production employees are not subject to collective bargaining agreements. However, we maintain a satisfactory working relationship with our employees, and we have not experienced any significant labor disputes or any difficulty in recruiting staff for our operations.

Our employees in China participate in a state pension plan mandated by Chinese municipal and provincial governments. Benefits include social security, pension benefits, and medical insurance. The Company contributes approximately 37% of annual salaries to the pension plan on behalf of all qualified employees.

We believe that we are in material compliance with relevant PRC labor laws.

## **Regulation**

### ***General Regulation of Business***

The Chinese legal system is based upon a civil law system of written statutes. Unlike the common law system in the United States, prior court decisions may be cited for reference but are not binding on subsequent cases and have limited value as precedent. Since 1979, the PRC legislative bodies have promulgated laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. We are subject to numerous Chinese provincial and local laws and regulations, which may be changed from time to time in response to economic or political conditions and have a significant impact upon overall operations. Changes in these regulations could require us to expend significant resources to comply with new laws or regulations or changes to current requirements and could have a material adverse effect on our operations and financial results.

The China Central Government has promulgated a series of ongoing macro-control policies which focus on the improvement of the country's investment structure, with the goal to secure a fast and sound development of the national economy. Excessive investment in certain sectors is placed under stringent control while incentives are given to other sectors.

### ***Environmental Laws***

We are currently subject to numerous Chinese provincial and local laws and regulations relating to the protection of the environment. These laws continue to evolve and are becoming increasingly stringent. The ultimate impact of complying with such laws and regulations is not always clearly known or determinable because regulations under some of these laws have not yet been promulgated or are undergoing revision.

The State Environmental Protection Administration Bureau is responsible for the supervision of environmental protection, the implementation of national standards for environmental quality and discharge of pollutants, and supervision of the environmental management system in China. Environmental protection bureaus at the county level or above are responsible for environmental protection within their jurisdictions. The laws and regulations on environmental protection require each company to prepare environmental impact statements for a construction project to the environmental protection bureaus at the county level. These must be prepared prior to when the construction, expansion or modification commences.

The Environmental Protection Law requires production facilities that may cause pollution or produce other toxic materials to take steps to protect the environment and establish an environmental protection and management system. The system includes the adoption of effective measures to prevent and control exhaust gas, sewage, waste residues, dust and other waste materials. Entities discharging pollutants must register with the relevant environmental protection authorities.

Penalties for breaching the Environmental Protection Law include a warning, payment of a penalty calculated on the damage incurred, or payment of a fine. When an entity has failed to adopt preventive measures or control facilities that meet the requirements of environmental protection standards, it may be required to suspend its production or operations and pay a fine. Material violations of environmental laws and regulations causing property damage or casualties may also be subject to criminal liabilities.

We believe that our current production and operating activities are in compliance with the environmental protection requirements. We are not subject to any admonition, penalty, investigations or inquiries imposed by the environmental regulators, nor are we subject to any claims or legal proceedings to which we are named as defendant for violation of any environmental laws and regulations. To the best of our knowledge, our cold-rolled mills produce no impermissible emissions. Our pickling process is outsourced to local companies which are wholly-responsible for any failure to comply with applicable law. In addition, our production facilities in Shanghai are on land formerly used for rice farming. We have no reason to believe that such land has been subjected to any prior contamination.

### ***Patent Protection***

The PRC's intellectual property protection regime is consistent with those of other modern industrialized countries, although enforcement of rights may prove difficult and complex. China has domestic laws for the protection of rights in copyrights, patents, trademarks and trade secrets. The PRC is also a signatory to most of the world's major intellectual property conventions, including:

Convention establishing the World Intellectual Property Organization (WIPO Convention) (June 4, 1980);

Paris Convention for the Protection of Industrial Property (March 19, 1985);

Patent Cooperation Treaty (January 1, 1994); and

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) (November 11, 2001).

Patents are governed by the China Patent Law and its Implementing Regulations, each of which went into effect in 1985 and have been amended subsequently. China is a signatory to the Paris Convention for the Protection of Industrial Property, in accordance with which any person who has duly filed an application for a patent in one signatory country shall enjoy, for the purposes of filing in the other countries, a right of priority during the period fixed in the convention (12 months for inventions and utility models, and 6 months for industrial designs).

The Patent Law covers three kinds of patents, i.e. patents for inventions, utility models and designs. The Chinese patent system adopts the principle of first to file. This means that, where more than one person files a patent application for the same invention, a patent can only be granted to the person who first filed the application. Consistent with international practice, the PRC only allows the patenting of inventions or utility models that possess the characteristics of novelty, inventiveness and practical applicability. For a design to be patentable, it should not be identical with or similar to any design which, before the date of filing, has been publicly disclosed in publications in the country or abroad or has been publicly used in the country and should not be in conflict with any prior right of another.

PRC law provides that anyone wishing to exploit the patent of another must conclude a written licensing contract with the patent holder and pay the patent holder a fee. One rather broad exception to this, however, is that where a party possesses the means to exploit a patent but cannot obtain a license from the patent holder on reasonable terms and in a reasonable period of time, the PRC State Intellectual Property Office, or SIPO, is authorized to grant a compulsory license. A compulsory license can also be granted where a national emergency or any extraordinary state of affairs occurs or where the public interest so requires. SIPO, however, has not granted any compulsory license up to now. The patent holder may appeal such decision within three months from receiving notification by filing a suit in the People's Court.

PRC law defines patent infringement as the exploitation of a patent without the authorization of the patent holder. A patent holder who believes his patent is being infringed may file a civil suit or file a complaint with a PRC local Intellectual Property Administrative Authority, which may order the infringer to stop the infringing acts. A preliminary injunction may be issued by the People's Court upon the patentee's or the interested parties' request before instituting any legal proceedings or during the proceedings. Evidence preservation and property preservation measures are also available both before and during the litigation. Damages in the case of patent infringement is calculated as either the loss suffered by the patent holder arising from the infringement or the benefit gained by the infringer from the infringement. If it is difficult to ascertain damages in this manner, damages may be reasonably determined in an amount in excess of the license fee under a contractual license. The infringing party may be also fined by Administration of Patent Management in an amount of up to three times the unlawful income earned by such infringing party. If there is no unlawful income so earned, the infringing party may be fined in an amount of up to RMB 500,000, or approximately \$74,000.

### ***Labor Laws***

The new Labor Contract Law took effect January 1, 2008 and governs standard terms and conditions for employment, including termination and lay-off rights, contract requirements, compensation levels and consultation with labor unions, among other topics. In addition, the law limits non-competition agreements with senior management and other employees with knowledge of trade secrets to two years and imposes restrictions or geographical limits.

### ***Taxation***

On March 16, 2007, the National People's Congress of China passed the Enterprise Income Tax Law, or the EIT Law, and on November 28, 2007, the State Council of China passed its implementing rules, both of which took effect on January 1, 2008. The EIT Law and its implementing rules impose a unified earned income tax, or EIT, rate of 25.0% on all domestic-invested enterprises and foreign invested enterprises, or FIEs, unless they qualify under certain limited exceptions. As a result, our PRC operating subsidiaries are subject to an earned income tax of 25.0%. Before the implementation of the EIT Law, FIEs established in the PRC, unless granted preferential tax treatments by the PRC government, were generally subject to an EIT rate of 33.0%, which included a 30.0% state income tax and a 3.0% local income tax.

In addition to the changes to the current tax structure, under the EIT Law, an enterprise established outside of China with “de facto management bodies” within China is considered a resident enterprise and will normally be subject to an EIT of 25% on its global income. The implementing rules define the term “de facto management bodies” as “an establishment that exercises, in substance, overall management and control over the production, business, personnel, accounting, etc., of a Chinese enterprise.” If the PRC tax authorities subsequently determine that we should be classified as a resident enterprise, then our organization’s global income will be subject to PRC income tax of 25%. For detailed discussion of PRC tax issues related to resident enterprise status, see Item 1A, “Risk Factors – Risks Related to Doing Business in China – Under the New Enterprise Income Tax Law, we may be classified as a “resident enterprise” of China. Such classification will likely result in unfavorable tax consequences to us and our non-PRC stockholders.”

### ***Foreign Currency Exchange***

All of our sales revenue and expenses are denominated in RMB. Under the PRC foreign currency exchange regulations applicable to us, RMB is convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions. Currently, our PRC operating subsidiaries may purchase foreign currencies for settlement of current account transactions, including payments of dividends to us, without the approval of the PRC State Administration of Foreign Exchange, or SAFE, by complying with certain procedural requirements. Conversion of RMB for capital account items, such as direct investment, loan, security investment and repatriation of investment, however, is still subject to the approval of SAFE. In particular, if our PRC operating subsidiaries borrow foreign currency through loans from us or other foreign lenders, these loans must be registered with SAFE, and if we finance the subsidiaries by means of additional capital contributions, these capital contributions must be approved by certain government authorities, including the PRC Ministry of Commerce, or MOFCOM, or their respective local branches. These limitations could affect our PRC operating subsidiaries’ ability to obtain foreign exchange through debt or equity financing.

### ***Dividend Distributions***

Our revenues are earned by our PRC subsidiaries. However, PRC regulations restrict the ability of our PRC subsidiaries to make dividends and other payments to their offshore parent company. PRC legal restrictions permit payments of dividend by our PRC subsidiaries only out of their accumulated after-tax profits, if any, determined in accordance with PRC accounting standards and regulations. Each of our PRC subsidiaries is also required under PRC laws and regulations to allocate at least 10% of our annual after-tax profits determined in accordance with PRC GAAP to a statutory general reserve fund until the amounts in such fund reaches 50% of its registered capital. These reserves are not distributable as cash dividends. Our PRC subsidiaries have the discretion to allocate a portion of their after-tax profits to staff welfare and bonus funds, which may not be distributed to equity owners except in the event of liquidation.



In addition, under the EIT Law, the *Notice of the State Administration of Taxation on Negotiated Reduction of Dividends and Interest Rates*, which was issued on January 29, 2008, and the *Notice of the State Administration of Taxation Regarding Interpretation and Recognition of Beneficial Owners under Tax Treaties*, which became effective on October 27, 2009, dividends from our PRC operating subsidiaries paid to us through our subsidiaries may be subject to a withholding tax at a rate of 10%. Furthermore, the ultimate tax rate will be determined by treaty between the PRC and the tax residence of the holder of the PRC subsidiary. Dividends declared and paid from before January 1, 2008 on distributable profits are grandfathered under the EIT Law and are not subject to withholding tax.

The Company intends on reinvesting profits, if any, and does not intend on making cash distributions of dividends in the near future.

#### **ITEM 1A. RISK FACTORS.**

*We operate in a highly competitive environment in which there are numerous factors which can influence our business, financial position or results of operations and which can also cause the market value of our common stock to decline. Many of these factors are beyond our control and therefore, are difficult to predict. The following section sets forth what we believe to be the principal risks that could affect us, our business or our industry, and which could result in a material adverse impact on our financial results or cause the market price of our common stock to fluctuate or decline.*

#### **RISKS RELATED TO OUR BUSINESS**

*Demand for our products has decreased and there can be no assurance it will increase in the foreseeable future.*

During the year ended June 30, 2013, we experienced a substantial reduction in demand for our cold rolled steel products. In addition, tightened credit, slowing growth and stricter industry rules and regulations in China have caused our allowance for bad and doubtful debts to rise sharply for the year ended June 30, 2013, a trend that is strongly correlated to those of the companies in the coal and steel sectors in China during the past two years. If demand for our products does not increase, it would continue to have a material adverse effect upon the Company and our results of operations.

***Steel consumption is cyclical and worldwide overcapacity in the steel industry and the availability of alternative products has resulted in intense competition, which may have an adverse effect on our profitability and cash flow.***

Steel consumption is highly cyclical and generally follows general economic and industrial conditions both worldwide and in various smaller geographic areas. The steel industry has historically been characterized by excess world supply. This has led to substantial price decreases during periods of economic weakness, which have not been offset by commensurate price increases during periods of economic strength. Substitute materials are increasingly available for many steel products, which may further reduce demand for steel. Additional overcapacity or the use of alternative products could have a material adverse effect upon our results of operations.

***The risk that we could suffer unrecoverable losses on our accounts receivable may be increased by our practice of offering extended customer credit and payment terms to our customers, together with the current negative global economic conditions. Any such unrecoverable losses could adversely affect our financial results.***

We operate our business in China. Credit periods vary substantially in China across industries, segments, types and size of companies. We operate in a niche of the China steel industry, specifically in the manufacture and sale of high precision cold-rolled steel products and in the provision of heat treatment and cutting of medium and high carbon hot-rolled steel strips. Our customers are also niche operators, including manufacturers of automobile parts and components, steel roofing, plane friction discs, appliances, food packaging materials, saw blades, textile needles and microelectronics. Because of the nature of our business, our business cycle and that of our customers is relatively long. As a result, the credit and payment terms that we extend to our customers in the normal course of business are also relatively long. We offer credit to our customers for periods of 60 days, 90 days, 120 days and 180 days, with the longer credit terms generally offered to longstanding recurring customers with good payment histories and sizable operations. The Company maintains an allowance for doubtful accounts based on its assessment of the collectability of the accounts receivable. Our management determines the collectability of outstanding accounts by maintaining at least quarterly communication with such customers and obtaining confirmation of their intent and ability 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 and the financial condition of the customer, to the extent discoverable.

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

The following table reflects the aging of our accounts receivable as of June 30, 2013 and 2012, after taking into consideration credit periods offered to our customers. As of June 30, 2013, our accounts receivable over 180 days is spread among approximately 11 different customers.

**June 30, 2013**

| US\$         | Total      | Current   | 1 to 30<br>days | 31 to 90<br>days | 91 to 180<br>days | 181 to 360<br>days | over<br>1 year |
|--------------|------------|-----------|-----------------|------------------|-------------------|--------------------|----------------|
| <b>TOTAL</b> | 60,123,111 | 6,328,112 | 1,605,948       | 955,364          | 8,932,972         | 23,314,353         | 18,986,362     |
| <b>%</b>     | 100        | 10        | 3               | 1                | 15                | 39                 | 32             |

**June 30, 2012**

| US\$         | Total      | Current    | 1 to 30<br>days | 31 to 90<br>days | 91 to 180<br>days | 181 to 360<br>days | over<br>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              |

Approximately 71% and 8% of our accounts receivable as of June 30, 2013 and 2012 were over 180 days past due. 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 100% provision for all accounts receivable over 1 year past due. There was a provision for accounts receivable bad debts of \$28,089,004 and \$2,150,984 recognized for the years ended June 30, 2013 and 2012, respectively. We note that the continuation or intensification of the credit tightening in China and the slowdown of the Chinese economy had and will continue to have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations to us.

We will regularly review credit periods offered, 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, including reducing such allowances if uncollectable accounts do not actually increase and the other factors we consider in determining the collectability of accounts do not deteriorate. However, if our actual collection experience with our customers or other conditions change, or the other factors that we consider indicate that it is appropriate, a further provision for doubtful accounts may be required, which could adversely affect our financial results.

***We provide advances to suppliers when placing purchase orders in the ordinary course of our business. If we must write off a material amount of these advances for any reason, or if we are unable to obtain delivery of raw material from suppliers to whom we have paid advances for any reason, our financial results will be negatively impacted.***

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 and the balance of our advances decrease when we take down contracted material at a future date. Balances decrease at a slower rate when demand is low as we take fewer deliveries from our suppliers.

Advances to suppliers are shown net of an allowance which represents potentially unrecoverable cash advances at each balance sheet date. 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 ensure the appropriateness of the allowance in light of the circumstances present at the time of the review. 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. 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 June 30, 2013 and 2012, the Company had made allowances of advances to suppliers of \$19,689,609 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. During the year ended June 30, 2013, due to stricter environmental rules imposed on Chinese steel manufacturers as part of the ongoing industry reform, one of our suppliers was ordered by the relevant authority to halt all production as nearby residents are exposed to dangerous pollution caused by its production and waste. We believe we will be not able to recover these advances paid to this supplier and have written off such advances. There was a provision for advances to suppliers bad debts of \$19,348,204 and \$2,871,154 recognized for the years ended June 30, 2013 and 2012, respectively. If any additional advances to suppliers must be written-off, or if we cannot secure delivery of raw materials that were prepaid with such advances, our financial results will be negatively impacted.

***Excess supply in China and other developing economies has resulted in additional excess worldwide capacity and falling steel prices, which is adversely impacting our results and may continue to do so in the future.***

During previous years steel consumption in China and other developing economies such as India increased at a rapid pace. Steel companies responded by increasing steel production capacity in these countries and entering into long-term contracts with iron ore suppliers in Australia and Brazil. During the past year demand for steel in China decreased significantly. The excess manufacturing capacity in China and worldwide has resulted in an excess supply of steel, which has in turn resulted in falling prices for steel and steel products. Our operating results have been materially and adversely affected, and we expect that we will continue to be impacted in the future. Although we are implementing a series of strategies to help improve our operating results, there can be no assurance that we will be able to return to profitability.

***Environmental compliance and remediation could result in substantially increased capital requirements and operating costs.***

Our operating subsidiaries, Chengtong and Shanghai Blessford, are subject to numerous Chinese provincial and local laws and regulations relating to the protection of the environment. These laws continue to evolve and are becoming increasingly stringent. The ultimate impact of complying with such laws and regulations is not always clearly known or determinable because regulations under some of these laws have not yet been promulgated or are undergoing revision. Our consolidated business and operating results could be materially and adversely affected if our operating subsidiaries were required to increase expenditures to comply with any new environmental regulations affecting its operations.

***We may require additional capital in the future and we cannot assure that capital will be available on reasonable terms, if at all, or on terms that would not cause substantial dilution to stockholdings.***

The development of high quality specialty precision steel requires substantial funds. Sourcing external capital funds for product development and requisite capital expenditures are key factors that have and may in the future constrain our growth, production capability and profitability. To achieve the next phase of our corporate growth, increased production capacity, successful product development and additional external capital will be necessary. There can be no assurance that such capital will be available in sufficient amounts or on terms acceptable to us, if at all. Any sale of a substantial number of additional shares of common stock or securities convertible into common stock will cause dilution to the holders of our common stock and could also cause the market price of our common stock to decline.

***We face significant competition from competitors who have greater resources than we do, and we may not have the resources necessary to successfully compete with them.***

We are one of a few manufacturers of specialty precision steel products in China. Differences in the type and nature of the specialty precision steel products in China's steel industry are relatively small, and, coupled with intense competition from international and local suppliers, to a limited extent, consumers' demand can be price sensitive. Competitors may increase their market share through pricing strategies that adversely impact our business. Our business is in an industry that is becoming increasingly competitive and capital intensive, and competition comes from manufacturers located in China as well as from international competition. Our competitors may have financial resources, staff and facilities substantially greater than ours and we may be at a competitive disadvantage compared with larger companies.

***We produce a limited number of products and may not be able to respond quickly to significant changes in the market or new market entrants.***

Cold-rolled specialty precision steel is a relatively new industry in China; Chinese manufacturers of durable goods previously relied solely on imports from Japan, Korea, the European Union and the United States. We believe the average quality and standards of products of China's high precision steel industry lags behind the international norm. During the last four years, we have developed a nationally recognizable brand, however, we are not yet an internationally recognizable brand for our specialty steel products. Although we offer high precision cold rolled steel products in over 100 specifications, there are many other specialty precision steel products of similar nature in the market, even though none currently compete directly with our products. If there are significant changes in market demands and/or competitive forces, we may not be able to change our product mix or adapt our production equipment quickly enough to meet customers' needs. Under such circumstances, our narrow band of precision steel products and/or new market entrants may negatively impact our financial performance.

