Tiangong International Company Limited
天工國際有限公司*
(incorporated in the Cayman Islands with limited liability)
(Stock Code: 826)

CLARIFICATION ANNOUNCEMENT AND RESUMPTION OF TRADING

Articles

The Company would like to respond to certain comments on the gross profit margin, the gearing ratio, the inventory level, the investment and the depreciation expenses as appeared in articles in various websites.

Suspension and Resumption of Trading

The trading of the shares of the Company was suspended at 10:03 a.m. on 29 April 2014 pending release of this announcement. Application has been made by the Company for the resumption in trading of the Shares of the Company with effect from 9:00 a.m. on 7 May 2014.

The Company notes that there were articles published on 28 April 2014 in various websites, including hexun.com, sina.com and takungpao.com, and on 29 April 2014 in finet.hk quoting certain allegations from an article in the 25 April 2014 edition of the publication "證券市場周刊" (Capital Week) ("**Articles**") concerning, amongst others, the gross profit margin, the gearing ratio, the inventory level, the investment and the depreciation of the Company as well as comments on the reduction in shareholding in the Company by Mr. Zhu Xiaokun, the Chairman of the Company.

The Company also notes that there was a more than 21% decrease in the trading price (when compared with the closing price as of 28 April 2014) and an increase in the trading volume of the Shares during the trading session in the morning of 29 April 2014 prior to the suspension of trading of the Shares of the Company. The Company has requested for a suspension of the trading of the Shares of the Company pending issue of this announcement.

The Company denies all allegations set out in the Articles concerning the gross profit margin, the gearing ratio, the inventory level, the investment and the depreciation expenses of the Company that suggest the non-existence of inventory, investments and profit of the Company. The Company's financial statements, prepared in accordance with International Financial Reporting Standards, have been audited by the Company's external auditors, which has expressed an unqualified opinion. The Company would clarify matters referred to in the allegations as below:

Gross Profit Margin

It is noted from the Articles that the author of these Articles are concerned that the gross profit margin of the Company as set out in the published financial results of the Company was higher than peers and doubt the correctness of such gross high profit margin. The Company does not want to comment on the selection of comparable companies but would like to clarify that:

The Company understands from the Articles that the Company has been considered to have achieved a higher profit margin than comparable companies in respect of High Speed Steel (HSS) and Die Steel. In this respect, the Company considers that its high profit margin was due to the fact that the Company adopted a recycling-grinding melting technique that allows it to recycle scrap HSS, Die Steel and other raw materials more efficiently, and this has enabled the Group to manage its costs with higher effectiveness (as disclosed in the prospectus of the Company). Scrap from production has been largely recycled. This not only reduces the raw material cost but also reduces the tax payable on purchase of raw material. In addition, the production of cutting tools is vertically integrated within the Company, the HSS produced by the Company would be used by the HSS Cutting Tools production within the Company other than sales, thus reducing the overall production costs by cutting intermediate expenditure and increasing the profit margin of the Company. The Company has installed machines which reduce the burn-up of the relevant steel and other alloyed materials. Further, since the promulgation of the relevant labour law and the shortage of labour in general, the Company has been replacing certain labour-intensive production lines by machines. Last but not least, the Company was able to schedule its production to minimise electricity expenses at non-peak hours. All-in-all, the Company considers that it has a room different from other companies to attain better gross profit margin.

Gearing

The Articles quoted from annual reports of the Company that the Company has increased its liability from RMB700 million to RMB2,700 million from 2007 to 2013. They have alleged that the Company had high net debt ratio of 86% in 2013 and has had negative free cashflow since listing, save for 2011.

The Company did not agree to the allegation of a 86% net debt ratio in 2013. Based on the information as set out in the financial statements for the year ended 31 December 2013, the consolidated net assets of the Company was RMB3,178 million and the net debt (being outstanding debt less cash, fixed deposits and pledged cash) was RMB1,834 million. As such, the net debt ratio (being net debt/net assets) was 57.7%.

