



## LETTER FROM CHAIRMAN AND CEO

**Tuesday, February 15, 2011**

Dear Investor

Alloy Steel International, Inc. has had a very strong financial performance for its 2010 financial year. The record production and sales for the 2010 financial year is a culmination of the production team, marketing strategy and sales effort for the preceding five years, matched to an increase in capacity and enhanced product range.

During the financial year it became apparent that opportunities for sales were constrained by the Company's capacity for secondary stages in the value added production process of ArcoPlate. As previously announced, a manufacturing site of 37,600 square metres was purchased at the Cilegong Manufacturing Estate located near Indonesia's capital. The Company has successfully completed this land purchase paid for from cash-flow generated internally. The Company intends to construct suitable production facilities and increase production capacity, again funded by cash-flow and appropriate external financing.

This strong financial performance has come at a critical time in the Company's development. The Board has been reviewing the best way to achieve further growth while protecting the interests of all shareholders. The Company has identified a new CEO, Chairman and new directors to help the Company in its next growth phase. We will advise shareholders once the appointments have been made. Regarding my role, I will resign as Chairman and CEO once the new Board and a replacement CEO are appointed, expected to be during the first calendar quarter of 2011. I will remain with the Company in the role of Technical Director to help supervise the continued development of Arcoplate and its production.

The Company's goal is to become a significant supplier of wear plate and anti hang-up materials within the next five years. The Company will continue to focus on consistent and timely delivery of a high quality wear plate solutions to its customers.

I extend my thanks and gratitude to the Alloy Steel International team for its continued outstanding performance and role in helping the Company set a solid base for its future growth. I look forward to working as part of the expanded Alloy Steel International team to grow the Company and to encourage customers to use our superior wear plate products. We aim to become a significant participant in the global wear plate market.

Yours sincerely  
**ALLOY STEEL INTERNATIONAL, INC.**

Gene Kostecki  
**CHAIRMAN AND CEO**



Manufactured in Australia  
Used the World Over

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ALLOY STEEL INTERNATIONAL, INC.

# **ALLOY STEEL INTERNATIONAL, INC.**

**ANNUAL FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2010**

## ALLOY STEEL INTERNATIONAL, INC. AND SUBSIDIARIES

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of Alloy Steel International, Inc.

We have audited the accompanying consolidated balance sheets of Alloy Steel International, Inc. and Controlled Entities (the "Company") as of September 30, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. 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 generally accepted in the United States of America. 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. 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 financial position of Alloy Steel International, Inc. and Controlled Entities as of September 30, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

  
UHY Haines Norton  
Chartered Accountants

Perth, Australia  
December 24, 2010

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**ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES**

**CONSOLIDATED BALANCE SHEETS**

September 30, 2010 and 2009

September - 10      September - 09

**ASSETS**

**CURRENT ASSETS**

Cash and cash equivalents	\$ 3,504,350	\$ 424,090
Accounts receivable, less allowance for doubtful accounts of \$nil at September, 2010 and September 30, 2009	5,597,253	3,104,393
Inventories	3,287,138	2,247,759
Prepaid expenses and other current assets	90,998	82,948
<b>TOTAL CURRENT ASSETS</b>	<u>12,479,739</u>	<u>5,859,190</u>

**PROPERTY AND EQUIPMENT, net**

6,558,410      3,350,600

**OTHER ASSETS**

Investments	75,493	222,702
Deferred tax asset	332,113	176,781
Other assets	17,863	17,863
<b>Total other assets</b>	<u>425,469</u>	<u>417,346</u>

**TOTAL ASSETS**

\$ 19,463,618      \$ 9,627,136

**LIABILITIES AND STOCKHOLDERS' EQUITY**

**CURRENT LIABILITIES**

Notes payable, current portion	\$ 217,553	\$ 93,868
Accrued officers' salaries	-	11,745
Royalties payable, related party	1,148,335	936,829
Current tax payable	1,981,375	-
Accounts payable and other current liabilities	3,434,746	2,338,297
<b>TOTAL CURRENT LIABILITIES</b>	<u>6,782,009</u>	<u>3,380,739</u>

**LONG-TERM LIABILITIES**

Notes payable, less current portion	581,492	145,843
Notes payable, officers	255	255
Employee entitlement provisions	-	11,916
Deferred tax liabilities	189,026	389,119
<b>TOTAL LONG-TERM LIABILITIES</b>	<u>770,773</u>	<u>547,113</u>