***Increased imports of steel products into China could negatively affect domestic steel prices and demand levels and reduce profitability of domestic producers.***

Based on our understanding, China's total production capacity of precision cold-rolled steel coils was over two million tons as of June 30, 2012. However, domestic production continues to be insufficient to meet demand due to limited processing capability and product offerings. As a result, China continues to import a significant portion of its steel products. Foreign competitors may have lower labor costs, and are often owned, controlled or subsidized by their governments, which allows their production and pricing decisions to be influenced by political and economic policy considerations as well as prevailing market conditions. Import levels may also be impacted by decisions of government agencies, under trade laws. Increases in future levels of imported steel could negatively impact future market prices and demand levels for our precision steel products.

***We are dependent on our Chinese manufacturing operations to generate the majority of our income and profits, and the deterioration of any current favorable local conditions may make it difficult or prohibitive to continue to operate or expand in China.***

Our current manufacturing operations are located in China, our administrative offices are in Hong Kong and we have additional establishments in the British Virgin Islands. The geographical distances between these facilities create a number of logistical and communications challenges, including time differences and differences in the cultures in each location, which makes communication and effective cooperation more difficult. In addition, because of the location of the manufacturing facilities in China, our operations in China could be affected by, among other things:

economic and political instability in China, including problems related to labor unrest;

lack of developed infrastructure;

variances in payment cycles;

currency fluctuations;

overlapping taxes and multiple taxation issues;

employment and severance taxes;

compliance with local laws and regulatory requirements;

greater difficulty in collecting accounts receivable; and

the burdens of cost and compliance with a variety of foreign laws.

Moreover, inadequate development or maintenance of infrastructure in China, including adequate power and water supplies, transportation, raw materials availability or the deterioration in the general political, economic or social environment could make it difficult, more expensive and possibly prohibitive to continue to operate or expand our facilities in China.

***Our operations are international and we are subject to significant worldwide political, economic, legal and other uncertainties that may make it difficult or costly to collect amounts owed to us or to conduct operations should materials needed from certain places be unavailable for an indefinite or extended period of time.***

We have subsidiaries in the British Virgin Islands and China. We manufacture all of our products in China and substantially all of the net book value of our total fixed assets is located there. However, we sell our products to customers outside of China as well as domestically. As a result, we have receivables from and goods in transit to locations outside of China. Protectionist trade legislation in the United States or other countries, such as a change in export or import legislation, tariff or duty structures, or other trade policies, could adversely affect our ability to sell products in these markets, or even to purchase raw materials or equipment from foreign suppliers. Moreover, we are subject to a variety of United States laws and regulations, changes to which may affect our ability to transact business with certain customers or in certain product categories.

In China, our operating subsidiaries Chengtong and Shanghai Blessford are subject to numerous national, provincial and local governmental regulations, all of which can limit our ability to react to market pressures in a timely or effective way, thus causing us to lose business or miss opportunities to expand our business. These include, among others, regulations governing:

environmental and waste management;

our relationship with our employees, including: wage and hour requirements, working and safety conditions, citizenship requirements, work permits and travel restrictions;

property ownership and use in connection with our leased facilities in China; and

import restrictions, currency restrictions and restrictions on the volume of domestic sales.

***The end-use markets for certain of our products are highly competitive and customers are willing to accept substitutes for our products which could reduce our results of operations.***

Buyers of certain cold-rolled steel products are in highly competitive markets. Cold-rolled precision steel competes with other materials, such as aluminum, plastics, composite materials and glass, among others, for industrial and



commercial applications. Customers have demonstrated a willingness to substitute other materials for cold-rolled steel. The willingness of our customers to accept substitutes for cold-rolled steel products could have a material adverse effect on our financial results.

*We may not be able to pass on to customers the increases in the costs of our raw materials, particularly crude steel.*

We require substantial amounts of raw materials in our business, consisting principally of steel slabs and strip steel. Any substantial increases in the cost of crude steel could adversely affect our financial condition and results of operations. The availability and price of crude steel depends on a number of factors outside our control, including general economic conditions, domestic and international supply and tariffs. Increased domestic and worldwide demand for crude steel has had and will continue to have the effect of increasing the prices that we pay for these raw materials, thereby increasing our cost of goods sold. Generally, there is a potential time lag between changes in prices under our purchase contracts and the point when we can implement a corresponding change under our sales contracts with our customers. As a result, we can be exposed to fluctuations in the price of raw materials, since, during the time lag period, we may have to temporarily bear the additional cost of the change under our purchase contracts, which could have a material adverse effect on our profitability margins. If raw material prices were to increase significantly without a commensurate increase in the market value of our products, our financial condition and results of operations would be adversely affected.

*Although we are dependent on a steady flow of raw materials for our operations, we do not have in place long-term supply agreements for all of our material requirements.*

Although a substantial portion of our raw material requirements was met by Maoxun Trading Co., Ltd. for the year ended June 30, 2013, we are not dependent on any one single supplier for supply of hot-rolled coils as these coils are generally available in the market. However, we do not currently have long-term supply contracts with any particular supplier, including Maoxun Trading Co., Ltd., to assure a continued supply of the raw materials we need in our operations. While we maintain good relationships with these suppliers, the supply of raw materials may nevertheless be interrupted on account of events outside our control, which will negatively impact our operations.

***We have substantial indebtedness with floating interest rates and the cost of our borrowings may increase.***

We are subject to interest rate risk on our non-derivative financial instruments. We do not hedge our interest rate risk. At June 30, 2013, our total outstanding bank borrowings amounted to \$44,228,722, all of which were interest-bearing. Substantially all of the bank debt was floating-rate debt with interest rates which vary with changes in the standard rate set by the People's Bank of China for RMB loans, and SIBOR and LIBOR for USD loans. A change in the interest rate or yield of fixed rate debt will only impact the fair value of such debt, while a change in the interest rate of floating rate, or variable rate, debt will impact interest expense as well as the amount of cash required to service such debt. To the extent interest rates increase, we will be liable for higher interest payments to our lenders. We anticipate that annual interest on loans for the fiscal year ending June 30, 2014 will be approximately \$2,830,095. The impact of a 1% increase in interest rates will increase interest expense by approximately \$442,288. An increase in short-term interest rates at the time that we seek to refinance short-term borrowings may increase the cost of borrowings, which may adversely affect our earnings and cash available.

***We are dependent on our borrowing facilities to meet our operating needs. Our failure to cure an ongoing default on repayment obligations under certain outstanding loans could have a material adverse impact on our business and operations.***

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 defaulted on its semi-annual principal and interest repayment obligation in June 2012. Further, the Company has not met its financial covenants under the DEG loan agreement including the Debt Service Coverage Ratio and the Interest Bearing Debt/EBITDA ratio. The Company is currently in discussions with DEG regarding the possibility to restructure the loan for repayment but has not yet agreed on specific terms. 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 \$27,246,477 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 are 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 possibility to restructure 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 this bank.

There can be no assurance that the Company will be able to successfully work out a repayment plan with DEG and RZB or otherwise fulfill its obligations under any of the loans. 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. Each of DEG and RZB 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 may not be able to generate sufficient cash to service all of our indebtedness and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.***

If we are unable to successfully work out a repayment plan for our defaulted bank loans, we may be forced to sell assets, seek additional capital or restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our outstanding debt service obligations. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. Our secured bank loans restrict our ability to dispose of assets and use the proceeds from the disposition. We may not be able to consummate those dispositions or to obtain the proceeds that we could realize from them, and these proceeds may not be adequate to meet any debt service obligations then due.

***The loss of any key executive or our failure to attract and retain key personnel could adversely affect our future performance, strategic plans and other objectives.***

The loss or failure to attract and retain key personnel could significantly impede our future performance, including product development, strategic plans, marketing and other objectives. Our success depends to a substantial extent not only on the ability and experience of our senior management, but particularly upon our Chairperson and Chief Financial Officer, Ms. Tak Tai Leada Li, our Chief Executive Officer, Mr. Hai Sheng Chen, and our Chief Operating Officer, Mr. Zu De Jiang. We do not currently have in place key man life insurance for these executive officers. To the extent that the services of these officers would be unavailable to us, we would be required to recruit other persons to perform the duties performed by them. We may be unable to employ other qualified persons with the appropriate background and expertise to replace these officers and directors on terms suitable to us.

***We may not be able to retain, recruit and train adequate management and production personnel. We rely heavily on those personnel to help develop and execute our business plans and strategies, and if we lose such personnel, it would reduce our ability to operate effectively.***

Our continued operations are dependent upon our ability to identify and recruit adequate management and production personnel in China. We require trained graduates of varying levels and experience and a flexible work force of semi-skilled operators. Many of our current employees come from the more remote regions of China as they are attracted by the wage differential and prospects afforded by Shanghai and our operations. With the economic growth currently being experienced in China, competition for qualified personnel is substantial, and there can be no guarantee that a favorable employment climate will continue and that wage rates we must offer to attract qualified personnel will enable us to remain competitive internationally. The inability to attract such personnel or the increased cost of doing so could reduce our competitive advantage relative to other precision steel producers, reducing or eliminating our growth in revenues and profits.

***We may not be able to protect adequately our intellectual property from infringement or unauthorized use by third parties.***

Except for a patent on the Environment-Conscious Mill Bearing with Inner Circular Lubrication, we have no patents or licenses that protect our intellectual property. Unauthorized parties may attempt to copy aspects of our processes and know-how or to obtain and use information that we regard as proprietary. Policing unauthorized use of our processes and know-how is difficult. Our experienced key engineers and management staff are extensively involved in all facets of research, design, craftwork, styling and development of the specialty precision products. Potential risks on the divulgence of skills and the development of new products increase should these employees resign, as we rely heavily on them. We have elected to protect internally developed know-how and production processes (such as system pressure, cleanliness of the lubrication, temperature control, appropriate allocation of oil supply and retrieving, which are vital in providing a radical solution to the difficulties associated with lubricating rolling mills' backing bearing) by requiring all key personnel (production engineers and management staff) to sign non-disclosure and confidentiality contracts. However, this means of protecting our proprietary rights may not be adequate. In addition, the laws of some foreign countries do not protect our proprietary rights as extensively as do U.S. laws. Our failure to protect adequately our proprietary rights may allow third parties to duplicate our products, production processes or develop functionally equivalent or superior technology. In addition, our competitors may independently develop similar technologies or design around our proprietary intellectual property.

***We are subject to risks associated with changing technology and manufacturing techniques, which could place us at a competitive disadvantage.***

The successful implementation of our business strategy requires us to continuously evolve our existing products and services and introduce new products and services to meet customers' needs. Our designs and products are characterized

by stringent performance and specification requirements that mandate a high degree of manufacturing and engineering expertise. We believe that our customers rigorously evaluate our services and products on the basis of a number of factors, including, but not limited to:

quality;

price competitiveness;

technical expertise and development capability;

innovation;

reliability and timeliness of delivery;

product design capability;

operational flexibility;

customer service; and

overall management.

Our success depends on our ability to continue to meet our customers' changing requirements and specifications with respect to these and other criteria. There can be no assurance that we will be able to address technological advances or introduce new designs or products that may be necessary to remain competitive within the precision steel industry.

***We depend upon our largest customers for a significant portion of our sales revenue, and we cannot be certain that sales to these customers will continue. If sales to these customers do not continue, then our sales may decline and our business may be negatively impacted.***

For the years ended June 30, 2013 and 2012, sales revenues generated from our top five major customers accounted for 49% and 47% of total sales revenues, respectively, with sales to the largest single customer accounting for 17% and 12% of total sales revenues, respectively. We do not enter into long-term contracts with our customers and therefore cannot be certain that sales to these customers will continue. The loss of any of our largest customers would likely have a material negative impact on our sales revenues and business.

***Defects in our products could impair our ability to sell products or could result in litigation and other significant costs.***

Detection of any significant defects in our precision steel products may result in, among other things, delay in time-to-market, loss of market acceptance and sales of its products, diversion of development resources, injury to our reputation, litigation or fines, or increased costs to correct such defects. Defects could harm our reputation, which could result in significant costs and could impair our ability to sell our products. The costs we may incur in correcting any product defects may be substantial and could decrease our profit margins.

***Failure to optimize our manufacturing potential and cost structure could materially increase our overhead, causing a decline in our margins and profitability.***

We strive to utilize the manufacturing capacity of our facilities fully but may not do so on a consistent basis. Our factory utilization is dependent on our success in, among other things:

accurately forecasting demand;

predicting volatility;

timing volume sales to our customers;

balancing our productive resources with product mix; and

planning manufacturing services for new or other products that we intend to produce.

Demand for contract manufacturing of these products may not be as high as we expect, and we may fail to realize the expected benefit from our investment in our manufacturing facilities. Our profitability and operating results are also dependent upon a variety of other factors, including, but not limited to:

- utilization rates of manufacturing lines;
- downtime due to product changeover;
- impurities in raw materials causing shutdowns; and
- maintenance of contaminant-free operations.

Failure to optimize our manufacturing potential and cost structure could materially and adversely affect our business and operating results.

Moreover, our cost structure is subject to fluctuations from inflationary pressures in China and other geographic regions where we conduct business. China has experienced dramatic growth in its economy in the past years. This growth may lead to continued pressure on wages and salaries that may exceed our budget and adversely affect our operating results.

***Our production facilities are subject to risks of power shortages which may adversely affect our ability to meet our customers' needs and reduce our revenues.***

Many cities and provinces in China have suffered serious power shortages since 2004. Many of the regional grids do not have sufficient power generating capacity to fully satisfy the increased demand for electricity driven by continual economic growth and persistent hot weather. Local governments have occasionally required local factories to temporarily shut down their operations or reduce their daily operational hours in order to reduce local power consumption levels. To date, our operations have not been affected by those administrative measures. However, there is a risk that our operations may be affected by those administrative measures in the future, thereby causing material production disruption and delay in delivery schedule. In such event, our business, results of operation and financial conditions could be materially adversely affected. We do not have any back-up power generation system. Although we have not experienced any power outages in the past, we may be adversely affected by power outages in the future.

***Unexpected equipment failures may lead to production curtailments or shutdowns.***

Interruptions in our production capabilities will adversely affect our production costs, products available for sales and earnings for the affected period. In addition to equipment failures, our facilities are also subject to the risk of catastrophic loss due to unanticipated events such as fires, explosions or violent weather conditions. Our

manufacturing processes are dependent upon critical pieces of equipment, such as our various cold-rolling mills, as well as electrical equipment, such as transformers, and this equipment may, on occasion, be out of service as a result of unanticipated failures. We have experienced and may in the future experience material plant shutdowns or periods of reduced production as a result of such equipment failures.



***Our insurance may not be adequate if our production facilities were destroyed or significantly damaged as a result of fire or some other natural disaster.***

All of our products are currently manufactured at our existing facilities located in the Jiading District in Shanghai, China. Fire fighting and disaster relief or assistance in China may not be as developed as in Western countries. While we maintain property damage insurance aggregating approximately \$83.7 million covering our inventories, equipment, plant and buildings and another \$35.1 million insurance against equipment damage, we do not maintain business interruption insurance. Material damage to, or the loss of, our production facilities due to fire, severe weather, flood or other act of God or cause, even if insured, could have a material adverse effect on our financial condition, results of operations, business and prospects.

***Our holding company structure may limit the payment of dividends.***

We have no direct business operations, other than our ownership of our subsidiaries. While we have no current intention of paying dividends, should we decide in the future to do so, as a holding company, our ability to pay dividends and meet other obligations depends upon the receipt of dividends or other payments from our operating subsidiaries and other holdings and investments. In addition, our operating subsidiaries, from time to time, may be subject to restrictions on their ability to make distributions to us, including as a result of restrictive covenants in loan agreements, restrictions on the conversion of local currency into U.S. dollars or other hard currency and other regulatory restrictions as discussed below. If future dividends are paid in RMB, fluctuations in the exchange rate for the conversion of RMB into U.S. dollars may reduce the amount received by U.S. stockholders upon conversion of the dividend payment into U.S. dollars.

Chinese regulations currently permit the payment of dividends only out of accumulated profits as determined in accordance with Chinese accounting standards and regulations. Our subsidiaries in China are also required to set aside a portion of their after tax profits according to Chinese accounting standards and regulations to fund certain reserve funds. Currently, our subsidiaries in China are the only sources of revenues or investment holdings for the payment of dividends. If they do not accumulate sufficient profits under Chinese accounting standards and regulations to first fund certain reserve funds as required by Chinese accounting standards, we will be unable to pay any dividends.

***We may be exposed to liabilities under the Foreign Corrupt Practices Act, and any determination that we violated the Foreign Corrupt Practices Act could have a material adverse effect on our business.***

We are subject to the Foreign Corrupt Practice Act, or FCPA, and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties by U.S. persons and issuers as defined by the statute for the purpose of obtaining or retaining business. We have operations, agreements with third

parties and make sales in China, which may experience corruption. Our activities in China create the risk of unauthorized payments or offers of payments by one of the employees, consultants, sales agents or distributors of our Company, because these parties are not always subject to our control. It is our policy to implement safeguards to discourage these practices by our employees. Also, our existing safeguards and any future improvements may prove to be less than effective, and the employees, consultants, sales agents or distributors of our Company may engage in conduct for which we might be held responsible. Violations of the FCPA may result in severe criminal or civil sanctions, and we may be subject to other liabilities, which could negatively affect our business, operating results and financial condition. In addition, the government may seek to hold our Company liable for successor liability FCPA violations committed by companies in which we invest or that we acquire.

***We may be exposed to potential risks relating to our ineffective internal controls over financial reporting which could have a material adverse effect on our results of operations and our stock price.***

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, or SOX 404, the SEC adopted rules requiring public companies to include a report of management on the company's internal controls over financial reporting in their annual reports, including Form 10-K. As required by Rule 13a-15 under the Exchange Act, our management evaluated the effectiveness of our internal controls over financial reporting as of June 30, 2013. Based upon, and as of the date of that evaluation, our management concluded that our internal control over financial reporting was not effective because 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. Effective internal control is necessary for us to produce reliable financial reports and is important to help prevent financial fraud. If we cannot remediate this material weakness in our internal controls in a timely manner, investors and others may lose confidence in the reliability of our financial statements, which in turn could have a material adverse effect on our business, operating results and the trading price of our Common Stock.

***The Company's Independent Auditor included a Going Concern emphasis-of-matter paragraph in its report on our June 30, 2013 consolidated financial statements.***

The independent auditor's report accompanying the Company's audited June 30, 2013 consolidated financial statements contains an explanatory paragraph expressing substantial doubt about the Company's ability to continue as a going concern. 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. If the Company does not continue as a going concern, it will have to cease operations and you would likely lose all of your investment in the Company.

## **RISKS RELATED TO DOING BUSINESS IN CHINA**

***Adverse changes in political and economic policies of the PRC government could impede the overall economic growth of China, which could reduce the demand for our products and damage our business.***

We conduct substantially all of our operations and generate most of our revenue in China. Accordingly, our business, financial condition, results of operations and prospects are affected significantly by economic, political and legal developments in China. The PRC economy differs from the economies of most developed countries in many respects, including:

- a higher level of government involvement;
- an early stage of development of the market-oriented sector of the economy;
- a rapid growth rate;
- a higher level of control over foreign exchange; and
- the allocation of resources.

As the PRC economy has been transitioning from a planned economy to a more market-oriented economy, the PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. While these measures may benefit the overall PRC economy, they may also have a negative effect on us.

Although the PRC government has in recent years implemented measures emphasizing the utilization of market forces for economic reform, the PRC government continues to exercise significant control over economic growth in China through the allocation of resources, controlling the payment of foreign currency-denominated obligations, setting monetary policy and imposing policies that impact particular industries or companies in different ways.

