

China Precision Steel, Inc.
Form 10-K/A
October 16, 2007

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

**FORM 10-K/A
(Amendment No. 2)**

(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, 2007
OR**

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (No Fee Required)

For the transition period from _____ to _____

Commission File Number 000-23039

CHINA PRECISION STEEL, INC.
(Exact name of registrant as specified in its charter)

Colorado
(State or other jurisdiction of
incorporation or organization)

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

**8th Floor, Teda
Building, 87 Wing
Lok Street,
Sheungwan
Hong Kong, The
People's Republic of
China**

(Address of principal
executive offices)

+1-852-2543-8223
(Registrant's telephone
number, including
area code)

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

Name of Exchange

Title of Class
Common Stock, par value \$.001

On Which Registered
The NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the 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 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 attachment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the 5,585,256 shares of voting stock and non-voting common stock held by non-affiliates of the registrant as of December 31, 2006 was \$60,041,502, based upon the last sale price of the registrant's common stock on December 29, 2006 (the last business day of the registrant's most recently completed second fiscal quarter) of \$10.75 per share, as reported by the NASDAQ Stock Market, Inc. On September 30, 2007, there were 37,378,143 shares of common stock, par value \$.001 per share, issued and outstanding and no shares of preferred stock, par value \$.001 per share, issued and outstanding.

Annual Meeting and Record Dates

Our Annual Meeting of Shareholders will be held on Monday, November 12, 2007 at 10:30 a.m., Eastern Time, at the offices of Kirkpatrick & Lockhart Preston Gates Ellis LLP, 599 Lexington Avenue, New York, New York 10022. The record date for the Annual Meeting is September 28, 2007 and all shareholders of record at the close of business on that day will be entitled to vote at the Annual Meeting.

Our Website

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d), as well as reports filed or furnished pursuant to Section 16, of the Securities Exchange Act of 1934 are available through our website (www.chinaprecisionsteelinc.com under the "Investor Relations" caption) free of charge as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission ("SEC").

Information relating to corporate governance at China Precision Steel, Inc., including our Code of Conduct and information concerning our executive officers, directors and Board committees (including committee charters), and transactions in our securities by directors and officers, is available on or through our website at www.chinaprecisionsteelinc.com under the "Corporate Governance" caption in the "Investor Relations" section.

We are not including any information on our website as part of, or incorporating it by reference into, our Form 10-K.

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the registrant's Proxy Statement for its 2007 Annual Meeting are incorporated by reference into Part III herein.

Explanatory Note

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

The purpose of this amendment is to update the Report of Independent Registered Public Accounting Firm and to correct certain typographical errors. No other items are amended hereby.

CHINA PRECISION STEEL, INC.

**FORM 10-K
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

TABLE OF CONTENTS

	PAGE
PART I	
ITEM 1. BUSINESS	4
ITEM 1A. RISK FACTORS	17
ITEM 1B. UNRESOLVED STAFF COMMENTS	34
ITEM 2. PROPERTIES	34
ITEM 3. LEGAL PROCEEDINGS	34
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	34
PART II	
ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	35
ITEM 6. SELECTED FINANCIAL DATA	38
ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	39
ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	51
ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	54
ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	81
ITEM 9A. CONTROLS AND PROCEDURES	81
ITEM 9B. OTHER INFORMATION	81
PART III	
ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	82
ITEM 11. EXECUTIVE COMPENSATION	82
ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	82
ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	82
ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES	82
PART IV	
ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES	83
<u>SIGNATURES</u>	
<u>EXHIBITS</u>	

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K and the documents incorporated by reference herein include “forward-looking statements” within the meaning of Section 27A of the United States Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the United States Securities Exchange Act of 1934, as amended, or the Exchange Act. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases like “anticipate,” “estimate,” “plans,” “projects,” “continuing,” “ongoing,” “target,” “expects,” “may believe,” “we believe,” “we intend,” “we may,” “we will,” “we should,” “we seek,” “we plan,” the negative of those terms or similar words or phrases. We base these forward-looking statements on our expectations, assumptions, estimates and projections about our business and the industry in which we operate as of the date of this Form 10-K. These forward-looking statements are subject to a number of risks and uncertainties that cannot be predicted, quantified or controlled and that could cause actual results to differ materially from those set forth in, contemplated by, or underlying the forward-looking statements. Statements in this Form 10-K and in documents incorporated herein describe factors, among others, that could contribute to or cause these differences. Actual results may vary materially from those anticipated, estimated, projected or expected should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, including, but not limited to, our critical accounting policies and statements relating to, among others:

- plans to expand our exports outside of China;
- plans to increase our production capacity and the anticipated dates that such facilities may commence operations;
 - our ability to obtain additional funding for our continuing operations and to fund our expansion;
 - our ability to meet our financial projections for any financial year;
 - our ability to retain our key executives and to hire additional senior management;
 - continued growth of the Chinese economy and industries demanding our products;
 - our ability to produce and sell cold-rolled precision steel products at high margins;
 - our ability to secure at acceptable prices the raw materials we need to produce our products;
- political changes in China that may impact our ability to produce and sell our products in our target markets;
- general business conditions and competitive factors, including pricing pressures and product development; and
 - changes in our relationships with customers and suppliers.

Because the factors discussed in this Form 10-K or documents incorporated by reference 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. 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. Except as required by law, we undertake no obligation to publicly revise our forward-looking statements to reflect events or circumstances that arise after the date of this Form 10-K or the date of documents incorporated by reference herein that include forward-looking statements.

3

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 and in the provision of heat treatment and cutting of medium and high carbon hot-rolled steel strips. We use commodity steel to create a specialty premium steel intended to yield above-average industry gross margins. 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 conduct our operations principally in China through our wholly-owned operating subsidiary, Shanghai Chengtong Precision Strip Co., Limited, or Chengtong. Most of our sales are made domestically in China; however, during fiscal 2007, we began exporting our cold-rolled steel products to Nigeria, Thailand, Indonesia and the Philippines. We intend to expand into additional overseas markets in the future, subject to suitable market conditions and favorable regulatory controls.

We produce and sell precision ultra-thin and high strength cold-rolled steel products with thicknesses ranging from 7.5 mm to 0.03 mm. We also provide heat treatment and cutting of medium and high carbon hot-rolled steel strips not exceeding 7.5 mm fineness. 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, plane friction discs, appliances, food packaging materials, saw blades, textile needles, microelectronics, packing and containers.

As of June 30, 2007, we had an annual production capacity of approximately 115,000 metric tons. We have been increasing our production capacity for cold-rolled precision steel as demand in China outpaces domestic supply. We began production with our second cold-rolled mill, which has a production design capacity of 150,000 metric tons, in October 2006, and we plan to commence construction of our third mill in 2008, which has an equivalent design capacity. Each mill takes approximately three to four years to reach full operating capacity. As of June 30, 2007, the second mill was operating at 30% capacity and is expected to reach 50% capacity by the end of calendar year 2007.

Our Directors believe that the increased annual production capacity of approximately 300,000 metric tons from the second and third mills will be fully utilized within three to four years after commencement of operation. These facilities will focus on the production of high carbon, high strength cold-rolled steel products and the production of more complex precision steel products that cannot be manufactured in our current rolling mill. Our first rolling mill, which has an operating capacity of 70,000 metric tons, will continue to primarily manufacture low carbon cold-rolled steel products.

During the fiscal years ended June 30, 2007, 2006 and 2005, we earned net income before discontinued operations of \$7,472,661, \$7,514,101 and \$6,366,411, respectively. The discontinued operations represent those of OraLabs, Inc. which was spun off from the Company in December of 2006. At June 30, 2007, we had total assets of \$82,157,566. Chengtong currently has approximately 280 employees, including 30 senior management and technical staff members, and leases 20,000 square meters of production facilities in Jiading District, Shanghai, on four acres of property.

Corporate History and Structure

We are a Colorado company and became a public company in May 1997 through a reverse merger with SSI Capital Corporation. At that time, we changed our name to OraLabs Holding Corp. and our principal business was 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 Partner Success Holdings Limited, or PSHL, a British Virgin Islands business company which owns Chengtong. In connection with that transaction, we subsequently redeemed all of the shares of our outstanding common stock owned by our former President, Gary Schlatter, in exchange for all of the issued shares of OraLabs, Inc. Thereafter, we renamed ourselves China Precision Steel, Inc. to reflect our continuing operations.

Our business is conducted principally through Chengtong, in Shanghai, China. Chengtong is a wholly foreign owned enterprise, or WFOE, under Chinese law.

Our corporate headquarters are located at 8th Floor, Teda Building, 87 Wing Lok Street, Sheung Wan, Hong Kong, and our telephone number is (011) 852-2543-8223. Our agent for service of process in the United States is The Corporation Company, 1675 Broadway, Suite 1200, Denver, Colorado 80202. Our common stock is listed on The NASDAQ Capital Market under the symbol "CPSL." Although we maintain a website at www.chinaprecisionsteelinc.com, we do not intend that information available on our website be incorporated into this filing. As used herein, the "Group" refers to the Company, PSHL and Chengtong on a consolidated basis.