**COMMITMENTS AND CONTINGENCIES**

**STOCKHOLDERS' EQUITY**

Preferred Stock: \$0.01 par value; authorized 3,000,000 shares; issued and outstanding – none	-	-
Common Stock: \$0.01 par value; authorized 50,000,000 shares; 17,350,000 issued and outstanding	173,500	173,500
Capital in excess of par value	1,767,512	1,767,512
Retained earnings	7,704,279	2,830,721
Accumulated other comprehensive income	2,272,956	931,743
<b>Total Alloy Steel International, Inc. Shareholders equity</b>	<u>11,918,247</u>	<u>5,703,476</u>
Non controlling interest	(7,411)	(4,212)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<u>11,910,836</u>	<u>5,699,264</u>

**TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY**

\$ 19,463,618      \$ 9,627,136

See accompanying notes to condensed consolidated financial statements

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**ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
Years Ended September 30, 2010 and 2009

	<b>Sep-10</b>	<b>Sep-09</b>
<b>Sales</b>	\$ 24,544,217	\$ 8,819,217
<b>Cost of Sales</b>	11,470,524	5,747,172
<b>Gross Profit</b>	13,073,693	3,072,045
<b>Operating Expenses</b>		
Selling, general and administrative expenses	5,634,490	3,056,352
<b>Profit (Loss) From Operations</b>	7,439,203	15,693
<b>Other Income (Expense)</b>		
Interest income	39,125	26,306
Interest expense	(74,123)	(39,363)
Dividend income	8,637	6,785
Insurance recovery	13,927	27,096
Sundry income	21,975	24,135
Realised foreign exchange profit (loss)	84,379	-
Unrealised foreign exchange profit (loss)	(160,821)	-
	(66,901)	44,959
<b>Income (Loss) Before Income Tax (Expense) Benefit</b>	7,372,302	60,652
Income tax (expense) benefit	(2,501,943)	(138,509)
<b>Net Income (Loss)</b>	4,870,359	(77,857)
Net (income) loss attributable to non-controlling interests	3,199	5,602
<b>Net Income (Loss) Attributable to Stockholders</b>	\$ 4,873,558	\$ (72,255)
<b>Basic Income (Loss) and Diluted Income (Loss) per Common Share</b>	\$ 0.28	\$ (0.004)
<b>Weighted Average Common Shares Used in computing basic and diluted income (loss) per share</b>	17,350,000	17,350,000

**ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**  
Years Ended September 30, 2009 and 2008

	Common Stock		Capital in excess of par value	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income	Non Controlling Interests	Total Stockholders' Equity
	Shares	Amount						
Balances, September 30, 2008	17,350,000	173,500	1,769,382	2,902,976		474,419	1,866	5,322,143
Net Loss attributable to stockholders				(72,255)	(72,255)			(72,255)
Other comprehensive income, Foreign currency translation adjustment					430,254	430,254		430,254
Fair value adjustment for available for sale assets					27,070	27,070		27,070
Total comprehensive income – Year ended September 30, 2009					<u>385,069</u>			
Non controlling interest in subsidiary								
Issued capital in subsidiary								
Accumulated income (loss)							(5,602)	
Current year other comprehensive loss							(476)	(6,078)
Income								
Reduction in capital on incorporation of subsidiaries			(1,870)					(1,870)
Balances, September 30, 2009	17,350,000	173,500	1,767,512	2,830,721		931,743	(4,212)	5,699,264
Net Income attributable to stockholders				4,873,558	4,873,558			4,873,558
Other comprehensive income, Foreign currency translation adjustment					1,341,213	1,341,213		1,341,213
Fair value adjustment for available for sale assets					(10,660)			
Total comprehensive income – Year ended September 30, 2010					<u>6,204,111</u>			
Non Controlling interest in Subsidiary								
Accumulated income (loss)							(3,199)	(3,199)
Current year other comprehensive Loss								
Balances, September 30, 2010	<u>17,350,000</u>	<u>173,500</u>	<u>1,767,512</u>	<u>7,704,279</u>		<u>2,272,956</u>	<u>(7,411)</u>	<u>11,910,836</u>

**ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
Years Ended September 30, 2010 and 2009

	<b>Sep-10</b>	<b>Sep-09</b>
<b>Cash flows from operating activities</b>		
Net income (loss)	\$ 4,873,558	\$ (72,255)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	338,996	187,877
Impairment of shares	(21,196)	-
Dividends reinvested directly to investments	(6,915)	(5,129)
Provision for loan	366,595	-
Loss on sale of plant and equipment	43,299	-
Loss attributable to non controlling interests	(3,199)	(5,602)
Increase (decrease) in cash and cash equivalents attributable to changes in operating assets and liabilities:		
Accounts receivable	(1,312,584)	(1,148,004)
Inventories	(717,235)	147,633
Income taxes receivable	-	(833,490)
Prepaid expenses and other current assets	(14,045)	2,184
Accounts payable and other current liabilities	2,913,317	1,921,860
Income taxes payable	(1,068,991)	-
<b>Net Cash Provided by Operating Activities</b>	<b>5,391,600</b>	<b>195,074</b>
<b>Cash Flows From Investing Activities</b>		
Purchase of property, plant and equipment	(3,221,745)	(345,400)
Proceeds on sale of property, plant and equipment	13,230	-
Proceeds of sale of listed financial assets	161,993	-
<b>Net Cash Provided by (Used in) Investing Activities</b>	<b>(3,046,522)</b>	<b>(345,400)</b>
<b>Cash Flows From Financing Activities</b>		
Loans to Companies	(398,199)	-
Proceeds from new notes and loans payable	702,424	-
Repayments on notes and loans payable	(149,691)	(67,586)
<b>Net Cash Used in Financing Activities</b>	<b>154,534</b>	<b>(67,586)</b>
<b>Effect of Foreign Exchange Rate Changes on Cash and Cash Equivalents</b>	<b>580,648</b>	<b>(22,052)</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>3,080,260</b>	<b>(239,964)</b>
<b>Cash and Cash Equivalents at Beginning of Period</b>	<b>424,090</b>	<b>664,054</b>
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 3,504,350</b>	<b>\$ 424,090</b>
<b>Supplemental disclosures of cash flow information,</b>		
Cash paid during the year for:		
Income taxes	\$1,068,991	\$ 971,999
Interest	\$43,289	\$ 39,568
Supplemental disclosures of non-cash investing and financing activities,		
Equipment acquired under notes payable	\$702,424	\$ -

## ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Nature of operations

Alloy Steel International, Inc. (ASII), its wholly-owned subsidiary, Alloy Steel Australia (Int.) Pty Limited (ASAI) and its wholly owned entity PT Alloy Manufacturing (PTAM), wholly owned subsidiaries Mossville Securities LLC and Alloy Steel North America LLC (ASNA) and majority owned subsidiary Alloy Steel Mongolia LLC (ASM) (collectively the "Company") manufacture and distribute Arcoplate, a wear-resistant fused-alloy steel plate, to customers throughout the world.

#### 2. Summary of significant accounting policies

##### *Basis of Presentation*

The Company adheres to accounting standards set by the Financial Accounting Standards Board (FASB). FASB sets generally accepted accounting principles (GAAP) in the United States of America that the Company follows to ensure the Company consistently reports its financial condition, results of operations and cash flows. References to GAAP issued by FASB in these notes are to *FASB Accounting Standards Codification*™, sometimes referred to as the Codification or ASC. FASB finalized the Codification effective for periods ending on or after September 15, 2009. Prior FASB standards are no longer being issued by the FASB.

The Company's consolidated financial statements are denominated in United States dollars.

##### *Principles of Consolidation*

The consolidated financial statements include the accounts of ASII, ASAI, ASNA and ASM. All material intercompany balances and transactions have been eliminated in consolidation.

##### *Revenue Recognition*

The Company recognizes revenues when products are shipped and title passes to customers. Provisions are established, as appropriate, for returns and allowances and warranties in connection with sales.

##### *Cash and Cash Equivalents*

The Company considers all highly-liquid instruments purchased with maturities of three months or less to be cash equivalents.

##### *Accounts Receivable*

The Company carries its accounts receivable at cost less an allowance for doubtful accounts. On a periodic basis, the Company evaluates its receivables and establishes an allowance for doubtful accounts, based on the history of past write-offs and collections and current credit conditions. The Company has reviewed its outstanding accounts and, given the company's credit criteria and quality of clients, notwithstanding the current economic climate, has assessed that there is no need to raise an allowance for doubtful debts. Accounts are written off as uncollectible once the Company has exhausted its collection efforts.