Any adverse change in economic conditions or government policies in China could have a material adverse effect on the overall economic growth in China, which in turn could lead to a reduction in demand for our services and consequently have a material adverse effect on our business and prospects.

***Uncertainties with respect to the PRC legal system could limit the legal protections available to you and us.***

We conduct substantially all of our business through our operating subsidiaries in the PRC. Our operating subsidiaries are generally subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to foreign-invested enterprises. The PRC legal system is based on written statutes, and prior court decisions may be cited for reference but have limited precedential value. Since 1979, a series of new PRC laws and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, since the PRC legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties, which may limit legal protections available to you and us. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. In addition, all of our executive officers and all of our directors are residents of China and not of the United States, and substantially all the assets of these persons are located outside the United States. As a result, it could be difficult for investors to affect service of process in the United States or to enforce a judgment obtained in the United States against our Chinese operations and subsidiaries.

***If we are found to have failed to comply with applicable laws, we may incur additional expenditures or be subject to significant fines and penalties.***

Our operations are subject to PRC laws and regulations applicable to us. However, many PRC laws and regulations are uncertain in their scope, and the implementation of such laws and regulations in different localities could have significant differences. In certain instances, local implementation rules and/or the actual implementation are not necessarily consistent with the regulations at the national level. Although we strive to comply with all the applicable PRC laws and regulations, we cannot assure you that the relevant PRC government authorities will not later determine that we have not been in compliance with certain laws or regulations.

In addition, our facilities and products are subject to many laws and regulations. Our failure to comply with these and other applicable laws and regulations in China could subject us to administrative penalties and injunctive relief, as well as civil remedies, including fines, injunctions and recalls of our products. It is possible that changes to such laws or more rigorous enforcement of such laws or with respect to our current or past practices could have a material adverse effect on our business, operating results and financial condition. Further, additional environmental, health or safety issues relating to matters that are not currently known to management may result in unanticipated liabilities and expenditures.

***The PRC government exerts substantial influence over the manner in which we must conduct our business activities.***

The PRC government has exercised and continues to exercise substantial control over virtually every sector of the Chinese economy through regulation and state ownership. Our ability to operate in China may be harmed by changes in its laws and regulations, including those relating to taxation, import and export tariffs, environmental regulations, land use rights, property and other matters. We believe that our operations in China are in material compliance with all applicable legal and regulatory requirements. However, the central or local governments of the jurisdictions in which we operate may impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures and efforts on our part to ensure our compliance with such regulations or interpretations.

Accordingly, government actions in the future, including any decision not to continue to support recent economic reforms and to return to a more centrally planned economy or regional or local variations in the implementation of economic policies, could have a significant effect on economic conditions in China or particular regions thereof and could require us to divest ourselves of any interest we then hold in Chinese properties or joint ventures.

***Restrictions on currency exchange may limit our ability to receive and use our sales effectively.***

The majority of our revenues will be settled in RMB and U.S. dollars, and any future restrictions on currency exchanges may limit our ability to use revenue generated in RMB to fund any future business activities outside China or to make dividend or other payments in U.S. dollars. Although the Chinese government introduced regulations in 1996 to allow greater convertibility of the RMB for current account transactions, significant restrictions still remain, including primarily the restriction that foreign-invested enterprises may only buy, sell or remit foreign currencies after providing valid commercial documents, at those banks in China authorized to conduct foreign exchange business. In addition, conversion of RMB for capital account items, including direct investment and loans, is subject to governmental approval in China, and companies are required to open and maintain separate foreign exchange accounts for capital account items. We cannot be certain that the Chinese regulatory authorities will not impose more stringent restrictions on the convertibility of the RMB.

***Fluctuations in exchange rates could adversely affect our business and the value of our securities.***

The value of our common stock will be indirectly affected by the foreign exchange rate between the U.S. dollar and RMB and between those currencies and other currencies in which our revenues may be denominated. Appreciation or depreciation in the value of the RMB relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business or results of operations. Fluctuations in the exchange rate will also affect the relative value of any dividend we issue that will be exchanged into U.S. dollars, as well as earnings from, and the value of, any U.S. dollar-denominated investments we make in the future.

Since July 2005, the RMB has no longer been pegged to the U.S. dollar. Although the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, the RMB may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future PRC authorities may lift restrictions on fluctuations in the RMB exchange rate and lessen intervention in the foreign exchange market.

Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions. While we may enter into hedging transactions in the future, the availability and effectiveness of these transactions may be limited, and we may not be able to successfully hedge our exposure at all. In addition, our foreign currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert RMB into foreign currencies.

Currently, some of our raw materials and major equipment are imported. In the event that the U.S. dollars appreciate against RMB, our costs will increase. If we cannot pass the resulting cost increases on to our customers, our profitability and operating results will suffer. In addition, since our sales to international customers are growing rapidly, we are increasingly subject to the risk of foreign currency depreciation.

***Restrictions under PRC law on our PRC subsidiaries' ability to make dividends and other distributions could materially and adversely affect our ability to grow, make investments or acquisitions that could benefit our business, pay dividends to you, and otherwise fund and conduct our business.***

Substantially all of our revenues are earned by our PRC subsidiaries. However, PRC regulations restrict the ability of our PRC subsidiaries to make dividends and other payments to their offshore parent company. PRC legal restrictions permit payments of dividends by our PRC subsidiaries only out of their accumulated after-tax profits, if any, determined in accordance with PRC accounting standards and regulations. Our PRC subsidiaries are also required under PRC laws and regulations to allocate at least 10% of their annual after-tax profits determined in accordance with PRC generally accepted accounting principles to a statutory general reserve fund until the amounts in said fund reaches 50% of our registered capital. Allocations to these statutory reserve funds can only be used for specific purposes and are not transferable to us in the form of loans, advances, or cash dividends. Any limitations on the ability of our PRC subsidiaries to transfer funds to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our business, pay dividends and otherwise fund and conduct our business.

***You may have difficulty enforcing judgments against us.***

We are a Delaware holding company and most of our assets are located outside of the United States. Almost all of our operations are conducted in the PRC. In addition, most of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons is located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce in U.S. courts judgments on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors, most of whom are not residents in the United States and the substantial majority of whose assets are located outside of the United States. In addition, there is uncertainty as to whether the courts of the PRC would recognize or enforce judgments of U.S. courts. Although the recognition and enforcement of foreign judgments are generally provided for under the PRC Civil Procedures Law. Courts in China may recognize and enforce foreign judgments in accordance with the requirements of the PRC Civil Procedures Law based on treaties between China and the country where the judgment is made or on reciprocity between jurisdictions. China does not have any treaties or other arrangements that provide for the reciprocal recognition and enforcement of foreign judgments with the United States. In addition, according to the PRC Civil Procedures Law, courts in the PRC will not enforce a foreign judgment against us or our directors and officers if they decide that the judgment violates basic principles of PRC law or national sovereignty, security or the public interest. So it is uncertain whether a PRC court would enforce a judgment rendered by a court in the United States.

***Our auditor, like other independent registered public accounting firms operating in China and Hong Kong (to the extent their audit clients have operations in China), is not permitted to be subject to inspections by the Public Company Accounting Oversight Board and, as such, our investors may be deprived of the benefits of such inspections.***

The independent registered public accounting firm that issues the audit reports included in our filings made with the SEC, as an auditor of companies that are traded publicly in the United States and a firm registered with the Public Company Accounting Oversight Board (United States), or PCAOB, is required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and professional standards. However, our operations are mainly located in the PRC, a jurisdiction where PCAOB is currently unable to conduct inspections without the approval of relevant PRC authorities. Our auditor, like other independent registered public accounting firms operating in China and Hong Kong (to the extent their audit clients have operations in China), is currently not subject to inspections conducted by the PCAOB.

Inspections of other firms that PCAOB has conducted outside of China and Hong Kong have identified deficiencies in those firms' audit and quality control procedures, which may be addressed as part of the inspection process to improve the quality of future audits. The inability of PCAOB to inspect independent registered public accounting firms operating in China and Hong Kong makes it more difficult to evaluate the effectiveness of our auditor's audit and quality control procedures compared to those conducted by auditors outside of China and Hong Kong that are subject to the PCAOB inspections. As a result, our investors may be deprived of the benefits of the PCAOB inspections.

***Failure to comply with PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident stockholders to personal liability, limit our ability to acquire PRC companies or to inject capital into PRC subsidiaries, limit our PRC subsidiary's ability to distribute profits to us or otherwise materially adversely affect us.***

In October 2005, SAFE issued the Notice on Relevant Issues in the Foreign Exchange Control over Financing and Return Investment Through Special Purpose Companies by Residents Inside China, generally referred to as Circular 75, which required PRC residents to register with the competent local SAFE branch before establishing or acquiring control over an offshore special purpose company, or SPV, for the purpose of engaging in an equity financing outside of China on the strength of domestic PRC assets originally held by those residents. Amendments to registrations made under Circular 75 are required in connection with any increase or decrease of capital, transfer of shares, mergers and acquisitions, equity investment or creation of any security interest in any assets located in China to guarantee offshore obligations. In the case of an SPV which was established, and which acquired a related domestic company or assets, before the implementation date of Circular 75, a retroactive SAFE registration was required to have been completed before March 31, 2006. Failure to comply with the requirements of Circular 75 may result in fines and other penalties under PRC laws for evasion of applicable foreign exchange restrictions. Any such failure could also result in the SPV's affiliates being impeded or prevented from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation to the SPV, or from engaging in other transfers of funds into or out of China.



We have asked our stockholders who are PRC residents as defined in Circular 75, to register with the relevant branch of SAFE as currently required in connection with their equity interests in us and our acquisitions of equity interests in our PRC subsidiary. However, we cannot provide any assurances that they can obtain the above SAFE registrations required by Circular 75. Moreover, because of uncertainty over how Circular 75 will be interpreted and implemented, and how or whether SAFE will apply it to us, we cannot predict how it will affect our business operations or future strategies. For example, our present and prospective PRC subsidiaries' ability to conduct foreign exchange activities, such as the remittance of dividends and foreign currency-denominated borrowings, may be subject to compliance with Circular 75 by our PRC resident beneficial holders.

In addition, such PRC residents may not always be able to complete the necessary registration procedures required by Circular 75. We also have little control over either our present or prospective direct or indirect stockholders or the outcome of such registration procedures. A failure by our PRC resident beneficial holders or future PRC resident stockholders to comply with Circular 75, if SAFE requires it, could subject these PRC resident beneficial holders to fines or legal sanctions, restrict our overseas or cross-border investment activities, limit our subsidiaries' ability to make distributions or pay dividends or affect our ownership structure, which could adversely affect our business and prospects.

***Under the New Enterprise Income Tax Law, we may be classified as a “resident enterprise” of China. Such classification will likely result in unfavorable tax consequences to us and our non-PRC stockholders.***

On March 16, 2007, the National People's Congress of China passed the EIT Law and on November 28, 2007, the State Council of China passed its implementing rules, both of which took effect on January 1, 2008. Under the EIT Law, an enterprise established outside of China with “de facto management bodies” within China is considered a “resident enterprise,” meaning that it can be treated in a manner similar to a Chinese enterprise for enterprise income tax purposes. The implementing rules of the EIT Law define de facto management as “substantial and overall management and control over the production and operations, personnel, accounting, and properties” of the enterprise.

On April 22, 2009, the State Administration of Taxation issued the Notice Concerning Relevant Issues Regarding Cognizance of Chinese Investment Controlled Enterprises Incorporated Offshore as Resident Enterprises pursuant to Criteria of de facto Management Bodies, or the Notice, further interpreting the application of the EIT Law and its implementation against non-Chinese enterprise or group controlled offshore entities. Pursuant to the Notice, an enterprise incorporated in an offshore jurisdiction and controlled by a Chinese enterprise or group will be classified as a “domestically incorporated resident enterprise” if (i) its senior management in charge of daily operations reside or perform their duties mainly in China; (ii) its financial or personnel decisions are made or approved by bodies or persons in China; (iii) its substantial assets and properties, accounting books, corporate chops, board and shareholder minutes are kept in China; and (iv) at least half of its directors with voting rights or senior management often resident in China. A resident enterprise would be subject to an enterprise income tax rate of 25% on its worldwide income and its non-PRC stockholders would be subject to a withholding tax at a rate of 10% when dividends are paid to such non-PRC stockholders. However, it remains unclear as to whether the Notice is applicable to an offshore enterprise incorporated by a Chinese natural person. Nor are detailed measures on enforcement of PRC tax against

non-domestically incorporated resident enterprises are available. Therefore, it is unclear how tax authorities will determine tax residency based on the facts of each case.

We may be deemed to be a resident enterprise by Chinese tax authorities. If the PRC tax authorities determine that we are a “resident enterprise” for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, we may be subject to the enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations. In our case, this would mean that income such as interest on financing proceeds and non-China source income would be subject to PRC enterprise income tax at a rate of 25%. Second, although under the EIT Law and its implementing rules dividends paid to us from our PRC subsidiary would qualify as “tax-exempt income,” we cannot guarantee that such dividends will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax, have not yet issued guidance with respect to the processing of outbound remittances to entities that are treated as resident enterprises for PRC enterprise income tax purposes. Finally, it is possible that future guidance issued with respect to the new “resident enterprise” classification could result in a situation in which a 10% withholding tax is imposed on dividends we pay to our non-PRC stockholders and with respect to gains derived by our non-PRC stockholders from transferring our shares. We are actively monitoring the possibility of “resident enterprise” treatment and are evaluating appropriate organizational changes to avoid this treatment, to the extent possible.

If we were treated as a “resident enterprise” by PRC tax authorities, we would be subject to taxation in both the U.S. and China, and our PRC tax may not be creditable against our U.S. tax.

## **RISKS RELATED TO THE MARKET FOR OUR STOCK**

*The market price for shares of our common stock could be volatile and could decline.*

The market price for the shares of our common stock may fluctuate in response to a number of factors, many of which are beyond our control. In some cases, these fluctuations may be unrelated to our operating performance. Many companies with Chinese operations have experienced dramatic volatility in the market prices of their common stock. We believe that a number of factors, both within and outside of our control, could cause the price of our common stock to fluctuate, perhaps substantially. Factors such as the following could have a significant adverse impact on the market price of our common stock:

our ability to obtain additional financing and, if available, the terms and conditions of the financing;

our financial position and results of operations;

period-to-period fluctuations in our operating results;

changes in estimates of our performance by any securities analysts;

substantial sales of our common stock pursuant to Rule 144 or otherwise;

new regulatory requirements and changes in the existing regulatory environment;

the issuance of new equity securities in a future offering;

changes in interest rates; and

general economic, monetary and other national conditions, particularly in the U.S. and China.

Securities class action litigation is often instituted against companies following periods of volatility in their stock price. This type of litigation could result in substantial costs to us and divert our management’s attention and resources. Moreover, securities markets may from time to time experience significant price and volume fluctuations for reasons unrelated to operating performance of particular companies. For example, in July 2008, the securities markets in the United States, China and other jurisdictions experienced the largest decline in share prices since September 2001. These market fluctuations may adversely affect the price of our common stock and other interests in our company at a time when you want to sell your interest in us.

***Although publicly traded, the trading market in our common stock has been substantially less liquid than the average trading market for a stock listed on the NASDAQ Capital Market and this low trading volume may adversely affect the price of our common stock.***

Our common stock is listed on the NASDAQ Capital Market under the symbol “CPSL”. The trading volume of our common stock has been comparatively low to other companies listed on NASDAQ. Limited trading volume will subject our shares of common stock to greater price volatility and may make it difficult for you to sell your shares of common stock at a price that is attractive to you.

***We may be required to raise additional financing by issuing new securities with terms or rights superior to those of our shares of common stock, which could adversely affect the market price of our shares of common stock.***

We may require additional financing to fund: repayment of debt, our future operations and working capital requirements, development and exploitation of existing and new products, and expansion into new markets. We may not be able to obtain financing on favorable terms, if at all. If we raise additional funds by issuing equity securities, the percentage ownership of our current shareholders will be reduced, and the holders of the new equity securities may have rights superior to those of the holders of shares of common stock, which could adversely affect the market price and the voting power of shares of our common stock. If we raise additional funds by issuing debt securities, the holders of these debt securities would similarly have some rights senior to those of the holders of shares of common stock, and the terms of these debt securities could impose restrictions on operations and create a significant interest expense for us.

***We do not intend to pay dividends for the foreseeable future.***

For the foreseeable future, we intend to retain any earnings to finance the development and expansion of our business, and we do not anticipate paying any cash dividends on our common stock. Accordingly, investors must be prepared to rely on sales of their common stock after price appreciation to earn an investment return, which may never occur. Investors seeking cash dividends should not purchase our common stock. Any determination to pay dividends in the future will be made at the discretion of our Board of Directors and will depend on our results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our board deems relevant.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

Not Applicable.

**ITEM 2. PROPERTIES.**

All land in China is owned by the State. Individuals and companies are permitted to acquire rights to use land or land use rights for specific purposes. In the case of land used for industrial purposes, the land use rights are granted for a period of 50 years. This period may be renewed at the expiration of the initial and any subsequent terms. Granted land use rights are transferable and may be used as security for borrowings and other obligations.

We currently have land use rights to approximately 48.38 acres consisting of manufacturing facilities, warehouse and office buildings in Shanghai, China. The chart below lists all facilities owned by us.

| <b>Location</b>            | <b>Type of Facility</b>                                  | <b>Size of Land<br/>(acre)</b> |
|----------------------------|--|--------------------------------|
| Jiading District, Shanghai | Manufacturing facilities, warehouse and office buildings | 21.34                          |
| Jiading District, Shanghai | Manufacturing facilities                                 | 27.04                          |

In August 2004, Tuorong agreed to purchase a land use right from the Shanghai Labor and Economic Development Council with respect to a 20-acre parcel for a lease period of 50 years at a cost of \$472,441. Additionally in November 2005, Chengtong agreed to purchase a land use right from the Shanghai Xuhang Industrial Development Co., Ltd. with respect to a 27.04-acre parcel for a lease period of 50 years at a cost of \$497,795. In November 2006, Chengtong entered into an agreement with the Shanghai Labor and Economic Development Council which supersedes the aforementioned Tuorong agreement to purchase a total of 21.34-acre parcel for a lease period of 50 years at an aggregate amount of \$672,126. In December 2006, Tuorong entered into a Compensation Agreement with the Shanghai Jiading Housing, Land and Resource Management Bureau to pay an aggregate amount of \$637,294 in connection to the two aforementioned parcels.

**ITEM 3. 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 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 alleges, 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. Mr. Zhang asserts a breach of an agreement to compensate him for services he allegedly performed in connection with seeking out a merger candidate for the Company. The Company filed a motion to dismiss, as did the other defendants, and that motion was granted on or about March 13, 2013. The Plaintiff had the right to appeal within 30 days of the court decision, and has done so. The Plaintiff has filed an appellate brief and the Company has filed a brief in opposition. We expect a decision within the next eight (8) months. 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.

In addition to the above, certain former officers and directors have filed a lawsuit against the Company claiming that they are entitled to defense and indemnification from the Company for the claims of Mr. Zhang and China Venture Partners. Because the underlying case was dismissed without any award to the plaintiffs, these former officers and directors are seeking to recover their costs and attorney's fees expended in defending against the claims of Mr. Zhang and China Venture Partners. This action is in its early stages. 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 or will be materially adversely affected.