Growth Strategy

We aim to maintain our position as the leading supplier of high strength and ultra-thin cold-rolled premium specialty steel products in China, while building brand awareness and demand for our products internationally. We have identified six factors critical to the achievement of this goal:

- *Focus on Rapidly Growing Niche Segment.* 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 a rate of 20% annually over the past five years in China. Export demand, coupled with domestic Chinese demand for automobile parts and components, saw blades, textile needles, microelectronics, packing and containers, is expected to continue, thereby increasing demand for high precision steel products. Moreover, new applications of steel products are continually being developed. Our research and development efforts are focused 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.
- *Leverage Our Strengths to Compete Effectively with Imports.* Specialty precision steel is a relatively new industry in China with the majority of precision steel imported from Japan, Korea, the European Union and the United States. As a result, the average quality and standards of China's high precision steel industry lags behind the international norm. Our lower cost base allows us to sell our products at an average of 10% below our international competitors with shorter delivery time and in accordance with customer specifications. We will leverage our lower operating cost base, our state-of-the-art patented manufacturing system and process, and our strategic relationships with our major suppliers to produce cold-rolled steel products with quality similar to international standards at lower cost than international competitors.

- *Focus on High Margin Products.* We will continue to manufacture products with high sustainable margins. We increased our gross margin from 5.8% in 2004 to 26.4% in 2007. The average gross margin of our high carbon steel products are 20-40% and 10-30% for our low carbon steel products. We will provide additional services such as heat treatment and cutting to further enhance our margins. We believe these high gross margins are sustainable despite fluctuations in steel prices because of the specialty of the end product which allows price increases of raw material to be passed directly to our customers.
- *Expand Manufacturing Capacity.* We will increase our production capacity by adding a third cold-rolled mill with a design capacity of 150,000 metric tons in 2008. This will increase our total production design capacity to approximately 400,000 metric tons. The rolling mill installed in 2006, together with the third mill, will produce high carbon, high strength, cold-rolled steel products and more complex precision steel products.
- *Compete Internationally.* We intend to expand our exports to compete in the international marketplace. We believe we are the only non-Japanese company able to compete in the global marketplace with low carbon precision cold-rolled steel products in the thickness range between 0.1 to 0.2 mm. In addition, we are not aware of any other company that currently manufactures high strength and ultra-thin cold-rolled steel with a width of 1400mm. These products provide us with a unique opportunity to compete in the global marketplace.
- *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 Chief Executive Officer, Wo Hing Li, and the General Manager of Chengtong, Hai Sheng Chen. Their experience in business operations and in Chinese 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 International Iron and Steel Institute, China is the largest steel producing country, producing approximately one-third of the world's steel. In 2006, China produced 418.8 million metric tons of steel, up 17.7% from 2005. World Steel Dynamics estimates that China's steel demand for 2007 will be 429 million metric tons and will reach 732 million metric tons by 2017, while global steel demand is projected to be 1,248 million metric tons and 1,829 million metric tons, respectively.

China has increased its steel exports from 7 million metric tons in 2003 to 43 million metric tons in 2006, making it the number one ranked steel exporter globally. Even though the amount exported accounts for only 9% of China's total 2006 production, Chinese steel exports accounted for 17% of the global steel trade in 2006. Notably, while China is a net exporter of crude steel, it is a net importer of higher value precision steel and ultra-thin steel products such as those produced by Chengtong.

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 sheets). 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 sheets. 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.

Based upon estimates from World Steel Dynamics, we believe that the Chinese market for cold-rolled steel coil and sheets will be approximately 58 million metric tons in 2007 and increasing to 78 million metric tons by 2010. During the same period, domestic capacity is estimated to increase from 56 million metric tons in 2007 to 84.7 million metric tons by 2010. Shortfalls in capacity have been filled to date by imports principally from Korea, Japan, the European Union and the United States. However, China is expected to have excess domestic capacity beginning in 2008 and, as a result, is expected to increase its exports of these products.

The Chinese government has historically provided a subsidy by means of a 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. A 5% rebate applies to 76 products including cold-rolled, galvanized, specialty and stainless steel. The rebate has been eliminated for 83 products, including hot-rolled, thin plate, steel wire, section, bar and H-beam. Most Chinese steel exporters have passed on the additional tax to their customers, with little adverse impact due to the overall favorable cost structure for Chinese steel products.