##### *Inventories*

Inventories are valued at the lower of cost or net realizable value. Cost is determined principally on the first-in, first-out method.

## ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 2. Summary of significant accounting policies (continued)

##### *Impairment of Long-Lived Assets*

The Company periodically assesses the recoverability of the carrying amounts of long-lived assets, including intangible assets. A loss is recognized when expected undiscounted future cash flows are less than the carrying amount of the asset. The impairment loss is the difference by which the carrying amount of the asset exceeds its fair value. No impairment losses on long lived assets were recorded in 2010 and 2009.

##### *Property and Equipment*

Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed using both the straight-line and declining value method over the estimated useful lives of the assets as follows:

<b>Asset</b>	<b>Estimated Useful Lives</b>
Plant and equipment	5-20 years
Furniture and fixtures	5-7 years
Vehicles	3-5 years
Office and computer equipment	3-5 years

Maintenance and repairs are charged to operations, while betterments and improvements are capitalized.

##### *Advertising*

Advertising costs are charged to operations as incurred and were approximately \$46,000 and \$12,000 for the years ended September 30, 2010 and 2009, respectively.

##### *Income Taxes*

The Company uses an asset and liability approach to financial reporting for income taxes. Deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities that will result in future taxable or deductible amounts, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amount expected to be realized.

The Company provides reserves for potential payments of tax to various tax authorities related to uncertain tax positions and other issues. Reserves are recorded based on a determination of whether and how much of a tax benefit taken in its tax filings or positions is more likely than not to be realized, assuming that the matter in question will be raised by the tax authorities. Potential interest and penalties associated with such uncertain tax positions are recorded as a component of income tax expense. The Company has made a comprehensive review of its uncertain tax positions. The Company believes appropriate provisions for outstanding issues have been made.

##### *Income (Loss) Per Common Share*

Basic income (loss) per share excludes dilution and is computed by dividing net income (loss) available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted income (loss) per common share was the same as basic income (loss) per common share since there were no common stock equivalents outstanding for both years presented.

## ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 2. Summary of significant accounting policies (continued)

##### *Use of Estimates*

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

##### *New Accounting Pronouncements*

In October 2009, the FASB issued authoritative guidance for revenue recognition for multiple-deliverable arrangements. This authoritative guidance impacts the determination of when the individual deliverables included in a multiple-deliverable arrangement may be treated as separate units of accounting. Additionally, this guidance modifies the manner in which the transaction consideration is allocated across the separately identified deliverables by no longer permitting the residual method of allocating arrangement consideration. The new guidance is effective for transactions entered into or modified in fiscal years beginning after June 15, 2010, which for the Company will be the first quarter of fiscal 2011. The Company is currently evaluating the potential impact of this authoritative guidance on the Company's financial position and results of operations.

In June 2009, the FASB issued authoritative guidance on variable interest entities, which becomes effective the first annual reporting period beginning after November 15, 2009 and will be effective for the Company in fiscal 2011. This authoritative guidance requires revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. The Company is currently evaluating the potential impact of this authoritative guidance on the Company's financial position and results of operations.

##### *Foreign Currency Translation*

Assets and liabilities of the Company's subsidiaries are translated into U.S. dollars at year-end exchange rates, revenues and expenses and cash flows are translated at average rates prevailing during the year. Resulting translation adjustments are recorded as a component of accumulated other comprehensive income.

Where the Company's subsidiaries undertake transactions in currencies other than their functional currency, the resulting gain or loss is recorded as income or expenditure as appropriate at the time the transaction is settled. Unsettled accounts at year end are revalued at the spot exchange rate as at that date and unrealized gains or losses are recorded in the Company's statement of operations.