In addition, the Company does not agree to the allegation that the Company has had negative free cashflow since listing, save for 2011. Based on the consolidated cashflow statements of the Company (a summary is set out in the table below), there were negative and positive net cashflow for the financial years since listing. Compared against 31 December 2006 (the latest financial statement date prior to listing of the Company), there was a net increase in cash and cash equivalent of RMB25 million since listing of the Company after taking into account cash generated and used in operating activities, investing activities and financing activities.

RMB'million

	2013	2012	2011	2010	2009	2008	2007
Net cash generated from (used in) operating activities	87	373	652	197	238	-77	-60
Net cash (used in) investing activities	-557	-525	-799	-130	-437	-521	-404
Net cash generated from (used in) financing activities	408	199	-66	186	166	537	558
Net increase (decrease) in cash and cash equivalent	-62	47	-213	253	-33	-61	94

As at 31 December 2011, 31 December 2012 and 31 December 2013 the gearing ratio (total debt to total asset ratio) of the Company were at similar level: 58.30%, 54.31% and 55.60%, respectively. To strike the balance between future growth of the Company and dilution of shareholders interests and in view of the equity market during the period, the Company has to choose debt financing for its future growth. As most of the debts of the Company were commercial loans from banks, the Company believes that notwithstanding a high gearing ratio, its gearing ratio and financial position are acceptable to the lender banks.

The aggregate outstanding short term bank loans of the Company due on or prior to 31 December 2014 is RMB1,540 million. Having taken into account the cash and cash equivalent position, short term fixed deposit and pledge deposit for issuance of bank acceptances bills and other banking facilities, trade and bills receivables and the profit level of the Company, the board of directors is of the view that the Company is in a healthy financial position.

Inventory level

The Company agrees that its inventory level is approaching a high level. Inventories of approximately RMB1,979 million was recorded as of 31 December 2013. One of the reasons for the high inventory level was because of a delay in the installation of the 4,500 tons forging machine. As a result of the delay in production schedule in fall 2013, there was an excess store-up of ingot (being work-in-progress material for end-product production) of approximately RMB110 million. In February 2014, the forging machine has commenced commercial production and thus the excess inventory of ingot has been reduced. Another reason was the stock-up of certain titanium raw material amounting to approximately RMB52 million, which based on historic data, was in the interests of the Company to acquire more when the price was low. Furthermore, with the installation of a 15 tons IF furnace production line and strong die steel production line, there was corresponding increase in raw material of approximately RMB50 million.

Due to competition in the market, and the importance of the main raw material costs and volatility, the Company must be equipped with sufficient inventory to meet customer and production requirements. As at December 31, 2013, raw material inventories amounted to RMB 85 million which was sufficient for two months production in general, there were finished goods inventories of RMB 977 million to cover for approximately four months average sales and work-in-progress inventories of RMB 916 million to cover average customer's four months need.

Notwithstanding that the finished goods inventories stood at RMB977 million, such level of inventory could only cover four months normal sale volume. Due to the vast varieties and specifications of the Company's products, it is necessary to maintain an inventory level of work-in-progress to provide seamless supplement to meet customers' needs and to complete the clearance of inventory of finished products and work-in-progress inventory within eight months. Downsizing inventory is an important task of the Company in 2014.

The Company conducts annual physical inventory count. During the annual audit for the year ended 31 December 2013, the physical inventory count performed by the Company was attended and observed by the Company's external auditors.

Investment

While the Company has raised HK$1,097 million (approximately RMB910 million) in its fund raising exercises, achieved an aggregate profit of RMB1,922 million since listing, the Company has declared dividends totalling RMB269 million and reported investments in titanium production of RMB175 million as well as upgrading and replacing labour intensive production line by machines of RMB1,560 million. The Company considers that as a long term goal to keep the Company cost efficient and effective, it is important that the Company invests in machines which will ultimately reduce its cost of production as well as diversify the Company's production to new growth area such as titanium production, which is seen to be of a very wide application in aerospace and other high technology industry in additional to traditional HSS market.