We expect that the Chinese government will continue to impose additional controls on domestic steel producers in order to reduce pollution and further restrict exports. For more information on Chinese regulations, see “Regulation” below.

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. The Company believes that generally, to date, the average quality and standards of China’s high precision steel industry lag behind the international norm. Nonetheless, during the last three years, Chengtong believes that it has begun to develop and establish itself as a nationally recognized brand in China. Despite having exported some 7,158 tons of precision steel products to Thailand and the Philippines during the year ended June 30, 2007, Chengtong is not yet an internationally recognized brand for specialty precision steel products.

As of June 30, 2007, Chengtong produced approximately 40 high precision steel products covering a range of over one hundred specifications. The Company currently produces high strength and ultra-thin cold-rolled precision steel coils and sheets with reduced thickness ranging from 7.5 mm to 0.03 mm. The Company also provides heat treatment and cutting and slitting of medium and high carbon hot-rolled steel strips not exceeding 7.5 mm fineness. Chengtong’s precision steel products and services can be categorized into four major categories:

Categories	Uses	Thickness
1. Low carbon steel (cold-rolled, acid wash)	Food packaging, dry batteries, ceiling coverings, electronic devices, kitchen tools	0.03-7.5mm
2. Medium and high carbon steel (cold-rolled, hard-rolled)	Automobile components, grinding pieces, saw blades, weaving needles, spring and mechanism components	0.03-7.5mm
3. Chrome stainless steel	Kitchen tools, automobile components	0.5-7.5mm
4. Steel services	Heat treatment of hot-rolled steel coils; cutting and slitting	

In 2006, we made a strategic decision to switch our product mix from a concentration in low carbon cold-rolled steel products with comparatively lower margins to a combination of low carbon and higher end, higher margin, high-carbon cold-rolled steel products as a result of continuous research and development and accumulated experience. We produce our high strength and ultra-thin cold-rolled precision steel strips using a proprietary patented technology process. The finished products have a reduced thickness ranging from 7.5 mm to 0.03 mm, or approximately one-third as thin as the average strand of human hair, and a width between 1000 mm to 1400 mm. We also provide heat treatment and cutting and slitting services for medium and high carbon hot-rolled steel coils with thicknesses not exceeding 7.5 mm. To the best of our knowledge, we are not aware of any other company in China that currently manufactures high strength and ultra-thin cold-rolled steel with a width of or exceeding 1400 mm.

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 appliances (refrigerators, washers, dryers, and other small appliances), automobiles (exposed as well as unexposed parts), food packaging materials, electric motors, microelectronics and packaging.

Hard-rolled steel represents steel products manufactured from cold reduction to the desired thinness without annealing. The product is very stiff and is intended for flat work where deformation is very minimal. This type of hard-rolled steel is most often applied to further processing for applications such as continuous galvanizing.

Hard-rolled or cold-rolled steel with low carbon has a carbon content of less than 0.1%. It is a very versatile and useful material, easily machined and worked into complex shapes, and has low cost and good mechanical properties. Hard-rolled or cold-rolled steel with medium carbon has a carbon content of 0.3%. It is a typical engineered steel product. 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.

Products with greater width have more applications and intended uses. Width is an important differentiating factor because certain end products such as washers and automobiles require materials with a certain minimum width. Although materials with smaller width could also be used for these applications through jointing, this increases production costs. As a result, wider products are more flexible and cost efficient, which further reduces the end user's overall cost.

Sales and Marketing

Our high precision steel products are sold directly to the end-users in various parts of China. Due to the nature of the industry, we do very little formal marketing. The majority of new orders come from current customers reducing imports and new customers who contact us directly or through trading agents.

All of Chengtong's production is based on confirmed sales orders. Generally, an initial deposit (approximately 30% of the aggregate contracted sales amount) is pre-paid when the contract is signed. Chengtong has approximately 200 major customers who are primarily located in East China. As a domestic manufacturer, Chengtong's location in Shanghai is particularly advantageous for meeting with customers to discuss product design. In addition, the delivery time is shorter and our products have lower associated cost than international competitors. We intend to increase our

customer base by expanding into the lucrative markets in Guangdong Province, where there is a heavy concentration of light industries, and into the Northeastern region of China, where the automotive industries are concentrated.

8

Below is a list of Chengtong's principal customers during the years ended June 30, 2007, and 2006:

Principal Customers

2007

% to sales

2006

% to sales