#### 3. Inventories

Inventories consist of the following at September 30, 2010 and 2009:

	2010	2009
Raw materials	\$ 1,247,790	\$ 642,461
Work in progress	393,791	124,343
Finished goods	1,645,557	1,480,955
	<u>\$ 3,287,138</u>	<u>\$ 2,247,759</u>

**ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. Property and equipment**

Property and equipment consists of the following at September 30, 2010 and 2009:

	<b>2010</b>	<b>2009</b>
Leasehold Land	\$ 23,123	\$ 23,123
Less accumulated amortization	5,435	3,894
	<u>\$ 17,688</u>	<u>19,229</u>
Deposit on land	\$ 1,663,135	-
Plant and equipment	\$ 6,046,530	\$ 4,212,274
Furniture and fixtures	49,526	43,235
Vehicles	423,075	278,287
Leasehold Improvements	37,193	33,466
Office and computer equipment	212,809	168,203
	<u>6,769,133</u>	<u>4,735,465</u>
Less accumulated depreciation	1,891,545	1,404,094
	<u>\$ 4,877,588</u>	<u>\$ 3,331,371</u>
Net property and equipment	<u>\$ 6,558,411</u>	<u>\$ 3,350,600</u>

Depreciation and amortization expense for the years ended September 30, 2010 and 2009 was approximately \$339,000 and \$188,000, respectively. At September 30, 2010 and 2009, property and equipment included approximately \$1,163,000 and \$458,000 and accumulated depreciation included approximately \$229,000 and \$173,000 related to assets acquired under notes payable, respectively.

**5. Investments**

The company holds investments in marketable securities as of September 30, 2010 and 2009 as follows:

Non-current assets	<u>\$75,493</u>	<u>\$222,702</u>
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The Company determines the fair value of assets and liabilities using a fair value hierarchy with the highest priority being quoted prices in active markets. The marketable securities are common stocks. Hierarchical levels, which are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1 — Inputs were unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 — Inputs (other than quoted prices included in Level 1) were either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.

Level 3 — Inputs reflected management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration was given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

**ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. Investments (continued)**

Determining which hierarchical level an asset or liability falls within requires significant judgment. The Company evaluates its hierarchy disclosures each quarter. The following table summarizes the financial instruments measured at fair value in the Consolidated Balance Sheet as of September 30, 2010:

	<b>Fair Value Measurements</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Marketable Securities Long term - 2010	\$75,493	-	-	\$75,493
Marketable Securities Long term - 2009	\$222,702	-	-	\$222,702

**6. Notes Payable**

Notes payable at September 30, 2010 and 2009 consists of the following:

	<b>2010</b>		<b>2009</b>	
Note payable (a)	\$	-	\$	9,248
Note payable (b)		48,275		93,924
Note payable (c)		-		9,095
Note payable (d)		32,289		35,358
Note payable (e)		78,309		92,086
Note payable (f)		28,436		-
Note payable (g)		42,919		-
Note payable (h)		34,974		-
Note payable (i)		150,074		-
Note payable (j)		383,769		-
		799,045		239,711
Less current portion		217,553		93,868
	\$	581,492	\$	145,843

- (a) The note was payable in monthly instalments of \$375 including interest at a rate of 7.61% per annum, with a final payment made in March 2010. The note was collateralized by the underlying equipment and was guaranteed by the officers of the Company.
- (b) The note is payable in monthly instalments of \$4,420 including interest at a rate of 7.25% per annum, with a final balloon payment in November 2010. The note is collateralized by the underlying equipment and is guaranteed by the officers of the Company.
- (c) The note was payable in monthly instalments of \$681 including interest at a rate of 7.61% per annum, with a final balloon payment in February 2010. The note was collateralized by the underlying equipment and was guaranteed by the officers of the Company.
- (d) The note is payable in monthly instalments of \$962 including interest at a rate of 9.22% per annum, with a final payment in March 2012. The note is collateralized by the underlying equipment and is guaranteed by the officers of the company.

## ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 6. Notes Payable (continued)

- (e) The note is payable in monthly instalments of \$2,226 including interest at a rate of 9.65% per annum, with a final payment in June 2012. The note is collateralized by the underlying equipment and is guaranteed by the officers of the company.
- (f) The note is payable in monthly instalments of \$571 including interest at a rate of 8.39% per annum, with a final payment in October 2013. The note is collateralized by the underlying equipment and is guaranteed by the officers of the company.
- (g) The note is payable in monthly instalments of \$968 including interest at a rate of 8.55% per annum, with a final payment in March 2015. The note is collateralized by the underlying equipment and is guaranteed by the officers of the company.
- (h) The note is payable in monthly instalments of \$780 including interest at a rate of 8.95% per annum, with a final payment in December 2013. The note is collateralized by the underlying equipment and is guaranteed by the officers of the company.
- (i) The note is payable in monthly instalments of \$4,556 including interest at a rate of 7.93% per annum, with a final payment in December 2013. The note is collateralized by the underlying equipment and is guaranteed by the officers of the company.
- (j) The note is payable in monthly instalments of \$8,025 including interest at a rate of 8.11% per annum, with a final payment in July 2015. The note is collateralized by the underlying equipment and is guaranteed by the officers of the company.