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 4. (REMOVED AND RESERVED).**

**PART II****ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS  
5. AND ISSUER PURCHASES OF EQUITY SECURITIES.****Market Information**

Our Common Stock has been trading on the NASDAQ Capital Market under the symbol "CPSL" since December 29, 2006 and was previously trading on that market under the symbol "OLAB." The CUSIP number for our common stock is 16941J205.

The following table sets forth, for the periods indicated, the high and low closing prices of our common stock. These prices reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

|                          | <b>Closing Bid Prices(1)</b> |            |
|--------------------------|------------------------------|------------|
|                          | <b>High</b>                  | <b>Low</b> |
| Year Ended June 30, 2013 |                              |            |
| 1st Quarter              | \$3.38                       | \$ 0.21    |
| 2nd Quarter              | 2.34                         | 1.35       |
| 3rd Quarter              | 2.23                         | 1.49       |
| 4th Quarter              | 1.49                         | 1.20       |
| Year Ended June 30, 2012 |                              |            |
| 1st Quarter              | \$1.17                       | \$ 0.52    |
| 2nd Quarter              | 0.57                         | 0.33       |
| 3rd Quarter              | 0.69                         | 0.35       |
| 4th Quarter              | 0.47                         | 0.24       |

---

(1) The above table sets forth the range of high and low closing prices per share of our common stock as reported by [www.quotemedia.com](http://www.quotemedia.com) for the periods indicated.

**Approximate Number of Holders of Our Common Stock**

As of September 25, 2013, there were approximately 9,712 holders of record of our common stock. This number excludes the shares of our common stock owned by stockholders holding stock under nominee security position listings.

### **Dividend Policy**

We have never declared or paid a cash dividend. Any future decisions regarding dividends will be made by our Board of Directors. We currently intend to retain and use any future earnings for the development and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. Our Board of Directors has complete discretion on whether to pay dividends, subject to the approval of our stockholders. Even if our Board of Directors decides to pay dividends, the form, frequency and amount will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors that the Board of Directors may deem relevant.

### **Securities Authorized for Issuance under Equity Compensation Plans**

See Item 12, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters – Securities Authorized for Issuance Under Equity Compensation Plans."

### **Recent Sales of Unregistered Securities**

We have not sold any equity securities during the fiscal year ended June 30, 2013 that were not previously disclosed in a quarterly report on Form 10-Q or a current report on Form 8-K that was filed during the 2013 fiscal year.

### **Purchases of Equity Securities**

No repurchases of our common stock were made during the fourth quarter of 2013.

### **ITEM 6. SELECTED FINANCIAL DATA.**

Not Applicable.





**ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

*The following management’s discussion and analysis should be read in conjunction with our financial statements and the notes thereto and the other financial information appearing elsewhere in this report. In addition to historical information, the following discussion contains certain forward-looking information. See “Special Note Regarding Forward Looking Statements” above for certain information concerning those forward looking statements. Our financial statements are prepared in U.S. dollars and in accordance with U.S. GAAP.*

**Introduction**

Management’s discussion and analysis of financial condition and results of operations is intended to help provide an understanding of China Precision Steel, Inc. and our subsidiaries’ (together, the “Group”) financial condition, changes in financial condition and results of operations. This discussion is organized as follows.

***Overview of the Company’s Business*** - This section provides a general description of the Group’s business, as well as recent developments that have either occurred during the fiscal year ended June 30, 2013 and are important in understanding the results of operations and financial condition or disclose known trends.

***Results of Operations*** - This section provides an analysis of our results of operations for the fiscal year ended June 30, 2013. This discussion includes a brief description of significant transactions and events that have an impact on the comparability of the results being analyzed.

***Liquidity and Capital Resources*** - This section provides an analysis of the Group’s cash flows for the fiscal year ended June 30, 2013. Included in this section is a discussion of the Group’s outstanding debt and the financial capacity available to fund the Group’s future commitments and obligations.

**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 and cash flows. 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) strengthening efforts of accounts receivables collection and limiting further credit sales. 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 a credit crunch which have caused many difficulties faced by businesses.

## Recent Developments

On August 13, 2012, October 9, 2012, and on May 9, 2013 respectively, each of Che Kin Lui, Daniel Carlson and David Peter Wong resigned from their respective positions as members of the Company's Board of Directors for personal reasons and not because of any disagreement with the Company on any matter relating to the Company's operations, policies or practices. While Mr. Carlson served as a non-executive and non-voting Director, Mr. Lui and Mr. Wong each served as an independent member of the Board and also served on the Company's Audit Committee, Compensation Committee and Corporate Governance and Nominating Committee. On May 9, 2013, the Board approved the appointment of Mr. Li Jian Lin as a member of the Board and as Chairman of the Audit Committee of the Company, effective July 1, 2013. As a result, the Company's Board currently consists of two independent members of the Board and Audit Committee. The Company is currently in the process of vetting suitable candidates to fulfill the composition requirements set forth in the NASDAQ's Listing Rule 5605 of at least three independent members on the Audit Committee. Such appointment will be announced as soon as it is completed.

## Fiscal 2013 Financial Performance Highlights

During the year ended June 30, 2013, we saw a substantial reduction in demand for our cold rolled steel products coupled with lower selling prices, which have substantially and adversely impacted our gross margin. Tightened credit, slowing growth in China and overcapacity in the steel sector have caused large losses across the industry during Calendar year 2012. We have also made substantial provisions for our accounts receivable and advances to suppliers for the year ended June 30, 2013 due to slow turnover and risks of recoverability, a trend that is strongly correlated to those of the companies in the coal and steel sectors in China during the past two years.

During the year ended June 30, 2013, we sold a total of 56,232 tons of products, a decrease of 115,333 tons from 171,565 tons a year ago, largely due to the decrease in sales of low-carbon cold-rolled steel products. Our average cost per unit sold decreased 0.9% while average selling prices decreased 22.0% year-on-year, mainly due to increases in factory overhead and direct labor cost per unit sold as a result of the substantially reduced total units sold. Decreased sales volume coupled with a substantial allowance for bad and doubtful debts of \$41,466,990 led to a net loss of \$68,939,386 for the year ended June 30, 2013. Total company backlog as of June 30, 2013 was \$7,576,418.

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 possibility to restructure 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 year ended June 30, 2013. Operating cash flows have also been significantly adversely impacted by the slow turnover of our accounts receivable. We also expect the ongoing credit tightening in China and the slowdown of the Chinese economy to continue to have negative consequences on the business operations of our customers and suppliers and adversely impact their ability to meet their financial obligations to us. 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 year ended June 30, 2013:

**Revenues:** Our revenues were approximately \$36.5 million for the year, a decrease of 74.5% from last year.

**Gross Margin:** Gross margin was (32.2%) for the year, compared to (4.1%) last year.

**Loss from operations before tax:** Loss from operations before tax was approximately \$68.9 million for the year, compared to a loss of approximately \$17.0 million last year.

**Net loss:** Net loss was approximately \$68.9 million for the year, compared to a net loss of approximately \$17.0 million last year.

**Fully diluted loss per share:** Fully diluted loss per share was \$17.76 for the year, compared to a loss per share of \$4.37 last year.

## Results of Operations

The following table sets forth key components of our results of operations for the fiscal years ended June 30, 2013 and 2012 and as a percentage of revenues.

(All amounts in U.S. dollars)

|   | 2013         |               | 2012          |               |
|---|--------------|---------------|---------------|---------------|
|   | Amount       | % of Revenues | Amount        | % of Revenues |
| Revenues  | 36,527,550   | 100.0         | 142,973,631   | 100.0         |
| Cost of sales (including depreciation and amortization) | 48,301,295   | 132.2         | 148,780,427   | 104.1         |
| Gross loss  | (11,773,745) | (32.2 )       | (5,806,796 )  | (4.1 )        |
| Selling expenses  | 112,991      | 0.3           | 209,793       | 0.1           |
| Administrative expenses                                 | 2,465,576    | 6.7           | 2,684,432     | 1.9           |
| Bad debts written off                                   | 14,147,604   | 38.7          | -             | -             |
| Allowance for bad and doubtful debts                    | 41,466,990   | 113.5         | 5,022,138     | 3.5           |
| Depreciation and amortization                           | 199,885      | 0.5           | 216,444       | 0.2           |
| Loss from operations                                    | (70,166,791) | (192.1 )      | (13,939,603 ) | (9.7 )        |
| Other income  | 4,784,116    | 13.1          | 89,604        | 0.1           |
| Interest and finance costs                              | (3,556,711 ) | (9.7 )        | (3,104,207 )  | (2.2 )        |
| Loss from operations before income tax                  | (68,939,386) | (188.7 )      | (16,954,206 ) | (11.9 )       |
| Income tax (benefit)                                    | -            | (0.0 )        | (5,061 )      | (0.0 )        |
| Net loss  | (68,939,386) | (188.7 )      | (16,949,145 ) | (11.9 )       |
| Basic (loss) per share                                  | (17.76 )     |               | (4.37 )       |               |
| Diluted (loss) per share                                | (17.76 )     |               | (4.37 )       |               |

### *Sales Revenues*

Sales volume decreased by 115,333 tons, or 67.2%, year-on-year, to 56,232 tons for the year ended June 30, 2013, from 171,565 tons for the year ended June 30, 2012 and as a result, sales revenues decreased by \$106,446,081, or 74.5%, year-on-year, to \$36,527,550 for the year ended June 30, 2013, from \$142,973,631 for the year ended June 30, 2012. The decrease in sales revenues year-on-year is attributable to the substantial decrease in demand for low-carbon products as well as decrease in average selling prices.

### Sales by Product Line

A break-down of our sales by product line for the years ended June 30, 2013 and 2012 is as follows:

| Product Category        | 2013            |            | % of Sales | 2012            |             | % of Sales | Year-on-Year Qty. Variance |
|-------------------------|-----------------|------------|------------|-----------------|-------------|------------|----------------------------|
|                         | Quantity (tons) | \$ Amount  |            | Quantity (tons) | \$ Amount   |            |                            |
| Low carbon hard rolled  | 4,818           | 3,558,582  | 10         | 10,126          | 7,512,713   | 5          | (5,308 )                   |
| Low carbon cold-rolled  | 29,813          | 18,302,075 | 50         | 133,055         | 105,893,793 | 74         | (103,242)                  |
| High-carbon hot-rolled  | 2,560           | 1,117,042  | 3          | 5,064           | 6,138,916   | 4          | (2,504 )                   |
| High-carbon cold-rolled | 16,702          | 12,825,599 | 35         | 19,796          | 20,043,175  | 14         | (3,094 )                   |
| Subcontracting income   | 2,339           | 155,846    | <1         | 3,524           | 1,144,270   | 1          | (1,185 )                   |
| Sales of scrap          | -               | 568,406    | 2          | -               | 2,240,764   | 2          | -                          |
| Total                   | 56,232          | 36,527,550 | 100        | 171,565         | 142,973,631 | 100        | (115,333)                  |

There were different trends of demand across various product categories during the year ended June 30, 2013. Low-carbon cold-rolled steel products accounted for 50% of the current sales mix at an average selling price of \$614 per ton for the year ended June 30, 2013, compared to 74% of the sales mix at an average selling price per ton of \$796 for the year ended June 30, 2012. The decrease in demand in this category was a result of largely decreased orders of steel used in the production of home appliances and steel roofing materials as a result of slowing in domestic consumer spending in these segments during the year. Low-carbon hard-rolled steel products accounted for 10% of the current sales mix at an average selling price of \$739 per ton for the year ended June 30, 2013, compared to 5% of the sales mix at an average selling price per ton of \$742 for the year ended June 30, 2012, the sales revenue of this category decreased due to RMB appreciation year-on-year which has made our pricing less attractive in the export market. High-carbon cold-rolled steel products accounted for 35% of the current sales mix at an average selling price of \$768 per ton for the year ended June 30, 2013, compared to 14% of the sales mix at an average selling price of \$1,012 for the year ended June 30, 2012. The products in this category are mainly used in the automobile industry and the decrease in sales volume year-on-year was a result of the slowing growth of automobile sales in the PRC market. Subcontracting income revenues accounted for \$155,846, or less than 1%, of the sales mix for the year ended June 30, 2013, a decrease from \$1,144,270, or 1%, of the sales mix for the year ended June 30, 2012. The products in this category are mostly high-carbon products and mainly used in electrical engineering and industrial grade tooling materials, for which we received limited orders during the year ended June 30, 2013.

|                         | 2013 | 2012  | Variance |        |
|-------------------------|------|-------|----------|--------|
| Average Selling Prices  | (\$) | (\$)  | (\$)     | (%)    |
| Low-carbon hard rolled  | 739  | 742   | (3 )     | (0.4 ) |
| Low-carbon cold-rolled  | 614  | 796   | (182)    | (22.9) |
| High-carbon hot-rolled  | 436  | 1,212 | (776)    | (64.0) |
| High-carbon cold-rolled | 768  | 1,012 | (244)    | (24.1) |
| Subcontracting income   | 67   | 325   | (258)    | (79.4) |

The average selling price per ton decreased to \$650 for the year ended June 30, 2013, compared to \$833 in 2012, representing a decrease of \$183, or 22.0%, year-on-year. This decrease was mainly due to decreases in steel prices and therefore our selling prices due to a slowdown of the Chinese economy and oversupply of steel products in the market during the year. There were decreases in average selling prices across all product categories during the year ended June 30, 2013.

#### Sales Breakdown by Major Customer

| Customers                              | 2013       |            | 2012         |            |
|--|------------|------------|--------------|------------|
|  | \$         | % of Sales | \$           | % of Sales |
| Shanghai Hongyu Metal Co., Ltd.        | 6,290,377  | 17         | -            | * - *      |
| Changshu Jiacheng Steel Plate Co., Ltd | 5,278,035  | 15         | 11,169,785   | 8          |
| Shanghai Wozi Jintian Blade Co., Ltd.  | 2,482,139  | 7          | -            | * - *      |
| Ludi Energy Group Co., Ltd.            | 1,993,226  | 5          | -            | * - *      |
| Unimax & Far Corporation               | 1,913,491  | 5          | -            | * - *      |
| Shanghai Shengdejia Metal Co., Ltd     | -          | * -        | * 17,829,967 | 12         |
| Shanghai Changshuo Steel Co., Ltd.     | -          | * -        | * 14,842,069 | 11         |
| Hangzhou Cogeneration Co., Ltd.        | -          | * -        | * 13,101,996 | 9          |
| Zhejiang Yongfeng Steel Co., Ltd.      | -          | * -        | * 10,408,914 | 7          |
|  | 17,957,268 | 49         | 67,352,731   | 47         |
| Others                                 | 18,570,282 | 51         | 75,620,900   | 53         |
| Total                                  | 36,527,550 | 100        | 142,973,631  | 100        |

\* Not major customers for the relevant years

Sales revenue generated from our top five major customers as a percentage of total sales was 49% and 47% for the years ended June 30, 2013 and 2012, respectively. Sales to Shanghai Hongyu Metal Co., Ltd., Shanghai Wozi Jintian Blade Co., Ltd., Ludi Energy Group Co., Ltd. And Unimax & Far Corporation, new major customers for the year ended June 30, 2013, accounted for 34% of our sales revenues. The change in customer mix reflects management's efforts in expanding our customer base and repositioning our products mix during the course of the year.



**Cost of Goods Sold**

Cost of sales decreased by \$100,479,132, or 67.5%, year-on-year, to \$48,301,295 for the year ended June 30, 2013, from \$148,780,427 for the year ended June 30, 2012. Cost of sales represented 132.2% of sales revenues for the year ended June 30, 2013, compared to 104.1% for the year ended June 30, 2012. Average cost per unit sold slightly decreased to \$859 for the year ended June 30, 2013, compared to \$867 for the year ended June 30, 2012, representing a decrease of \$8 per ton, or 0.9%, year-on-year.

|                                     | 2013       | 2012        | Variance      |        |
|-------------------------------------|------------|-------------|---------------|--------|
|                                     | (\$)       | (\$)        | (\$)          | (%)    |
| Cost of goods sold                  |            |             |               |        |
| - Raw materials                     | 38,254,765 | 135,715,619 | (97,460,854 ) | (71.8) |
| - Direct labor                      | 547,839    | 585,332     | (37,493 )     | (6.4 ) |
| - Manufacturing overhead            | 9,498,691  | 12,479,476  | (2,980,785 )  | (23.9) |
|                                     | 48,301,295 | 148,780,427 | (100,479,132) | (67.5) |
| Cost per unit sold                  |            |             |               |        |
| Total units sold (tons)             | 56,232     | 171,565     | (115,333 )    | (67.0) |
| Average cost per unit sold (\$/ton) | 859        | 867         | (8 )          | (0.9 ) |

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

a decrease in cost of raw materials per unit sold of \$111, or 14.0%, from \$791 for the year ended June 30, 2012, to \$680 for the year ended June 30, 2013;

an increase in factory overhead per unit sold of \$96, or 131.5%, from \$73 for the year ended June 30, 2012, to \$169 for the year ended June 30, 2013; and

an increase in direct labor per unit sold of \$7, or 233.3%, from \$3 for the year ended June 30, 2012, to \$10 for the year ended June 30, 2013.

Because of the downward trend in steel prices and the substantial decrease in sales volume during the year, the cost of raw materials consumed decreased by \$97,460,854, or 71.8%, year-on-year, to \$38,254,765 for the year ended June 30, 2013, from \$135,715,619 for the year ended June 30, 2012.

Direct labor costs decreased by \$37,493, or 6.4%, year-on-year, to \$547,839 for the year ended June 30, 2013, from \$585,332 for the year ended June 30, 2012.

Manufacturing overhead costs decreased by \$2,980,785, or 23.9%, year-on-year, to \$9,498,691 for the year ended June 30, 2013, from \$12,479,476 for the year ended June 30, 2012. The decrease was mainly attributable to the combined effect of a decrease in utilities of \$1,575,449, or 48.1%, year-on-year, to \$1,702,507 for the year ended June 30, 2013, from \$3,277,956 for the year ended June 30, 2012 and a decrease in low consumables of \$679,972, or 36.6%, year-on-year, to \$1,179,409 for the year ended June 30, 2013, from \$1,859,381 for the year ended June 30, 2012. The substantially decreased units sold, year-on-year, have led to an increase in average manufacturing overhead cost per unit sold of 131.5% due to decreased economies of scale.

### ***Gross Loss***

Gross loss increased by \$5,966,949, or 102.8%, year-on-year, to \$11,773,745 for the year ended June 30, 2013, from a gross loss of \$5,806,796 for the year ended June 30, 2012. Gross profit margin decreased to (32.2)% for the year ended June 30, 2013, from (4.1)% for the year ended June 30, 2012. The decrease in gross profit margin is mainly attributable to the effect of a 22.0% decrease in average selling prices, year-on-year, due to slowing demand and falling steel prices during the year ended June 30, 2013.

***Selling Expenses***

Selling expenses decreased by \$96,802, or 46.1%, year-on-year, to \$112,991 for the year ended June 30, 2013, from \$209,793 in 2012. The decrease was mainly attributable to less selling expenses associated with lower sales revenues year-on-year.

***Administrative Expenses***

Administrative expenses decreased by \$218,856, or 8.2%, year-on-year, to \$2,465,576 for the year ended June 30, 2013, compared to \$2,684,432 for the year ended June 30, 2012. This was chiefly due to lower wages paid out on lower average headcount during the year ended June 30, 2013.

***Bad debts written off***

Bad debts written off for the year ended June 30, 2013 was in the amount of \$14,147,604, compared to \$nil for the year ended June 30, 2012, mainly due to write off of long-outstanding receivables and advances according to management's assessment.