Set out below a summary of the actual use of proceeds from IPO and fund raising exercises conducted since listing:

HKD'000

Application of proceeds from initial public offering	Proposed application	Utilisation in 2007	Utilisation in 2008
Repayment of bank loans	316,000	316,000	
Capital expenditure	350,000	210,000	140,000
General working capital	28,600	28,600	

Application of proceeds from placing of unlisted warrants in 2011 and exercise of subscription rights by holder of warrants	Proposed application	Utilisation in 2011	Utilisation in 2012
Working Capital (proceeds from warrants placed)	550	550	
General working capital and future development (proceeds from exercise of warrants)	168,000		168,000#

\#	Of the proceeds raised, approximately RMB100 million has been applied towards the construction of phase I of the tool and die steel bar wire rod production line, RMB15 million has been applied towards the construction of the 15,000 square metre cutting tools production plant and the balance of approximately RMB15 million has been applied towards wire drawing equipment production line.

Application of proceeds from placing of 125,000,000 new shares in 2012	Proposed application	Utilisation in 2012	Utilisation in 2013
Titanium production facilities and general working capital	233,750	130,000	103,750

Application of proceeds from placing of unlisted warrants in 2013 and exercise of subscription rights by holder of warrants	Proposed application	Utilisation in 2013	Utilisation in 2014
Working Capital (proceeds from warrants placed)	500	500	
General working capital and future Development (proceeds from exercise of warrants)	106,000*		

*	The subscription rights attached to the unlisted warrants have yet to be exercised.

Based on the above information, the net proceeds of the above fund raising activities amounted to HK$1,097 million (approximately RMB910 million). There were no change in the use of proceeds.

Depreciation Expenses

The Company would like to clarify that the change in disclosure of the upper limit of the estimated useful life of plant and machinery in the accounting policy as set out in the notes to financial statements in the 2008 from 5 – 10 years to 5 - 20 years was due to the addition of new plant and machinery during the year with estimated useful lives of 20 years. The depreciation rates and expenses for all categories of assets pre-existed 2008 have not been changed. The Company had not changed the estimated useful life of any assets that brought forward from years prior to 2008.

As set out in the prospectus of the Company, a substantial portion of the proceeds raised from the initial offering would be applied towards the purchase, installation and implementation of various production equipment to produce HSS cutting tools and die steel products of larger specification and higher grade. Depreciation expenses in respect of these more recent and large machines have to reflect the estimated useful life of these machineries of 20 years. The depreciation expenses for other pre-existing machines remains unchanged.

Shareholding

Finally, in respect of the reduction in shareholding interests in the Company by Mr. Zhu Xiaokun, it is noted that Mr. Zhu and his associates' shareholding percentage was reduced from approximately 52.49% to approximately 48.85% after the top-up placing of 125,000,000 shares by the Company as announced on 18 April 2012. Mr. Zhu and his associates' shareholding percentage was further reduced as a result of the full exercise of the subscription rights of the 32,000,000 unlisted warrants issued by the Company in January 2011 (which have been exercised in full during the exercise period) to approximately 45.17%. The Company has made enquiry with Mr. Zhu Xiaokun as to his disposal of interests in the Company. According to Mr. Zhu, he has been approached by institutions in respect of his disposals. It was not correct to say that it was because of any reason alleged in the Articles which has led to his reduction in shareholding in the Company.

Trading Suspension and Resumption of Trading

The trading of the shares of the Company was suspended at 10:03 a.m. on 29 April 2014 pending release of this announcement. Application has been made by the Company for the resumption in trading of the Shares of the Company with effect from 9:00 a.m. on 7 May 2014.

We have noted the recent decreases in the price and increases in the trading volume of the Shares of the Company. Having made such enquiry with respect to the Company as is reasonable in the circumstances, the Directors of the Company confirmed that they are not aware of any reasons for these price or volume movements or of any information which must be announced to avoid a false market in the Company's securities or of any inside information that needs to be disclosed under Part XIVA of the Securities and Futures Ordinance.

Warning

Shareholders and investors are advised to exercise caution when dealings in the Shares of the Company.

By Order of the Board
Tiangong International Company Limited
ZHU Xiaokun
Chairman

Hong Kong, 5 May 2014

As at the date of this announcement, the directors of the Company are:
Executive Directors: ZHU Xiaokun, WU Suojun, YAN Ronghua and JIANG Guangqing
Independent non-executive Directors: GAO Xiang, LEE Cheuk Yin, Dannis and YIN Shuming
** for the identification purposes only*