As of September 30, 2010, aggregate annual principal payments for each of the following years are as follows:

#### Year ending September 30,

2011	272,534
2012	260,835
2013	191,903
2014	73,773
	<u>\$ 799,045</u>

#### 7. Income taxes

Income (loss) before income tax expense (benefit) for the years ended September 30, 2010 and 2009 were derived in the following jurisdictions:

	2010	2009
Australia	\$8,328,979	\$ 412,267
Mongolia	(7,996)	(14,006)
Indonesia	(8,438)	-
United States	(940,243)	(337,609)
	<u>\$7,372,302</u>	<u>\$ 60,652</u>

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**ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****7. Income taxes (continued)**

The components of income tax expense (benefit) are as follows for the years ended September 30, 2010 and 2009:

	<b>2010</b>	<b>2009</b>
<b>Current</b>		
Foreign	\$2,844,903	\$ (14,692)
<b>Deferred</b>		
Foreign	(342,960)	153,201
	<u>\$2,501,943</u>	<u>\$ 138,509</u>

As of September 30, 2010, the Company had US net operating loss carry forwards of approximately \$2,832,000 expiring through 2025.

The components of the deferred tax assets and liabilities consist of the following at September 30, 2010 and 2009:

	<b>2010</b>	<b>2009</b>
Deferred tax assets		
Net operating loss carry forwards	\$991,421	\$794,496
Timing differences	332,113	176,781
	1,323,533	911,127
Less valuation allowance	(991,421 )	(794,496 )
	332,113	176,781
Deferred tax liabilities		
Other	(189,026 )	(389,119 )
Deferred tax assets (liabilities), net	<u>\$143,087</u>	<u>\$(212,338)</u>

The Company records a valuation allowance when it is more likely than not that some portion or all of the deferred income tax asset will not be realized. The change in the valuation allowance amounted to approximately \$196,000 and \$118,000 for the years ended September 30, 2010 and 2009, respectively. The ultimate realization of this deferred income tax asset depends on the Company's ability to generate sufficient taxable income in future years in the United States of America.

The Company also has certain foreign tax credits available for future use.

The effective tax rate in 2010 and 2009 differs from the U.S. federal statutory rate as follows:

	<b>2010</b>	<b>2009</b>
U.S. federal statutory rate	35%	35%
Change in valuation allowance	5%	195%
Benefit of lower foreign effective tax rate/Other	(6)%	(1)%
Effective tax rate	<u>34%</u>	<u>228%</u>

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**ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****7. Income taxes (continued)**

The Company has considered its income tax positions, including any positions that may be considered uncertain by the relevant tax authorities in the jurisdictions in which the Company operates. As of September 30, 2010 and 2009, the Company had no uncertain tax positions and no unrecognized tax benefits. The Company has paid interest of \$- and \$19,865 during the years ended September 30, 2010 and 2009 respectively in relation to an arrangement negotiated by one of its subsidiaries to pay its income tax liability in deferred instalments. The Company has not incurred any penalties relating to income taxes recognized in the consolidated financial statements as of and for the years ended September 30, 2010 and 2009. The following table summarizes tax years that remain subject to examination by major tax jurisdictions:

<b>Jurisdiction</b>	<b>Open Years</b>
United States	2004-2010
Australia	2004-2010

**8. Stock options**

During 2000, the Company's Board of Directors (the Committee) adopted, and the stockholders approved, the 2000 stock option plan (the Plan) pursuant to which 2,000,000 shares of common stock were reserved for issuance upon the exercise of options granted to key employees, members of the Committee and consultants of the Company. Options under the Plan may be incentive stock options, nonqualified stock options, or any combination thereof, and the Committee may grant options at an exercise price which is not less than the fair market value on the date such options are granted. The Plan further provides that the maximum period in which stock options may be exercised will be determined by the Committee, except that they may not be exercisable after ten years from the date of grant or five years from the date of grant for any person owning more than ten percent of the voting power of all classes of the Company's stock. For the years ending September 30, 2010 and 2009, there were no stock options granted or outstanding stock options.