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

Allowance for bad and doubtful debts increased by \$36,444,852 year-on-year. Allowance recognized for the year ended June 30, 2013 was in the amount of \$41,466,990 in accordance with our policy for allowance for bad and doubtful debts set forth under the "Critical Accounting Policies and Estimates" heading in this report. Included in this amount is \$28,089,004 for provision for accounts receivable bad debts, \$19,348,204 for provision for advances to suppliers bad debts, \$1,266,064 for reversal of provision for accounts receivable bad debts, and \$4,704,154 for reversal of provision for advances to suppliers bad debts.

### ***Loss from Operations***

Loss from operations increased by \$56,227,188, or 403.4%, year-on-year, to \$70,166,791 for the year ended June 30, 2013 from a loss of \$13,939,603 for the year ended June 30, 2012, as a result of the factors discussed above.

### ***Other Income***

Other income increased \$4,694,512 or 5,239.2%, to \$4,784,116 for the year ended June 30, 2013 from \$89,604 for the year ended June 30, 2012. As a percentage of revenues, other income increased to 13.1% for the year ended June 30, 2013 from less than 0.1% for the year ended June 30, 2012. The increase in other income was primarily due to reversal of certain other payables during the year ended June 30, 2013 as these payables are no longer required from us.

### ***Interest Expense***

Total interest expense increased \$452,504, or 14.6%, to \$3,556,711 for the year ended June 30, 2013, from \$3,104,207 for the year ended June 30, 2012 due to the accrual of overdue and penalty interest resulting from our loan default during the year ended June 30, 2013.

### ***Income Tax***

For the year ended June 30, 2013, we recognized no income tax benefit or expense, compared to an income tax benefit of \$5,061 for the year ended June 30, 2012. The decrease of \$5,061, or 100.0%, was due to a net loss for the year ended June 30, 2013 and tax refund received as a result of the net loss in 2012.

### ***Net Loss***

Net loss increased by \$51,990,241, or 306.7%, year-on-year, to \$68,939,386 for the year ended June 30, 2013, compared to \$16,949,145 for the year ended June 30, 2012. The increase in net loss is attributable to a combination of all the factors discussed above, the major factors being a substantial decrease in sales revenues, a negative gross profit

margin, and a substantial 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 historically met these liquidity requirements with cash provided by operations, equity financing, and bank debt. As of June 30, 2013, we had cash and cash equivalents of approximately \$0.1 million.

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

#### CASH FLOWS

|   | Year Ended June 30, |             |
|---|---------------------|-------------|
|   | 2013                | 2012        |
| Net cash (used in)/provided by operating activities | \$(178,047 )        | \$1,832,228 |
| Net cash (used in) investing activities             | (492,263 )          | (284,149 )  |
| Net cash (used in) financing activities             | (757,381 )          | (2,697,352) |
| Net cash flows                                      | (1,527,562)         | (1,104,949) |

Net cash flows used in operating activities for the year ended June 30, 2013 were \$178,047 as compared to net cash flows provided by operating activities of \$1,832,228 for the year ended June 30, 2012, for a net decrease of \$2,010,275. This decrease was mainly due to an increase in cash outflows from other taxes payable of \$2,492,303, a decrease in cash inflows from advances to suppliers of \$9,168,513, offset by an increase in cash inflows from accounts payable and accrued expenses of \$1,590,725 during the year ended June 30, 2013.

For the year ended June 30, 2013, sales revenues generated from the top five major customers as a percentage of total sales were 49%, compared with 47% for the prior year. The loss of all or portion of the sales volume from a significant customer would have an adverse effect on our operating cash flows. In addition, we have made substantial provisions for our accounts receivable and advances to suppliers for the year ended June 30, 2013 due to slow turnovers and risks of recoverability, a trend that is strongly correlated to those of the companies in the coal and steel sectors in China during the past two years. We note that the continuation or intensification of the credit tightening in China and the slowdown of the Chinese economy have had and will continue to have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations to us, resulting in further unrecoverable losses on our accounts receivable. We will regularly 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***

Net cash flows used in investing activities for the year ended June 30, 2013 was \$492,263, as compared with \$284,149 for the year ended June 30, 2012. Our main uses of cash for investing activities during the year ended June 30, 2013 were for the purchase of property, plant and equipment to complement our existing production facilities.

We forecast low capital expenditures in the coming years as the Company does not have any expansion plans as at June 30, 2013.

### ***Financing Activities***

Net cash flows used in financing activities for the year ended June 30, 2013 were \$757,381, as compared to \$2,697,352 for the year ended June 30, 2012, for a net decrease of \$1,939,971. During the year ended June 30, 2013, the Company made a partial repayment of short-term loans in the amount of \$757,381.

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 \$44,228,722. We are currently in discussions with our banks regarding the possibility to restructure 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. We believe that we have the financial resources needed to meet business requirements for the next twelve months if we are able to work out a repayment plan acceptable to us with our banks for the defaulted 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.

### *Current Assets*

Current assets decreased by \$59,278,576, or 51.3%, year-on-year, to \$56,301,263 as of June 30, 2013, from \$115,579,839 as of June 30, 2012, principally as a result of a decrease in advances to suppliers of \$28,079,837, or 75.1%, year-on-year, and a decrease in accounts receivable of \$29,636,193 or 50.1%, year-on-year, due to the substantial allowance for bad and doubtful debts made during the year ended June 30, 2013.

Accounts receivable, representing 52.4% of total current assets as of June 30, 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.

As we expect the continuation or intensification of the credit tightening in China and the slowdown of the Chinese economy to continue to have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations to us, we have largely limited further credit sales and will only offer credit terms to customers with good payment histories.

To reserve for potentially uncollectible accounts receivable, for the year ended June 30, 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. We will also regularly 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. Any such additional bad debt charges could materially and adversely affect our future operating results.

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

**June 30, 2013**

| US\$         | Total      | Current   | 1 to 30<br>days | 31 to 90<br>days | 91 to 180<br>days | 181 to 360<br>days | over<br>1 year |
|--------------|------------|-----------|-----------------|------------------|-------------------|--------------------|----------------|
| <b>TOTAL</b> | 60,123,111 | 6,328,112 | 1,605,948       | 955,364          | 8,932,972         | 23,314,353         | 18,986,362     |
| <b>%</b>     | 100        | 10        | 3               | 1                | 15                | 39                 | 32             |

**June 30, 2012**

| US\$         | Total      | Current    | 1 to 30<br>days | 31 to 90<br>days | 91 to 180<br>days | 181 to 360<br>days | over<br>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              |

***Current Liabilities***

Current liabilities increased by \$342,067, or 0.5%, year-on-year, to \$67,017,943 as of June 30, 2013, from \$66,675,876 as of June 30, 2012. We have classified all of the remaining balance of our long-term loan as current liabilities as we have defaulted on the principal and interest repayment obligations of such loan in June 2012. The Company is currently in discussions with its bank regarding the possibility to restructure the loan for repayment but has not yet agreed on specific terms. Until such agreement is reached, the bank 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.



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

As of June 30, 2013, we also had \$28,028,722 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 discussions with its bank regarding the possibility to restructure the 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 year ended June 30, 2013, we invested \$489,526 in purchases of property, plant and equipment, and construction projects in relation to the additional equipment to complement our existing production facilities.

**Loan Facilities**

The following table illustrates our credit facilities as of June 30, 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  | Maturity Date | Duration | Interest Rate               | Principal Amount                                     |
|--|---------------|---------------|----------|-----------------------------|--|
| Raiffeisen Zentralbank Österreich AG ("RZB")                   | June 29, 2011 | July 31, 2012 | 1 year   | 1.15 times of the PBOC rate | \$ 8,171,612<br>RMB (50,154,084 )                    |
| Raiffeisen Zentralbank Österreich AG                           | June 29, 2010 | July 31, 2012 | 1 year   | 1.15 times of the PBOC rate | \$ 19,857,110<br>RMB (121,875,000 )<br>\$ 28,028,722 |
| DEG – Deutsche Investitions – und Entwicklungsgesellschaft mbH | June 29, 2010 | June 15, 2016 | 6 years  | 6 month USD LIBOR + 4.5%    | \$ 16,200,000<br>RMB (99,429,120 )<br>\$ 16,200,000  |
| Total  |               |               |          |                             | \$ 44,228,722  |

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, as well as on repayment of the June 15, 2011 installment. The Company is currently in discussions with DEG regarding the possibility to restructure the loan 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 \$28,028,722 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 possibility to restructure 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 June 30, 2013, including the foregoing debt obligations comprised of principal and interest payments:

|                             | Payments Due By Year |                     |                          |                          |                                    |
|-----------------------------|----------------------|---------------------|--------------------------|--------------------------|------------------------------------|
|                             | Total                | Fiscal Year<br>2014 | Fiscal Year<br>2015-2016 | Fiscal Year<br>2017-2018 | Fiscal Years<br>2019 and<br>Beyond |
| Contractual obligations:    |                      |                     |                          |                          |                                    |
| Short-Term Debt Obligations | \$ 30,062,626        | \$ 30,062,626       | \$-                      | \$-                      | \$-                                |

|   |               |               |      |      |      |
|---|---------------|---------------|------|------|------|
| Current Portion of Long-Term Debt Obligations | \$ 16,996,191 | \$ 16,996,191 | \$ - | \$ - | \$ - |
|   | \$ 47,058,817 | \$ 47,058,817 | \$ - | \$ - | \$ - |

### 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 July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (“ASU 2013-11”). The objective of this Update is to eliminate the diversities that exist in financial statement presentation. The amendments aim at attaining this objective by giving explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments of ASU 2013-11, when adopted, are not expected to have a material impact on the Company’s consolidated financial statements.

### **Critical Accounting Policies and Estimates**

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

#### ***Functional Currency and Translating Financial Statements***

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

### ***Revenue Recognition***

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

### ***Accounts Receivable***

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

Accounts receivable is recorded at the time revenue is recognized and is stated net of allowance for doubtful accounts. The Company maintains an allowance for doubtful accounts based on its assessment of the collectability of the accounts receivable. Management determines the collectability of outstanding accounts by maintaining regular communication with such customers and obtaining confirmation of their intent to fulfill their obligations to the Company. Management also considers past collection experience, our relationship with customers and the impact of current economic conditions on our industry and market. However, we note that the continuation or intensification of the current global economic crisis may have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial obligations. 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. We also regularly 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 June 30, 2013 and 2012, the Company had \$30,642,373 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 \$28,089,004 and \$2,150,984 recognized for the years ended June 30, 2013 and 2012, respectively. There was a reversal of provision for bad debts of \$1,266,064 and \$nil recognized for the years ended June 30, 2013 and 2012, respectively.

### *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 June 30, 2013 and 2012, the Company had made allowances of advances to suppliers of \$19,689,609 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. During the year ended June 30, 2013, due to stricter environmental rules imposed by the Chinese government on steel manufacturers as part of the ongoing industry reform, one of our suppliers were ordered by the relevant authority to halt all production as nearby residents are exposed to dangerous pollution caused by its production and waste. We believe we will be not able to recover these advances paid to this supplier and have provided provision on such advances. There was a provision for advances to suppliers bad debts of \$19,348,204 and \$2,871,154 recognized for the years ended June 30, 2013 and 2012, respectively. There was a reversal of provision for advances to suppliers bad debts of \$4,704,154 and \$nil recognized for the years ended June 30, 2013 and 2012, respectively.

### *Inventories*

Inventories are stated at the lower of cost or market. Cost is determined using the weighted average method.

There was an inventory provision of \$518,184 and \$350,817 for the years ended June 30, 2013 and 2012, respectively.

### *Intangible Assets*

Intangible assets represent land use rights in China acquired by the Company and are stated at cost less amortization and impairment, if any. Amortization of land-use rights is calculated on the straight-line method, based on the period over which the right is granted by the relevant authorities in China. The Company acquired land use rights in August 2004 and December 2006 for 50 years that expire in August 2054 and December 2056, respectively. The land use rights are amortized over a fifty-year term. 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. As of June 30, 2013, as the Company's market capitalization was lower than the carrying value of its assets and the Company experienced continuing losses, management performed an impairment test in accordance with ASC360. As the fair market value substantially exceeds the carrying value of our land use rights due to appreciation in the value of land use rights in China in the past decade, no impairment charges were recognized for the relevant year. As of June 30, 2013, the Company expects these assets to be fully recoverable based on the result of the impairment test.

***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.

The Company accounts for impairment of property, plant and equipment and amortizable intangible assets in accordance with ASC 360, which requires the Company to evaluate a long-lived asset for recoverability when there is an event or circumstance that indicates the carrying value of the asset may not be recoverable. We determine such impairment by measuring the estimated undiscounted future cash 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. As of June 30, 2013, the Company's market capitalization was significantly lower than its total stockholders' equity. Management considered this to be an indicator of impairment, and accordingly, performed an impairment test, using a normal and a worse-case scenario, and assessed undiscounted cash flows based on average tons sold, selling price per ton, gross margin, and other cash inflows and outflows for the next ten years where our mills are expected to remain in operation. We estimated volume sold and the sales revenues based upon prices at which Management reasonably estimates them to be sold in the next ten years. In performing the impairment test, Management also made assumptions that the Company would be able to restructure its defaulted bank loans with favorable and less favorable terms, respectively. No impairment charges were recognized for the current year. Assumptions and estimates used in our impairment test provide the general direction of major factors expected to affect our business and cash flows, and are subject to risks and uncertainties such as changes in interest rates, industry cyclicality, and factors surrounding the general Chinese and global economies. Those estimates will be reassessed for their reasonableness at each impairment test.

***Other Policies***



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

### **Seasonality**

Our operating results and operating cash flows historically have been subject to seasonal variations. Our revenues are usually higher in the second half of the 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 year ended June 30, 2013, we did not have any off-balance sheet arrangements.

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

Not Applicable.

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

The full text of our audited consolidated financial statements as of June 30, 2013 and 2012 begins on page F-1 of this report.

**CHINA PRECISION STEEL, INC.**

**INDEX TO FINANCIAL STATEMENTS FOR THE YEARS**

**ENDED JUNE 30, 2013 AND 2012**

| <b>Contents</b>  | <b>Page(s)</b> |
|--|----------------|
| <u>Report of Independent Registered Public Accounting Firm</u>   | F-1            |
| <u>Consolidated Balance Sheets as of June 30, 2013 and 2012</u>  | F-2            |
| <u>Consolidated Statements of Operations and Comprehensive Income for the Years Ended June 30, 2013 and 2012</u> | F-3            |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the Years Ended June 30, 2013 and 2012</u>     | F-4            |
| <u>Consolidated Statements of Cash Flows for the Years June 30, 2013 and 2012</u>                                | F-5            |
| <u>Notes to Consolidated Financial Statements</u>  | F-6            |

## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of

China Precision Steel, Inc.

We have audited the accompanying consolidated balance sheets of China Precision Steel, Inc. and subsidiaries (collectively, the “Company”) (see Note 1 to the consolidated financial statements) as of June 30, 2013 and 2012, and the related consolidated statements of operations and comprehensive income, changes in stockholders’ equity, and cash flows for each of the two years in the period ended June 30, 2013. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of June 30, 2013 and 2012, and the results of its operations and cash flows for each of the two years in the period ended June 30, 2013, in conformity with generally accepted accounting principles in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Notes 2, 13 and 14 to the consolidated financial statements, the Company has suffered a very significant loss in the year ended June 30, 2013 and defaulted on interest and principal repayments of bank borrowings that raise substantial doubt about its ability to continue as a going concern. Management’s plans in regards to these matters are also described in Notes 13 and 14. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Moore Stephens

*Certified Public Accountants*

Hong Kong

October 11, 2013

F-1

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

|   | Notes | <b>June 30,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|---|-------|--------------------------|--------------------------|
| <b>Assets</b>   |       |                          |                          |
| <b>Current assets</b>   |       |                          |                          |
| Cash and cash equivalents   |       | \$75,243                 | \$1,602,805              |
| Accounts receivable   |       |                          |                          |
| Trade, net of allowances of \$30,642,373 and \$3,231,613 at June 30, 2013 and 2012, respectively                | 5     | 29,480,738               | 59,116,931               |
| Bills receivable  |       | 94,089                   | 173,089                  |
| Other   |       | 1,041,255                | 1,117,243                |
| Inventories, net  | 8     | 15,837,201               | 15,516,220               |
| Prepaid expenses  |       | 467,890                  | 668,867                  |
| Advances to suppliers, net of allowance of \$19,689,609 and \$4,623,323 at June 30, 2013 and 2012, respectively | 9     | 9,304,847                | 37,384,684               |
| <b>Total current assets</b>   |       | <b>56,301,263</b>        | <b>115,579,839</b>       |
| <b>Property, plant and equipment</b>  |       |                          |                          |
| Property, plant and equipment, net  | 10    | 61,366,745               | 67,752,991               |
| Construction-in-progress  | 11    | 255,996                  | 233,512                  |
|   |       | 61,622,741               | 67,986,503               |
| Intangible assets, net  | 12    | 1,903,675                | 1,880,129                |
| Goodwill  |       | 99,999                   | 99,999                   |
| <b>Total assets</b>   |       | <b>\$119,927,678</b>     | <b>\$185,546,470</b>     |
| <b>Liabilities and Stockholders' Equity</b>   |       |                          |                          |
| <b>Current liabilities</b>  |       |                          |                          |
| Short-term loans  | 13    | \$28,028,722             | \$27,246,477             |
| Long-term loan - current portion  | 14    | 16,200,000               | 16,200,000               |
| Accounts payable and accrued liabilities  |       | 7,044,007                | 6,772,892                |
| Advances from customers   |       | 1,456,420                | 2,253,956                |
| Other taxes payables  |       | 8,295,220                | 8,446,373                |
| Current income taxes payable  |       | 5,993,574                | 5,756,178                |
| <b>Total current liabilities</b>  |       | <b>67,017,943</b>        | <b>66,675,876</b>        |

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

|   |    |                |                |
|---|----|----------------|----------------|
| Long-term loan  | 14 | -              | -              |
| Stockholders' equity:   |    |                |                |
| Preferred stock: \$0.001 per value, 8,000,000 shares authorized, no shares outstanding at June 30, 2013 and 2012, respectively          | 15 |                |                |
| Common stock: \$0.001 par value, 62,000,000 shares authorized, 3,880,866 issued and outstanding at June 30, 2013 and 2012, respectively | 15 | 3,880          | 3,880          |
| Additional paid-in capital  | 15 | 75,685,066     | 75,685,066     |
| Accumulated other comprehensive income  |    | 22,075,822     | 19,097,295     |
| (Accumulated deficit)/retained earnings   |    | (44,855,033 )  | 24,084,353     |
| Total stockholders' equity  |    | 52,909,735     | 118,870,594    |
| Total liabilities and stockholders' equity  |    | \$ 119,927,678 | \$ 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 Years Ended June 30, 2013 and 2012**

|   | Notes | 2013           | 2012            |
|---|-------|----------------|-----------------|
| Sales revenues                              |       | \$36,527,550   | \$142,973,631   |
| Cost of goods sold                          |       | 48,301,295     | 148,780,427     |
| Gross (loss)                                |       | (11,773,745)   | (5,806,796 )    |
| Operating expenses                          |       |                |                 |
| Selling expenses                            |       | 112,991        | 209,793         |
| Administrative expenses                     |       | 2,465,576      | 2,684,432       |
| Bad debts written off                       |       | 14,147,604     | -               |
| Allowance for bad and doubtful debts        |       | 41,466,990     | 5,022,138       |
| Depreciation and amortization expense       |       | 199,885        | 216,444         |
| Total operating expenses                    |       | 58,393,046     | 8,132,807       |
| (Loss) from operations                      |       | (70,166,791)   | (13,939,603 )   |
| Other income/(expense)                      |       |                |                 |
| Other revenues                              |       | 4,784,116      | 89,604          |
| Interest and finance costs                  |       | (3,556,711 )   | (3,104,207 )    |
| Total other income/(expense)                |       | 1,227,405      | (3,014,603 )    |
| (Loss) from operations before income tax    |       | (68,939,386)   | (16,954,206 )   |
| Provision for income tax                    | 16    |                |                 |
| Current                                     |       | -              | (5,061 )        |
| Total income tax (benefit)                  |       | -              | (5,061 )        |
| Net (loss)                                  |       | \$(68,939,386) | \$(16,949,145 ) |
| Basic (loss) per share                      | 17    | \$(17.76 )     | \$(4.37 )       |
| Basic weighted average shares outstanding   |       | 3,880,866      | 3,880,866       |
| Diluted (loss) per share                    | 17    | \$(17.76 )     | \$(4.37 )       |
| Diluted weighted average shares outstanding |       | 3,880,866      | 3,880,866       |