**9. Commitments and contingencies***Operating Lease*

The Company leases its office and manufacturing space from a related party for approximately \$279,000 per annum plus certain expenses (as defined in the agreement). The lease expired on June 30, 2010, however the lease continues on a month-to-month basis due to the possibility of expansion plans. Rent expense for the years ended September 30, 2010 and 2009 was approximately \$279,000 and \$177,000 respectively.

## ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 9. Commitments and contingencies (continued)

##### *Land Acquisition*

The Company entered an agreement with PT Krakatau Industrial Estate Cilegon whereby the Company, through a subsidiary now incorporated in Indonesia, PT Alloy Manufacturing, agreed to take delivery and have use of an area of 36,700 square meters of land for the purposes of constructing a factory for the manufacture of Arcoplate products. The contract price was for 25,850,000,000 Indonesian Rupiah, or approximately \$2,820,240, requiring a deposit of 5% which was paid during the quarter ended June 30, 2010. A subsequent payment of 15% was due and paid on July 25, 2010.

Further installments of the purchase price are required in equal monthly installments from August, 2010 to January, 2011. The Company is currently funding the installments from operating activities and as of balance date it had four payments to make totaling \$1,504,128. As of sign-off date there is one payment left to make of \$328,000.

Subject to the Company being issued with the necessary permits, the agreement provides that the Company will construct its factory within 24 months of completing the payment for the land.

Also, if all conditions are met, the Company will have the right to occupy the land for a period of 30 years, with further extensions of 20 years and 30 years upon expiry of each term available upon payment of any required fee applicable at the time of the extension.

##### *Royalty Agreements*

The Company has a licensing agreement with a related party which relates to the sale of all products sold. Under the terms of the agreement, the Company is required to pay royalties of 2% on the net sales of these products, calculated at the end of each quarter. The agreement expires in 2025 and has three ten-year renewal options to extend unless written notice of non-renewal is given by either party within 120 days prior to its expiration. At September 30, 2010 and 2009, approximately \$1,148,000 and \$937,000 respectively, was payable under this agreement and is included in accounts payable and other current liabilities.

Royalty expense was approximately \$479,000 and \$174,000 for the years ended September 30, 2010 and 2009, respectively.

##### *Employment Agreements*

The Company has employment agreements with its director, who is a principal stockholder, requiring the payment of a minimum annual base compensation of approximately \$161,000 and \$175,000 adjusted semi-annually for increases approved by the Board of Directors, but not less than the base year amount, plus incentive compensation based on the executives' performance and the Company's success. Approximately \$161,000 and \$175,000 has been expensed under these agreements in each of the years ended September 30, 2010 and 2009 respectively, and is included in selling, general and administrative expenses.

##### *Contingencies*

The Company is considering its position in relation to the supply of certain equipment which was eventually discovered not to operate within the required specifications. This was determined after a number of months of operation of the new equipment. The Company can make no reasonable estimation as to any costs recovered as yet.

## ALLOY STEEL INTERNATIONAL, INC. AND CONTROLLED ENTITIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 10. Major customers, suppliers and geographic information

The Company had revenues from four customers for the year ended September 30, 2010 and two customers for the year ended September 30, 2009 of approximately \$11,532,000 and \$2,493,000 respectively. Accounts receivable due from the respective customers were approximately \$3,056,000 and \$1,380,000 at September 30, 2010 and 2009.

Customer A	22.69	%	20.40	%
Customer B	0.00	%	7.90	%
Customer C	14.00	%	0.00	%
Customer D	10.31	%	0.00	%

For the years ended September 30, 2010 and 2009, the Company purchased approximately 56% and 46% of its inventories from two suppliers, respectively.

For the years ended September 30, 2010 and 2009, revenues were derived from the following:

	2010		2009	
Australia	72	%	85	%
Americas	15	%	5	%
Other	13	%	10	%
	100	%	100	%

Revenue is attributed to each country based on the location of the customer.

#### 11. Subsequent Events

Management has performed a review of subsequent events through to December 24, 2010, which is the date the financial statements were available to be issued. There are no material subsequent events.

**Alloy Steel International, Inc.**  
**Supplemental Information**  
**2010 Financial Year**

**Product Overview**

Alloy Steel International, Inc. manufactures and distributes Arcoplate, a wear-resistant alloy overlay wear plate produced through a patented process. It has been recognized that wear is the largest single factor leading to production losses in the mining, mineral-processing, and steel manufacturing industries. Consequently, wear solutions are indispensable for these businesses. Without products such as Arcoplate, these industries' increased downtime would significantly affect performance. The wearing of metal parts is generally defined as a gradual decay or breakdown of the metal. This wear of equipment may be due to many causes and accordingly, the selection of wear plate solutions can be a relatively complex process.

In order to minimize the effects of wear, businesses have traditionally employed various wear-combating materials with limited success. Alloy Steel International believes that Arcoplate provides industry with cost effective solutions to many wear-related problems.

**Financial Results**

For the year ended September 30, 2010, total sales increased to \$24.5 million as compared to \$8.8 million for the same period in 2009. Net income after tax for 2010 was \$4.9 million or \$0.28 per common share, compared with a net loss after tax of (\$0.07) million or (\$0.004) per common share for the same period in 2009.

During the quarter ended September 30, 2010, total quarterly sales increased to \$8.8 million as compared to \$4.2 million in the fourth quarter of 2009. These sales consist solely of the Company's Arcoplate products. Income before tax for the fourth quarter of 2010 was \$2.7 million or \$0.16 per common share, compared with income before tax of \$0.5 million or \$0.03 per common share for the same period in 2009.

**Gross Profit and Cost of Sales**

Alloy Steel International had a cost of sales of \$11.4 million and \$5.7 million for the year ended September 30, 2010 and the year ended September 30, 2009 respectively. Alloy Steel's gross profit was \$13.1 million or 53.5% of sales, and \$3.1 million or 35.3% of sales, for the respective annual periods. The increase in gross profit percentage is attributable mainly to increased margins on various orders as demand has continued to grow allowing the Company to return to more normal pricing models from the discount pricing models that were being used to generate sales during the global financial crisis.

Alloy Steel International had cost of sales of \$4.2 million for the three months ended September 30, 2010, compared to \$2.7 million for the three months ended September 30, 2009. The gross profit amounted to \$4.6 million for the three months ended September 30, 2010, compared to \$1.5 million for the three months ended September 30, 2009.

**Operating Expenses**

Alloy Steel International had operating expenses of \$5.7 million and \$3.1 million for the twelve months ended September 30, 2010 and twelve months ended September 30, 2009 respectively.

Alloy Steel International had selling, general and administrative expenses of \$1.7 million for the three months ended September 30, 2010, compared to \$0.9 million for the three months ended September 30, 2009.

The expenditure for the three and twelve month periods ended September 30, 2010 increased compared to the three and twelve month periods ended September 30, 2009 as operations increased to produce orders received from customers. Areas in which costs increased include bonuses paid in line with the increased sales achieved, administrative staff remuneration through increased salaries and additional staff and increased off-site temporary storage costs for goods produced and raw materials.

**Alloy Steel International, Inc.**  
**Supplemental Information**  
**2010 Financial Year**

**Income (Loss) Before Taxes**

Alloy Steel International had a net income before income taxes of \$7.3 million and a net income before income taxes of \$0.06 million for the twelve months ended September 30, 2010 and twelve months ended September 30, 2009 respectively.

Alloy Steel International's income before income tax expense was \$2.9 million for the three months ended September 30, 2010, compared to a profit before income tax of \$0.6 million for the three months ended September 30, 2009.

**Net Income (Loss)**

Alloy Steel International had a net income after tax of \$4.9 million, or \$0.28 per share, and (\$0.007) million, or (\$0.004) per share, for the twelve months ended September 30, 2010 and twelve months ended September 30, 2009 respectively.

Alloy Steel International had a net income after tax of \$1.9 million, or \$0.109 per share, for the three months ended September 30, 2010, compared to a net income after tax of \$0.3 million, or \$0.018 per share, for the three months ended September 30, 2009.

**Results of Operations**

For the year ended September 30, 2010, sales have improved by 178 percent compared to sales for the year ended September 30, 2009. This occurred due to an increase in demand for ArcoPlate facilitated by increased production. It was previously announced in the fourth quarter 2009 that the second mill had commenced production, although problems were encountered. During the commissioning process, it became evident that further enhancements were required to make the mill more efficient. The increased productive capacity of the Company is reflected in the quarterly production and sales for the fourth quarter 2010 and beyond.