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

|   |                |                 |
|---|----------------|-----------------|
| Components of comprehensive (loss):     |                |                 |
| Net (loss)                              | \$(68,939,386) | \$(16,949,145 ) |
| Other comprehensive income:             |                |                 |
| Foreign currency translation adjustment | 2,978,527      | 2,275,110       |
| Comprehensive (loss)                    | \$(65,960,859) | \$(14,674,035 ) |

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

F-3



**China Precision Steel, Inc. and Subsidiaries****Consolidated Statements of Changes in Stockholders' Equity****For the Years Ended June 30, 2013 and 2012**

|   | Common Stock |          | Additional   | Accumulated   | Retained        | Total          |
|---|--------------|----------|--------------|---------------|-----------------|----------------|
|   | Share        | Amount   | Paid-in      | Other         | Earnings/       | Stockholders'  |
|   |              |          | Capital      | Comprehensive | (Accumulated    | Equity         |
|   |              |          |              | Income        | Deficit)        |                |
| Balance at June 30, 2011                | 3,880,866    | \$ 3,880 | \$75,685,066 | \$ 16,822,185 | \$41,033,498    | \$ 133,544,629 |
| Foreign currency translation adjustment | -            | -        | -            | 2,275,110     | -               | 2,275,110      |
| Net loss                                | -            | -        | -            | -             | (16,949,145 )   | (16,949,145 )  |
| 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 | -            | -        | -            | 2,978,527     | -               | 2,978,527      |
| Net loss                                | -            | -        | -            | -             | (68,939,386 )   | (68,939,386 )  |
| Balance at June 30, 2013                | 3,880,866    | \$ 3,880 | \$75,685,066 | \$ 22,075,822 | \$(44,855,033 ) | \$52,909,735   |

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 Years Ended June 30, 2013 and 2012**

|  | 2013           | 2012           |
|--|----------------|----------------|
| Cash flows from operating activities   |                |                |
| Net (loss)   | \$(68,939,386) | \$(16,949,145) |
| Adjustments to reconcile net income to net cash provided by operating activities |                |                |
| Depreciation and amortization  | 9,104,176      | 9,043,993      |
| Allowance for bad and doubtful debts   | 47,437,208     | 5,022,138      |
| Reversal of provision for bad and doubtful debts                                 | (5,970,218 )   | -              |
| Bad debts written off  | 14,147,604     | -              |
| Other income - write off of accounts payable and other payables                  | (3,116,535 )   | -              |
| Other income - write off of advances from customers                              | (984,970 )     | -              |
| Inventory provision  | 518,184        | 350,817        |
| Gain on disposal of property, plant and equipment                                | -              | (36,993 )      |
| Net changes in assets and liabilities:   |                |                |
| Accounts receivable, net   | 3,328,317      | (19,407,494)   |
| Inventories  | (298,456 )     | 9,637,950      |
| Prepaid expenses   | 212,651        | (31,828 )      |
| Advances to suppliers  | 1,464,390      | 10,632,903     |
| Accounts payable and accrued expenses  | 3,211,106      | 1,620,381      |
| Advances from customers  | 124,940        | (60,058 )      |
| Other taxes payable  | (450,470 )     | 2,041,833      |
| Current income taxes   | 33,412         | (32,269 )      |
| Net cash (used in)/provided by operating activities                              | (178,047 )     | 1,832,228      |
| Cash flows from investing activities   |                |                |
| Purchase of property, plant and equipment, including construction in progress    | (489,526 )     | (340,155 )     |
| Purchases of intangible assets   | (2,737 )       | -              |
| Proceeds from disposal of property, plant and equipment                          | -              | 56,006         |
| Net cash (used in) investing activities  | (492,263 )     | (284,149 )     |
| Cash flows from financing activities   |                |                |
| Repayments of short-term loans   | (757,381 )     | (2,697,352 )   |
| Net cash (used in) financing activities  | (757,381 )     | (2,697,352 )   |
| Effect of exchange rate  | (99,871 )      | 44,324         |
| Net (decrease) in cash   | (1,527,562 )   | (1,104,949 )   |

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

|  |           |             |
|--|-----------|-------------|
| Cash and cash equivalents, beginning of year       | 1,602,805 | 2,707,754   |
| Cash and cash equivalents, end of year             | \$75,243  | \$1,602,805 |
| Supplemental disclosures of cash flow information: |           |             |
| Cash paid during the year for:                     |           |             |
| Interest   | \$829,234 | \$2,000,125 |
| Taxes  | \$-       | \$27,225    |

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

F-5

## **China Precision Steel, Inc.**

### **Notes to the Consolidated Financial Statements**

#### **1. Description of Business**

China Precision Steel, Inc. (the “Company,” “CPSL” or “we”) is a niche 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 emerging need for highly engineered end use applications. Precision steel pertains to the precision of measurements and tolerances of the above factors, especially thickness tolerance.

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 generally accepted accounting principles 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 \$44,228,772. 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 consolidated balance sheets as of June 30, 2013 and 2012 include CPSL, PSHL, Blessford International, Chengtong, Shanghai Blessford, and Tuorong, collectively referred to as “the Group”. The consolidated statements of operations for the years ended June 30, 2013 and 2012 include CPSL, PSHL, Blessford International, Chengtong, Shanghai Blessford and Tuorong. Intercompany items have been eliminated.

### 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 a maturity period of three months or less to be cash equivalents. The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents approximate their fair value.

**Accounts Receivable** – Credit periods vary substantially across industries, segments, types and size of companies in the PRC where we operate our business. Because of the niche products that we process, our customers are usually also niche players in their own respective segment, who then sell their products to end product manufacturers. The business cycle is relatively long, as well as the credit periods. The Company offers credit to its customers for periods of 60 days, 90 days, 120 days and 180 days. We generally offer 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. We note that the continuation or intensification of the credit tightening in China and the slowdown of the Chinese economy had and will continue to 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. We also regularly 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 June 30, 2013 and 2012, the Company had \$30,642,373 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 \$28,089,004 and \$2,150,984 recognized for the years ended June 30, 2013 and 2012, respectively. There was a reversal of provision for bad debts of \$1,266,064 and \$nil recognized for the years ended June 30, 2013 and 2012, respectively.

**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.

As of June 30, 2013 and 2012, the Company had \$937,695 and \$396,322 of inventory provision, respectively. There was an inventory provision of \$518,184 and \$350,817 for the years ended June 30, 2013 and 2012, respectively.

**Intangible Assets and Amortization** – Intangible assets represent land use rights in China acquired by the Company and are stated at cost less amortization and impairment, if any. 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. 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 June 30, 2013 and 2012, the Company had made allowances of advances to suppliers of \$19,689,609 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. During the year ended June 30, 2013, due to stricter environmental rules imposed by the Chinese government on steel manufacturers as part of the ongoing industry reform, one of our suppliers was ordered by the relevant authority to halt all production as nearby residents are exposed to dangerous pollution caused by its production and waste. We believe we will be not able to recover these advances paid to this supplier and have provided provision on such advances. There was a provision for advances to suppliers bad debts of \$19,348,204 and \$2,871,154 recognized for the years ended June 30, 2013 and 2012, respectively. There was a reversal of provision for advances to suppliers bad debts of \$4,704,154 and \$nil recognized for the years ended June 30, 2013 and 2012, respectively.

**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. We primarily use the income valuation approach to determine the fair value of our long-lived assets, with fair value being the price that would be received from selling an asset in an orderly transaction between market participants at the measurement date.

**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 years ended June 30, 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.

**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 2013 and 2012.

At June 30, 2013 and 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 2009 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 2009.

#### 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.

*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 June 30, 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 June 30, 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.

#### *Value added tax*

Under the Provisional Regulations of the People’s Republic of China Concerning Value Added Tax and its Implementing Rules, 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 years ended June 30, 2013 and 2012, the Company's pension cost charged to the statements of operations under the plan amounted to \$249,567 and \$264,258, 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 June 30, 2013 and 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 US GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

The Company's list of customers whose purchases from us were 10% or more of total sales during the years ended June 30, 2013 and 2012 is as follows:

|   | 2013      |            | 2012         |            |
|---|-----------|------------|--------------|------------|
| a. Customers                            | \$        | % to sales | \$           | % to sales |
| Shanghai Hongyu Metal Co., Ltd.         | 6,290,377 | 17         | -            | * - *      |
| Changshu Jiacheng Steel Plate Co., Ltd. | 5,278,035 | 15         | -            | * - *      |
| Shanghai Shengdejia Metal Co. Ltd       | -         | * -        | * 17,829,967 | 12         |
| Shanghai Changshuo Steel Company, Ltd   | -         | * -        | * 14,842,069 | 11         |

\* Not 10% customers for the relevant years

The Company's list of suppliers whose sales to us were 10% or more of our total purchases during the years ended June 30, 2013 and 2012 is as follows:

|   | 2013      |                | 2012         |                |
|---|-----------|----------------|--------------|----------------|
| b. Suppliers                                    | \$        | % to Purchases | \$           | % to purchases |
| Maoxun Trading Co., Ltd.                        | 4,640,101 | 14             | -            | * - *          |
| Changshu Jiacheng Steel Plate Co., Ltd.         | 3,122,782 | 10             | -            | * - *          |
| Dachang Huizu Baosheng Steel Products Co., Ltd. | -         | * -            | * 31,035,606 | 26             |
| Hebei Nuojin Trading Co., Ltd.                  | -         | * -            | * 28,581,403 | 24             |
| Wuxi Hangda Trading Co., Ltd.                   | -         | * -            | * 14,389,057 | 12             |

\* Not 10% suppliers for the relevant years

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 \$29,480,738 and \$59,116,931 as of June 30, 2013 and 2012, respectively.

Accounts receivable are regularly 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 credit tightening in China and the slowdown of the Chinese economy had and will continue to have negative consequences on the business operations of our customers and adversely impact their ability to meet their financial 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. Valuation and Qualifying Accounts

| Description                                  | Balance at<br>Beginning<br>of Year | Additions<br>Charged to<br>Costs and<br>Expenses | Deductions/<br>Write-offs<br>Charged to<br>Allowance | Exchange<br>Difference | Balance at<br>End of<br>Year |
|--|------------------------------------|--|--|------------------------|------------------------------|
| Allowance for Doubtful Accounts (Trade):     |                                    |  |  |                        |                              |
| Year ended June 30, 2012                     | 1,063,620                          | 2,150,984  | -  | 17,009                 | 3,231,613                    |
| Year ended June 30, 2013                     | 3,231,613                          | 28,089,004                                       | (1,266,064 )   | 587,820                | 30,642,373                   |
| Allowance for Doubtful Accounts (Suppliers): |                                    |  |  |                        |                              |
| Year ended June 30, 2012                     | 1,724,275                          | 2,871,154  | -  | 27,894                 | 4,623,323                    |
| Year ended June 30, 2013                     | 4,623,323                          | 19,348,204                                       | (4,704,154 )   | 422,236                | 19,689,609                   |
| Valuation Allowance for Deferred Tax Assets: |                                    |  |  |                        |                              |
| Year ended June 30, 2012                     | 4,370,401                          | 4,311,949  | -  | 37,589                 | 8,719,939                    |
| Year ended June 30, 2013                     | 8,719,939                          | 15,024,088                                       | -  | 309,011                | 24,053,038                   |

## 7. Condensed Financial Information of Parent Company

Payments of dividends may be subject to some restrictions due to the fact that the operating activities are conducted in subsidiaries residing in the PRC. The laws and regulations of the PRC currently permit the payment of dividends only out of accumulated profits as determined in accordance with Chinese accounting standards and regulations. Our subsidiaries in the PRC are also required to set aside a portion of their after tax profits according to Chinese accounting standards and regulations to fund certain reserve funds. Currently, our subsidiaries in China are the only sources of revenues or investment holdings for the payment of dividends. If they do not accumulate sufficient profits under Chinese accounting standards and regulations to first fund certain reserve funds as required, we will be unable to pay any dividends. We currently intend to retain any future earnings for use in the operation and expansion of our business. No cash dividends have been paid to the parent company for the last three fiscal years. In accordance with Rule 504/4.08 (e) (3) of Regulation S-X, the following are condensed parent company only financial statements as of and for the two years ended June 30, 2013 and 2012.

China Precision Steel, Inc.

Condensed Parent Company Only Balance Sheets

June 30, 2013 and 2012

|   | 2013         | 2012          |
|---|--------------|---------------|
| Cash and cash equivalents   | \$2,400      | \$29,235      |
| Prepayments   | 270,262      | 339,433       |
| Total current assets  | 272,662      | 368,668       |
| Property, plant and equipment   | 2,111        | 2,938         |
| Investment in subsidiaries, reported on equity method   | (9,615,599 ) | 55,471,427    |
| Advances to subsidiaries  | 62,520,206   | 63,266,786    |
| Total assets  | \$53,179,380 | \$119,109,819 |
| Current liabilities:  |              |               |
| Accounts payable  | \$265,079    | \$234,659     |
| Accrued expenses  | 4,566        | 4,566         |
| Total current liabilities   | \$269,645    | \$239,225     |
| Stockholders' equity:   |              |               |
| Common stock, \$.001 par value; 62,000,000 shares authorized; 3,880,866 shares issued and outstanding at June 30, 2013 and 2012, respectively | 3,880        | 3,880         |
| Additional paid-in capital  | 75,685,066   | 75,685,066    |
| Other comprehensive income  | 22,075,822   | 19,097,295    |
| Retained earnings/accumulated deficit   | (44,855,033) | 24,084,353    |



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

|  |              |               |
|--|--------------|---------------|
| Total stockholders' equity                 | \$52,909,735 | \$118,870,594 |
| Total liabilities and stockholders' equity | \$53,179,380 | \$119,109,819 |

F-12

## China Precision Steel, Inc.

## Condensed Parent Company Only Income Statements

For the Years Ended June 30, 2013 and 2012

|   | 2013           | 2012           |
|---|----------------|----------------|
| Sales   | \$-            | \$-            |
| Operating and administrative expenses:            |                |                |
| General and administrative expenses               | 873,932        | 882,273        |
| Loss from operations                              | (873,932 )     | (882,273 )     |
| Other income:                                     |                |                |
| Interest income                                   | 99             | 418            |
| Other income                                      | -              | 52,153         |
| Equity in earnings of unconsolidated subsidiaries | (68,065,553)   | (16,119,443)   |
| (Loss) before income taxes                        | (68,939,386)   | (16,949,145)   |
| Provision for income taxes                        | -              | -              |
| Net (loss)  | \$(68,939,386) | \$(16,949,145) |
| The components of comprehensive (loss):           |                |                |
| Net (loss)  | \$(68,939,386) | \$(16,949,145) |
| Foreign currency translation adjustment           | 2,978,527      | 2,275,110      |
| Comprehensive (loss)                              | \$(65,960,859) | \$(14,674,035) |

## China Precision Steel, Inc.

## Condensed Parent Company Only Statements of Cash Flows

For the Years Ended June 30, 2013 and 2012

|   | 2013           | 2012           |
|---|----------------|----------------|
| Cash flows from operating activities:                         |                |                |
| Net (loss)  | \$(68,939,386) | \$(16,949,145) |
| Adjustments to reconcile net income to operating activities - |                |                |
| Add: depreciation   | 827            | 681            |
| Less: equity in earnings of unconsolidated subsidiaries       | 68,065,553     | 16,119,443     |
| Net changes in assets and liabilities                         |                |                |

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

|   |            |            |
|---|------------|------------|
| Prepayments   | 69,171     | 81,421     |
| Accounts payable  | 30,420     | 78,736     |
| Net cash (used in) operating activities                     | (773,415 ) | (668,864 ) |
| Cash flows from investing activities:                       |            |            |
| Repayment of advances by subsidiaries                       | 746,580    | 518,559    |
| Purchase of fixed assets                                    | -          | (1,249 )   |
| Net cash provided by/(used in) investing activities         | 746,580    | 517,310    |
| Effect of exchange rate change on cash and cash equivalents | -          | -          |
| Net (decrease) in cash and cash equivalents                 | (26,835 )  | (151,554 ) |
| Cash and cash equivalents, beginning of year                | 29,235     | 180,789    |
| Cash and cash equivalents, end of year                      | \$2,400    | \$29,235   |
| Supplemental disclosures of cash flow information:          |            |            |
| Interest paid, net of capitalized amounts                   | \$-        | \$-        |
| Income taxes paid   | \$-        | \$-        |

## 8. 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 \$518,184 and \$350,817 for the years ended June 30, 2013 and 2012, respectively. These amounts were recognized as a loss of the current period.

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

|                  | June 30,<br>2013 | June 30,<br>2012 |
|------------------|------------------|------------------|
| <b>At cost:</b>  |                  |                  |
| Raw materials    | \$1,502,235      | \$1,711,735      |
| Work in progress | 1,483,490        | 1,064,229        |
| Finished goods   | 7,383,617        | 6,409,395        |
| Consumable items | 6,405,554        | 6,727,183        |
|                  | 16,774,896       | 15,912,542       |
| Less: provision  | (937,695 )       | (396,322 )       |
|                  | \$15,837,201     | \$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 \$6,832,699 (June 30, 2012: \$6,299,566) were pledged for short-term loans totaling \$19,857,110 at June 30, 2013 (June 30, 2012: \$19,354,534).

## 9. Advances to Suppliers

Cash advances are shown net of allowances of \$19,689,609 and \$4,623,323 at June 30, 2013 and 2012, respectively.

Due to an overall negative operating environment for steel businesses in China at present, caused by oversupply, increased cost of imported iron ore and tightened credit, we will regularly review our suppliers and our policy for provision for allowance for advances to suppliers 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.

## 10. Property, Plant and Equipment

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

|                                | June 30, 2013 | June 30, 2012 |
|--------------------------------|---------------|---------------|
| Plant and machinery            | \$80,161,729  | \$77,064,727  |
| Buildings                      | 24,268,727    | 23,438,143    |
| Motor vehicles                 | 734,764       | 651,595       |
| Office equipment               | 564,087       | 539,416       |
|                                | 105,729,307   | 101,693,881   |
| Less: Accumulated depreciation | (44,362,562 ) | (33,940,890 ) |
|                                | \$61,366,745  | \$67,752,991  |

Depreciation expense related to manufacturing is included as a component of cost of goods sold. During the years ended June 30, 2013 and 2012, depreciation totaling \$6,161,739 and \$6,351,180, respectively, was included as a component of cost of goods sold.

Plant and machinery amounting to \$31,431,182 (June 30, 2012: \$34,533,411) and \$17,513,168 (June 30, 2012: \$19,514,340) were pledged for short-term loans totaling \$28,028,722 and long-term loans including current portion totaling \$16,200,000, respectively, at June 30, 2013 (June 30, 2012: \$27,246,477 and \$16,200,000, respectively).

## 11. Construction-In-Progress

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

|                    | June 30, 2013 | June 30, 2012 |
|--------------------|---------------|---------------|
| Construction costs | \$255,996     | \$233,512     |

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

## 12. Intangible Assets

Land use rights amounting to \$1,900,914 (June 30, 2012: \$1,877,363) were pledged for short-term loans totaling \$28,028,722 at June 30, 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.

## 13. Short-Term Loans

Short-term loans consisted of the following:

|   | <b>June 30,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|---|--------------------------|--------------------------|
| Bank 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") (7.2565% at June 30, 2013) per annum (Notes 10 and 12) | 8,171,612                | 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 (7.2565% at June 30, 2013) per annum (Notes 8, 10 and 12)                              | 19,857,110               | 19,354,534               |
|   | <b>\$28,028,722</b>      | <b>\$27,246,477</b>      |

The above bank loans outstanding at June 30, 2013 are Renminbi ("RMB") loans. Other than the bank loan dated January 19, 2011 that was secured by bills receivable, all other short-term loans carry an interest rate of 1.15 times of 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 June 30, 2013 and 2012 was 7.26% and 7.26%, respectively. Principal and interest under the short-term loans totaling \$28,028,722 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 year ended June 30, 2013.

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

|  | <b>June 30,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|--|--------------------------|--------------------------|
| Bank loan dated June 29, 2010, due June 15, 2016 with an interest rate of the London Interbank Offered Rate (“LIBOR”) plus 4.5% (4.9148% at June 30, 2013) per annum (Note 10) | \$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 new cold rolling line and annealing furnaces at Shanghai Blessford’s facilities and guaranteed by the Company.

In June 2012, the Company defaulted on its semi-annual principal and interest repayment obligation. The Company is currently in discussions with DEG regarding a possibility to restructure the loan 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.

**15. 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*



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

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. Warrants issued to investors were not exercised and expired on May 5, 2013.

Information with respect to stock warrants outstanding is as follows:

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

## 16. Income Taxes

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

|   | June 30, 2013 | June 30, 2012 |
|---|---------------|---------------|
| Deferred tax assets and liabilities:            |               |               |
| Net operating loss carried forward              | \$11,247,441  | \$6,668,613   |
| Temporary differences resulting from allowances | 12,805,597    | 2,051,326     |
| Net deferred income tax asset                   | \$24,053,038  | \$8,719,939   |
| Valuation allowance                             | (24,053,038)  | (8,719,939)   |
|   | \$-           | \$-           |

The Company has not recognized a deferred tax liability as its foreign subsidiaries do not have any undistributed earnings as of June 30, 2013. A deferred tax liability will be recognized when the Company no longer plans to permanently reinvest undistributed earnings.

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

|   | Year ended June 30, |               |
|---|---------------------|---------------|
|   | 2013                | 2012          |
| Computed tax at the PRC statutory rate of 25% | \$(17,395,501)      | \$(4,311,962) |
| Valuation allowance                           | 15,333,099          | 4,349,538     |
| Income not subject to tax                     | (41,896 )           | (37,589 )     |
| Expenses not deductible for tax               | 2,104,298           | 13            |
| Overprovision                                 | -                   | (5,061 )      |
| Income tax (benefit) per books                | \$-                 | \$(5,061 )    |

Income tax (benefit) consists of:

|   | Year ended June 30, |             |
|---|---------------------|-------------|
|   | 2013                | 2012        |
| Income tax (benefit) for the year – PRC | \$ -                | \$ (5,061 ) |
| Deferred income tax benefit – PRC       | -                   | -           |
| Income tax (benefit) per books          | \$ -                | \$ (5,061 ) |

## 17. (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 year ended June 30, 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<br>(Numerator) | Shares<br>(Denominator) | Per Share<br>Amount |
|-----------------------------------|-----------------------|-------------------------|---------------------|
| For the year ended June 30, 2013: |                       |                         |                     |
| Net (loss)                        | \$(68,939,386)        |                         |                     |

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

|   |                |           |            |
|---|----------------|-----------|------------|
| Basic EPS (loss) available to common shareholders   | \$(68,939,386) | 3,880,866 | \$(17.76 ) |
| Effect of dilutive securities:                      |                |           |            |
| Warrants  |                | -         |            |
| Diluted EPS (loss) available to common shareholders | \$(68,939,386) | 3,880,866 | \$(17.76 ) |
| For the year ended June 30, 2012:                   |                |           |            |
| Net (loss)  | \$(16,949,145) |           |            |
| Basic EPS (loss) available to common shareholders   | \$(16,949,145) | 3,880,866 | \$(4.37 )  |
| Effect of dilutive securities:                      |                |           |            |
| Warrants  |                | -         |            |
| Diluted EPS (loss) available to common shareholders | \$(16,949,145) | 3,880,866 | \$(4.37 )  |

## 18. 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 alleges, 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. Mr. Zhang asserts a breach of an agreement to compensate him for services he allegedly performed in connection with seeking out a merger candidate for the Company. The Company filed a motion to dismiss, as did the other defendants, and that motion was granted on or about March 13, 2013. The Plaintiff had the right to appeal within 30 days of the court decision, and has done so. The Plaintiff has filed an appellate brief and the Company has filed a brief in opposition. We expect a decision within the next eight (8) months. 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.

In addition to the above, certain former officers and directors have filed a lawsuit against the Company claiming that they are entitled to defense and indemnification from the Company for the claims of Mr. Zhang and China Venture Partners. Because the underlying case was dismissed without any award to the plaintiffs, these former officers and directors are seeking to recover their costs and attorney's fees expended in defending against the claims of Mr. Zhang and China Venture Partners. This action is in its early stages. 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 or will be materially adversely affected.

### *Capital Commitments*

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

## **19. 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 June 30, 2013, as the Company's market capitalization was lower than the carrying value of its assets and the Company experienced continuing losses, 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 June 30, 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 June 30, 2013 was considered immaterial and not tested for impairment in accordance with ASC 350.

## **20. Business Segment Information**

Operations for the Company are summarized below by geographic area:

**Year Ended June 30, 2013**

|            | <b>PRC</b>   | <b>Foreign</b> | <b>Total</b> |
|------------|--------------|----------------|--------------|
| Revenue    | \$32,968,968 | \$3,558,582    | \$36,527,550 |
| % of sales | 90           | 10             | 100          |

**Year Ended June 30, 2013**

|            | <b>PRC</b>    | <b>Foreign</b> | <b>Total</b>  |
|------------|---------------|----------------|---------------|
| Revenue    | \$135,460,918 | \$7,512,713    | \$142,973,631 |
| % of sales | 95            | 5              | 100           |

**21. Quarterly Data - Unaudited**

The following table sets forth certain information regarding the Company's results of operations for each full quarter within the fiscal years ended June 30, 2013 and 2012:

|  | Quarter Ended |              |              |               |
|--|---------------|--------------|--------------|---------------|
|  | June 30,      | March 31,    | December 31, | September 30, |
| Fiscal 2013:                           |               |              |              |               |
| Revenues                               | \$13,843,026  | \$8,563,497  | \$8,164,267  | \$5,956,760   |
| Gross (loss)                           | (6,629,531 )  | (2,375,307 ) | (1,301,958 ) | (1,466,949 )  |
| Loss from operations before income tax | (40,345,203)  | (13,487,395) | (10,884,505) | (4,222,283 )  |
| Net loss                               | (40,345,203)  | (13,487,395) | (10,884,505) | (4,222,283 )  |
| Basic (loss) per share                 | \$(10.40 )    | \$(3.48 )    | \$(2.80 )    | \$(1.09 )     |
| Diluted (loss) per share               | \$(10.40 )    | \$(3.48 )    | \$(2.80 )    | \$(1.09 )     |
| Fiscal 2012:                           |               |              |              |               |
| Revenues                               | \$37,649,588  | \$29,494,865 | \$33,662,335 | \$42,166,843  |
| Gross (loss)/profit                    | (2,952,641 )  | (1,117,208 ) | (1,798,717 ) | 61,770        |
| Loss from operations before income tax | (9,051,355 )  | (3,312,915 ) | (3,565,153 ) | (1,024,783 )  |
| Net loss                               | (9,019,105 )  | (3,313,023 ) | (3,537,922 ) | (1,079,095 )  |
| Basic (loss) per share                 | \$(2.32 )     | \$(0.85 )    | \$(0.91 )    | \$(0.28 )     |
| Diluted (loss) per share               | \$(2.32 )     | \$(0.85 )    | \$(0.91 )    | \$(0.28 )     |

Earnings per share amounts for each quarter are required to be computed independently. As a result their sum may not equal the total year basic and diluted earnings per share.

## 22. 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 July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (“ASU 2013-11”). The objective of this Update is to eliminate the diversities that exist in financial statement presentation. The amendments aim at attaining this objective by giving explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments of ASU 2013-11, when adopted, are not expected to have a material impact on the Company’s consolidated financial statements.

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

None.

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

**Evaluation of Disclosure Controls and Procedures**

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 June 30, 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 June 30, 2013 our disclosure controls and procedures were not effective.

**Management's Annual Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting refers to the process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP, and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of June 30, 2013. In making this assessment, management used the framework set forth in the report entitled Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, our management concluded that our internal control over financial reporting was not effective, as of June 30, 2013, as 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 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 year ended June 30, 2013, such as to contain a material misstatement.

Because the Company is a smaller reporting company, this annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm.

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

There were no changes in our internal controls over financial reporting during the fourth quarter of our fiscal year ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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

We have no information to disclose that was required to be disclosed in a report on Form 8-K during fourth quarter of fiscal year 2013, but was not reported.



**PART III**

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

**Directors and Executive Officers**

The following sets forth the name and position of each of our current executive officers and directors.

| <b>NAME</b>      | <b>AGE</b> | <b>POSITION</b>                                 |
|------------------|------------|---|
| Leada Tak Tai Li | 33         | Director (Chairperson), Chief Financial Officer |
| Hai Sheng Chen   | 50         | Chief Executive Officer and Director            |
| Zu De Jiang      | 67         | Chief Operating Officer                         |
| Tung Kuen Tsui   | 68         | Director  |
| Jian Lin Li      | 42         | Director  |

**Leada Tak Tai Li.** Leada Tak Tai Li has been the Chair of our Board of Directors since August 1, 2011 and Chief Financial Officer since December 28, 2006. From October 2005 until December 28, 2006, Ms. Li was the Chief Financial Officer of PSHL. Ms. Li has been a Non-Executive Director of STAR Pharmaceutical Limited since August 2009, and was an assistant to the Chairman for the same company between June 2004 and October 2005, where she was assisting with group activities and financial reporting. From November 2003 until May 2004, Ms. Li was an accountant with KPMG Hong Kong, a company engaged in audit, assurances and consulting services, conducting commercial due diligence on businesses in China. From January 2002 until September 2002, Ms. Li was an investment advisor conducting research and analysis with the private equity firm Suez Asia Holdings (Hong Kong) Ltd. In 2003, Ms. Li received her Master's Degree in Accounting and Finance from Napier University in the U.K., and a Bachelors Degree in Commerce from the University of Melbourne in 2001.

**Hai Sheng Chen.** Mr. Hai Sheng Chen is a co-founder of the Company and has been our Chief Executive Officer since May 1, 2010. He also served as an Executive Director and General Manager of the Company and its operating subsidiary, Chengtong, since July 2002. Prior to joining us, Mr. Chen served from July 2001 to July 2002, as the Managing Director of Shanghai Krupp Stainless Steel Co. Limited, a steel processing company, and from August 1999 to May 2001, as the Deputy General Manager of Pudong Steel Co. Limited, a subsidiary of the Baosteel Group, a steel processing company. Mr. Chen has an Executive MBA Degree from China Europe International Business School and a Bachelors Degree in Metallic Pressure Processing from the Beijing University of Science and Technologies.

**Zu De Jiang.** Zu De Jiang has been our Chief Operating Officer since May 1, 2010, and has been with us since our founding in 2002. He served as our Assistant General Manager from February 2002 to February 2007, and has served as Assistant CEO since March 2007. Prior to joining us, Mr. Jiang served from September 1996 to June 2001, as the Deputy General Manager of Shanghai Pudong Stainless Steel Thin Plate Co., Ltd. and from April 1984 to September 1996, as the Deputy Head of Operations of the Cold Rolling Plant at Shanghai Pudong Steel (Group) Co., Ltd. Prior to that, Mr. Jiang held various positions between September 1967 and April 1984 at Shanghai No. 3 Steel Factory, including Division Chief of the Cold Rolling Division. Mr. Jiang graduated from Shanghai Metallurgical Academy in September 1967 and holds a diploma in Steel Rolling.

**Tung Kuen Tsui.** Tung Kuen Tsui has been a member of our Board of Directors since December 28, 2006. Mr. Tsui has been retired since 1998. From 1995 to 1998, Mr. Tsui served as a Senior Credit Controller for PricewaterhouseCoopers. Prior to working as the Senior Credit Controller, Mr. Tsui held a variety of positions with PricewaterhouseCoopers since 1971, including Senior Manager, Information Systems. Mr. Tsui has a Master in Business Administration from the University of Macau. Mr. Tsui graduated as an Associate Member of Chartered Institute of Secretaries and Administrators in the United Kingdom.

**Jian Lin Li.** Mr. Li has been a member of our Board of Directors since July 1, 2013. Mr. Li is currently a Partner and Director at Jonten Certified Public Accountants (“Jonten”). From October 2002 to August 2006, Mr. Li was the Department Manager at China Enterprise Appraisals Company. Prior to that, Mr. Li was the Project Manager at Shenzhen Huaxin CPA Firm from January 2001 to October 2002. Mr. Li graduated with a Bachelor’s degree in Accountancy from Hunan University of Commerce and is also a member of the Expert Advisory Committee for the Ministry of Information Industry, and a member of the Expert Advisory Committee for State-owned Assets Supervision and Administration Commission of Shenzhen.

There are no agreements or understandings for any of our executive officers or director to resign at the request of another person and no officer or director is acting on behalf of nor will any of them act at the direction of any other person.

Directors are elected until their successors are duly elected and qualified.

## Qualifications, Attributes, Skills and Experience Represented on the Board

The Board has identified particular qualifications, attributes, skills and experience that are important to be represented on the Board as a whole, in light of the Company's current needs and business priorities. The Company is a NASDAQ listed company that offers products in the steel industry in China. Therefore, the Board believes that a diversity of professional experiences in the steel industry, specific knowledge of key geographic growth areas, and knowledge of U.S. capital markets and of U.S. accounting and financial reporting standards should be represented on the Board. Set forth below is a tabular disclosure summarizing some of the specific qualifications, attributes, skills and experiences of our directors.

| <b>Director</b>     | <b>Titles</b>                           | <b>Material Qualifications</b>  |
|---------------------|---|---|
| Leada Tak<br>Tai Li | Director and<br>Chairperson             | Master in accounting and finance<br><br>Knowledge of U.S. accounting and financial reporting standards<br>Contributes invaluable long-term knowledge of our business and operations and of the steel industry and the cold rolling niche markets in China   |
| Hai Sheng<br>Chen   | Director and Chief<br>Executive Officer | Co-founder of the Company and its oldest subsidiary<br><br>EMBA in Business Administration<br>Expertise in cold rolling and general knowledge of the steel industry with over 20 years of experience<br>Contributes invaluable long-term knowledge of our business and operations and of the steel industry and the cold rolling niche markets in China |
| Tung Kuen<br>Tsui   | Director                                | Master in Business Administration<br><br>Served with PricewaterhouseCoopers for 27 years prior to his retirement in 1998<br>Knowledge of U.S. accounting and financial reporting standards.   |
| Jian Lin Li         | Director                                | In-depth knowledge of the business regulations in China<br>Extensive experience in accounting and asset valuation covering a diverse range of industries<br>Familiar with various accounting standards including the U.S. GAAP and International Accounting Standards   |

## Family Relationships

There are no family relationships among any of our officers and directors.

## **Involvement in Certain Legal Proceedings**

To the best of our knowledge, none of our directors or executive officers has, during the past ten years:

been convicted in a criminal proceeding or been subject to a pending criminal proceeding (excluding traffic violations and other minor offences);

had any bankruptcy petition filed by or against the business or property of the person, or of any partnership, corporation or business association of which he was a general partner or executive officer, either at the time of the bankruptcy filing or within two years prior to that time;

been subject to any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction or federal or state authority, permanently or temporarily enjoining, barring, suspending or otherwise limiting, his involvement in any type of business, securities, futures, commodities, investment, banking, savings and loan, or insurance activities, or to be associated with persons engaged in any such activity;

been found by a court of competent jurisdiction in a civil action or by the Securities and Exchange Commission or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated;

been the subject of, or a party to, any federal or state judicial or administrative order, judgment, decree, or finding, not subsequently reversed, suspended or vacated (not including any settlement of a civil proceeding among private litigants), relating to an alleged violation of any federal or state securities or commodities law or regulation, any law or regulation respecting financial institutions or insurance companies including, but not limited to, a temporary or permanent injunction, order of disgorgement or restitution, civil money penalty or temporary or permanent cease-and-desist order, or removal or prohibition order, or any law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or

been the subject of, or a party to, any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26))), any registered entity (as defined in Section 1(a)(29) of the Commodity Exchange Act (7 U.S.C. 1(a)(29))), or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

Except as set forth in our discussion below in Item 13, “Certain Relationships and Related Transactions, and Director Independence – Transactions with Related Persons,” none of our directors, director nominees or executive officers has been involved in any transactions with us or any of our directors, executive officers, affiliates or associates which are required to be disclosed pursuant to the rules and regulations of the SEC.

### **Board Composition and Committees**

Our Board of Directors currently consists of four members: Leada Tak Tai Li, Hai Sheng Chen, Tung Kuen Tsui and Jian Lin Li. Each of Che Kin Lui, Daniel Carlson and David Peter Wong, former members of our Board of Directors, resigned from their positions on the Company’s Board of Directors on August 13, 2012, October 9, 2012 and May 9, 2013, respectively. Each of Tung Kuen Tsui and Jian Lin Li serves on our Board of Directors as an “independent director” as defined by as defined by Rule 5605(a)(2) of the NASDAQ Listing Rules and we are in the process of vetting candidates to serve as a third independent director to fill the vacancy left by Mr. Wong’s departure. Our Board of Directors has determined that Jian Lin Li possesses the accounting or related financial management experience that qualifies him as financially sophisticated within the meaning of Rule 5605(c)(2)(A) of the NASDAQ Listing Rules and that he is an “audit committee financial expert” as defined by the rules and regulations of the SEC.

Our Board of Directors has established three committees: an audit committee, a compensation committee, and a corporate governance and nominating committee. Each committee is comprised entirely of independent directors. From time to time, our Board of Directors may establish other committees. Our Board of Directors has adopted a written charter for each of the committees, which is available on our website [www.chinaprecisionsteelinc.com](http://www.chinaprecisionsteelinc.com). Printed copies of these charters may be obtained, without charge, by contacting the Corporate Secretary, China Precision Steel, Inc., 18th Floor, Teda Building, 87 Wing Lok Street, Sheung Wan, Hong Kong, People’s Republic of China.

#### ***Audit Committee***

Our independent directors, Tung Kuen Tsui, and Jian Lin Li, serve as members of our audit committee. Mr. Li serves as chair of the audit committee.

The purpose of the audit committee is to oversee our accounting and financial reporting processes and the audits of our financial statements. The primary function of the audit committee is to oversee the Board by reviewing the financial information that will be provided to the stockholders and others, the preparation of our internal financial statements, and our audit and financial reporting process, including internal control over financial reporting. In addition, our audit committee is responsible for maintaining free and open lines of communication among the committee, the independent auditors and management. Our audit committee consults with our management and

independent auditors before the presentation of financial statements to stockholders and, as appropriate, initiates inquiries into various aspects of our financial affairs. The committee is also responsible for considering, appointing, and establishing fee arrangements with our independent auditors and, if necessary, dismissing them. It is not responsible for preparing our financial statements or for planning or conducting the audits.

### *Compensation Committee*

Our independent directors, Tung Kuen Tsui, and Jian Lin Li, serve as members of our compensation committee. Mr. Tung Kuen Tsui serves as Chair of the compensation committee.

Our compensation committee assists the Board in reviewing and approving the compensation structure of our directors and executive officers, including all forms of compensation to be provided to our directors and executive officers. Our chief executive officer may not be present at any committee meeting during which his compensation is deliberated. The compensation committee is responsible for, among other things:

approving and overseeing the compensation package for our executive officers;

reviewing and making recommendations to the Board with respect to the compensation of our directors;

reviewing and approving corporate goals and objectives relevant to the compensation of our chief executive officer, evaluating the performance of our chief executive officer in light of those goals and objectives, and setting the compensation level of our chief executive officer based on this evaluation; and

reviewing periodically and making recommendations to the Board regarding any long-term incentive compensation or equity plans, programs or similar arrangements, annual bonuses, employee pension and welfare benefit plans.

### *Corporate Governance and Nominating Committee*

Our independent directors, Tung Kuen Tsui, and Jian Lin Li, serve as members of our corporate governance and nominating committee. Mr. Tung Kuen Tsui serves as Chair of the corporate governance and nominating committee.

The corporate governance and nominating committee assists the Board of Directors in identifying individuals qualified to become our directors and in determining the composition of the Board and its committees. It is responsible for, among other things:

identifying and recommending to the Board nominees for election or re-election to the board, or for appointment to fill any vacancy;

reviewing annually with the Board the current composition of the Board in light of the characteristics of independence, age, skills, experience and availability of service to us;

identifying and recommending to the Board the directors to serve as members of the Board's committees; and

monitoring compliance with our code of business conduct and ethics.

In identifying and recommending nominees for election or re-election to the board, or for appointment to fill any vacancy, the corporate governance and nominating committee is also committed to engendering Board strength and effectiveness by seeking candidates with a diverse set of business, academic and life experiences and backgrounds who also possess knowledge and skills in areas of importance to the Company. The Committee does not use quotas but considers diversity when evaluating potential new directors.

The Committee identifies director candidates primarily through recommendations made by the non-employee directors. These recommendations are developed based on the directors' own knowledge and experience in a variety of fields. Additionally the Committee considers recommendations made by the employee directors, stockholders, and others. All recommendations, regardless of the source, are evaluated on the same basis.

Stockholders may send recommendations for director candidates to the Corporate Secretary, China Precision Steel, Inc., 18th Floor, Teda Building, 87 Wing Lok Street, Sheung Wan, Hong Kong, People's Republic of China. A submission recommending a candidate should include sufficient biographical information to allow the Committee to evaluate the candidate, information concerning any relationship between the candidate and the stockholder

recommending the candidate and material indicating the willingness of the candidate to serve if nominated and elected.

### Section 16(A) Beneficial Ownership Reporting Compliance

Under U.S. securities laws, directors, certain executive officers and persons holding more than 10% of our common stock must report their initial ownership of the common stock, and any changes in that ownership, to the SEC. The SEC has designated specific due dates for these reports.

### Code of Ethics

Our Board of Directors has adopted a Code of Business Conduct and Ethics applies to all of our directors, officers and employees, including our principal executive officer, principal financial officer and principal accounting officer. During the fiscal year ended June 30, 2013, there were no waivers of our Code of Business Conduct and Ethics.

### ITEM 11. EXECUTIVE COMPENSATION.

#### Summary Compensation Table – Fiscal Years Ended June 30, 2012 and 2011

The following table sets forth information concerning all cash and non-cash compensation awarded to, earned by or paid to the named persons for services rendered in all capacities during the noted periods. No other executive officer received total annual salary and bonus compensation in excess of \$100,000.

| Name and Principal Position                               | Year | Salary<br>(\$) | Bonus<br>(\$) | Stock<br>Awards<br>(\$) | All Other<br>Compensation<br>(\$) | Total<br>(\$) |
|---|------|----------------|---------------|-------------------------|-----------------------------------|---------------|
| Hai Sheng Chen, Chief Executive Officer                   | 2013 | 29,400         | -             | -                       | -                                 | 29,400        |
|   | 2012 | 28,391         | -             | -                       | -                                 | 28,391        |
| Leada Tak Tai Li, Chairperson and Chief Financial Officer | 2013 | 84,000         | -             | -                       | -                                 | 84,000        |
|   | 2012 | 84,000         | -             | -                       | -                                 | 84,000        |



## Employment Agreements

We have entered into executive employment agreements with each of Hai Sheng Chen, our Chief Executive Officer, Leada Tak Tai Li, our Board Chair and Chief Financial Officer and Zu De Jiang, our Chief Operating Officer. All executive employment agreements were entered into as of January 1, 2007, except Mr. Jiang's employment agreement which was entered into on May 1, 2010, and will continue indefinitely until terminated in accordance with the terms of agreement. The base salary shown in the Summary Compensation Table above is described in each of the executive officer's respective employment agreement, and each of them has the right to participate in our employee benefit plans. The executives are also entitled to reimbursement, to the fullest extent authorized by Delaware law, of all expenses incurred or suffered by them in connection with any claim brought against them because of or in connection with their positions with us or any of our affiliates, except to the extent that, such expenses arise as a result of the bad faith, willful misconduct or gross negligence of the executive, or as a result of his or her conviction for a felony.

Each of the executive employment agreements permits us to terminate the executive's employment at any time by giving a written notice to the executive officer, provided that, if we terminate the executive's employment without cause, the executive will be entitled to a termination payment equal to six months of his or her then current base salary, payable in six equal installments over the six-month period immediate following the date of termination. We may also terminate for cause, at any time, without notice or remuneration, for certain acts of the executive, including but not limited to a conviction or plea of guilty to a felony, negligence or dishonesty to our detriment and failure to perform agreed duties after a reasonable opportunity to cure the failure. An executive may terminate his or her employment upon thirty days' written notice if there is a material reduction in his authority, duties and responsibilities or if there is a material breach by the us of the terms or conditions of the agreement after a reasonable opportunity to cure the breach. The agreements also provide that, if within 12 months following a change of control, any of the executives are terminated without cause or any of them terminate for good reason, then the vesting and exercisability of 50% of his or her stock options that are unvested at the time of the termination (if any) will accelerate and immediately become vested and exercisable as of the termination date, and will remain exercisable for 12 months following the termination date.

Each of the executive employment agreements contains customary non-competition, confidentiality, and non-disclosure covenants. Specifically, each executive officer has agreed, both during and after he or she is no longer employed by us, to hold in strict confidence and not to use, except as required in the performance of his duties in connection with the employment, any confidential information, technical data, trade secrets and know-how of our company or the confidential information of any third party, including our affiliated entities and our subsidiaries, received by us. The executive officers have also agreed to disclose in confidence to us all inventions, designs and trade secrets which they conceive, develop or reduce to practice and to assign all right, title and interest in them to us. In addition, each of the executive officers has agreed not to, while employed by us and for a period of 3 years following the termination or expiration of the agreement: approach our clients, customers or contacts or other persons or entities, and not to interfere with the business relationship between us and such persons and/or entities; assume employment with or provide services as a director for any of our competitors, or engage in any business which is in direct or indirect competition with our business; or solicit the services of any of our employees.

**Outstanding Equity Awards at Fiscal Year End**

No unexercised options or warrants were held by any of the named executive officers at year end. No equity awards were made during the year ended June 30, 2013.

**Compensation of Directors**

The table below sets forth the compensation of our directors for serving as our directors for the fiscal year ended June 30, 2013:

| Name              | Fees Earned<br>or Paid in Cash<br>(\$) | Stock<br>Awards<br>(\$) | Option<br>Awards<br>(\$) | Non-Equity<br>Incentive Plan<br>Compensation<br>(\$) | All Other<br>Compensation<br>(\$) | Total<br>(\$) |
|-------------------|--|-------------------------|--------------------------|--|-----------------------------------|---------------|
| Che Kin Lui*      | 3,652                                  | -                       | -                        | -  | -                                 | 3,652         |
| David Peter Wong* | 36,016                                 | -                       | -                        | -  | -                                 | 36,016        |
| Tung Kuen Tsui    | 36,000                                 | -                       | -                        | -  | -                                 | 36,000        |
| Daniel Carlson*   | 9,783                                  | -                       | -                        | -  | -                                 | 9,783         |

\* Che Kin Lui, Daniel Carlson, and David Peter Wong resigned from their positions on the Company's Board of Directors on August 13, 2012, October 9, 2012, and May 9, 2013, respectively.

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

**Security Ownership of Certain Beneficial Owners and Management**

The following table sets forth information regarding beneficial ownership of our common stock as of September 25, 2013 (i) by each person who is known by us to beneficially own more than 5% of our common stock; (ii) by each of our officers and directors; and (iii) by all of our officers and directors as a group. Unless otherwise specified, the address of each of the persons set forth below is in care of China Precision Steel, Inc., 18th Floor, Teda Building, 87 Wing Lok Street, Sheung Wan, Hong Kong, People's Republic of China.

| Name & Address of Beneficial Owner                            | Office, If Any                          | Title of Class                  | Amount & Nature of Beneficial Ownership <sup>(1)</sup> | Percent of Class <sup>(2)</sup> |
|---|---|---------------------------------|--|---------------------------------|
| <b>Officers and Directors</b>                                 |   |                                 |  |                                 |
| Hai Sheng Chen  | Chief Executive Officer and Director    | Common Stock, \$0.001 par value | -  | *                               |
| Leada Tak Tai Li  | Chief Financial Officer and Board Chair | Common Stock, \$0.001 par value | 16,667   | *                               |
| Zu De Jiang   | Chief Operating Officer                 | Common Stock, \$0.001 par value | -  | *                               |
| Tung Kuen Tsui  | Director                                | Common Stock, \$0.001 par value | -  | *                               |
| David Peter Wong  | Director                                | Common Stock, \$0.001 par value | -  | *                               |
| All Officers and Directors as a group (5 persons named above) |   |                                 | 16,667   | *                               |
| <b>5% Security Holders</b>                                    |   |                                 |  |                                 |
| Wo Hing Li  |   | Common Stock, \$0.001 par value | 1,279,103  | 33.0 %                          |

\* Less than 1%

(1) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities.

(2)

A total of 3,880,866 shares of our common stock are considered to be outstanding pursuant to SEC Rule 13d-3(d)(1) as of September 25, 2013. For each beneficial owner above, any options exercisable within 60 days have been included in the denominator.

### Changes in Control

There are no arrangements known to us, including any pledge by any person of our securities, the operation of which may at a subsequent date result in a change in control of the Company.

### Securities Authorized for Issuance under Equity Compensation Plans

The following table includes the information as of the end of fiscal year 2013 for each category of our equity compensation plan:

| Plan category  | Number of securities to be issued upon exercise of outstanding restricted stock, warrants and rights<br>(a) | Weighted-average exercise price of outstanding options, restricted stock, warrants and rights<br>(b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br>(c) |
|--|---|--|--|
| Equity compensation plans approved by security holders(1)  | -   | -  | 180,435  |
| Equity compensation plans not approved by security holders | -   | -  | -  |
| Total  | -   | -  | 180,435  |

The China Precision Steel, Inc. 2006 Omnibus Long-Term Incentive Plan was approved by our stockholders on December 27, 2006. The plan is administered by our compensation committee and allows us to grant awards of stock options (including incentive stock options), stock appreciation rights, restricted stock, restricted stock units, unrestricted stock and cash awards to: (i) any employee, officer or director of the Company or our affiliates, or a consultant or adviser currently providing services to the Company or an affiliate; (ii) any outside director; and (iii) any other individual whose participation in the plan is determined to be in the best interests of the Company by the compensation committee. We have reserved a maximum of 180,435 shares of our common stock to be issued under the plan. No shares have been awarded under the 2006 Omnibus Long-Term Incentive Plan.

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

**Transactions with Related Persons**

None of our directors, director nominees or executive officers has been involved in any transactions with us or any of our directors, executive officers, affiliates or associates (other than compensation described under Item 11, "Executive Compensation") since the beginning of our 2009 fiscal year which are required to be disclosed pursuant to the rules and regulations of the SEC.

**Promoters and Certain Control Persons**

We did not have any promoters at any time during the past five fiscal years.

**Director Independence**

Messrs. Tung Kuen Tsui, and Jian Lin Li each serves on our Board of Directors as an "independent director" as defined by Rule 5605(a)(2) of the NASDAQ Listing Rules.

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

**Independent Registered Public Accounting Firm's Fees**

The following is a summary of the fees billed to the Company by Moore Stephens for professional services rendered for the fiscal years ended June 30, 2013 and 2012:

|                    | June 30, 2013 | June 30, 2012 |
|--------------------|---------------|---------------|
| Audit Fees         | \$ 174,000    | \$ 164,000    |
| Audit Related Fees | -             | -             |
| Tax Fees           | -             | -             |

|                |            |            |
|----------------|------------|------------|
| All Other Fees | -          | -          |
| TOTAL          | \$ 174,000 | \$ 164,000 |

“Audit Fees” consisted of the fees billed for professional services rendered for the audit of our annual financial statements and the reviews of the financial statements included in our Forms 10-Q and for any other services that were normally provided by Moore Stephens in connection with our statutory and regulatory filings or engagements.

“Audit Related Fees” consisted of the fees billed for professional services rendered for assurance and related services that were reasonably related to the performance of the audit or review of our financial statements and were not otherwise included in Audit Fees.

“Tax Fees” consisted of the fees billed for professional services rendered for tax compliance, tax advice and tax planning. Included in such Tax Fees were fees for preparation of our tax returns and consultancy and advice on other tax planning matters.

“All Other Fees” consisted of the fees billed for products and services provided by Moore Stephens and not otherwise included in Audit Fees, Audit Related Fees or Tax Fees. Included in such Other Fees were fees for services rendered by Moore Stephens in connection with our S-3 registration statements and private and public offerings conducted during such years.

Our audit committee has considered whether the provision of the non-audit services described above is compatible with maintaining auditor independence and determined that such services are appropriate. Before auditors are engaged to provide us audit or non-audit services, such engagement is (without exception, required to be) approved by the audit committee of our Board of Directors.

### **Pre-Approval Policies and Procedures**

Under the Sarbanes-Oxley Act of 2002, all audit and non-audit services performed by our auditors must be approved in advance by our Board of Directors to assure that such services do not impair the auditors’ independence from us. In accordance with its policies and procedures, our Board of Directors pre-approved the audit service performed by Moore Stephens for our financial statements as of and for the year ended June 30, 2013.

## PART IV

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

#### Financial Statements and Schedules

The financial statements are set forth under Item 8 of this annual report on Form 10-K. Financial statement schedules have been omitted since they are either not required, not applicable, or the information is otherwise included.

#### Exhibit List

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

#### Exhibit No. Description

- |      |   |
|------|---|
| 3.1  | Certificate of Incorporation (incorporated herein by reference to Annex 2 to the Company's Definitive Proxy Statement filed on October 16, 2007)  |
| 3.2  | Bylaws (incorporated herein by reference to Annex 3 to the Company's Definitive Proxy Statement filed on October 16, 2007)  |
| 4.1  | Form of Warrant, dated November 6, 2007 (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on November 1, 2007)                                   |
| 4.2  | Warrant, dated November 6, 2007, issued to Roth Capital Partners LLC (incorporated herein by reference Exhibit 4.2 to the Company's Current Report on Form 8-K filed on November 1, 2007)         |
| 4.3  | Form of Warrant, dated February 2007 (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on February 22, 2007)                                     |
| 4.4  | Warrant, dated February 22, 2007, issued to Belmont Capital Group Limited (incorporated herein by reference Exhibit 4.2 to the Company's Current Report on Form 8-K filed on February 22, 2007)   |
| 4.5  | Warrant, dated February 22, 2007, issued to CCG Elite Investor Relations (incorporated herein by reference to Exhibit 4.3 to the Company's Current Report on Form 8-K filed on February 22, 2007) |
| 10.1 | Form of Subscription Agreement, dated November 1, 2007 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 1, 2007)                   |

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

- 10.2 Form of Placement Agency Agreement, dated October 31, 2007 (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on November 1, 2007)
- 10.3 Form of Stock Purchase Agreement, dated February 16, 2007 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 22, 2007)
- 10.4 Form of Limited Standstill Agreement (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on February 22, 2007)
- 10.5 Redemption Agreement, dated December 28, 2006 (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 4, 2007)
- 10.6 Senior Loan Agreement, dated January 29, 2010, between Shanghai Blessford Alloy Co., Ltd. and DEG – Deutsche Investitions und Entwicklungsgesellschaft MBH (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on February 16, 2010)
- 10.7 China Precision Steel, Inc. 2006 Omnibus Long Term Incentive Plan (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on January 4, 2007)
- 10.8 2006 Director Stock Plan, dated March 1, 2006 (incorporated herein by reference to Annex 3 to the Company's Definitive Proxy Statement filed on November 22, 2006)
- 10.9 Executive Employment Agreement, dated as of January 1, 2007, between the Company and Wo Hing Li (incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on May 11, 2009)
- 10.10 Executive Employment Agreement, dated as of January 1, 2007, between the Company and Leada Tak Tai Li (incorporated herein by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on May 11, 2009)
- 10.11 Executive Employment Agreement, dated as of January 1, 2007, between the Company and Hai Sheng Chen (incorporated herein by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on May 11, 2009)
- 14 Code of Business Conduct and Ethics (incorporated herein by reference to Exhibit 14 to the Company's Annual Report on Form 10-K filed on September 15, 2010)
- 21 Subsidiaries of the Company (incorporated herein by reference to Exhibit 21 to the Company's Annual Report on Form 10-K filed on September 15, 2008)
- 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\*\*



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

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.

\*\* In accordance with Regulation S-T, the XBRL-formatted interactive data files that comprise Exhibit 101 in this Annual Report on Form 10-K shall be deemed “furnished” and not “filed”.

- 49 -

## SIGNATURES

In accordance with section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant caused this Report on Form 10-K to be signed on its behalf by the undersigned, thereto duly authorized individual.

Date: October 11, 2013

### **CHINA PRECISION STEEL, INC.**

By: */s/ Hai Sheng Chen*  
Hai Sheng Chen  
Chief Executive Officer

By: */s/ Leada Tak Tai Li*  
Leada Tak Tai Li  
Chief Financial Officer

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

| Signature                                       | Title  | Date             |
|---|--|------------------|
| <i>/s/ Hai Sheng Chen</i><br>Hai Sheng Chen     | Chief Executive Officer and Director<br>(Principal Executive Officer)  | October 11, 2013 |
| <i>/s/ Leada Tak Tai Li</i><br>Leada Tak Tai Li | Chair of the Board of Directors and<br>Chief Financial Officer<br>(Principal Financial and Accounting Officer) | October 11, 2013 |
| <i>/s/ Tung Kuen Tsui</i><br>Tung Kuen Tsui     | Director   | October 11, 2013 |
| <i>/s/ Jian Lin Li</i><br>Jian Lin Li           | Director   | October 11, 2013 |



