Tiangong International Company Limited
天工國際有限公司*

(incorporated in the Cayman Islands with limited liability)

(Stock Code:826)

ANNUAL RESULTS ANNOUNCEMENT FOR THE YEAR ENDED 31 DECEMBER 2018

FINANCIAL HIGHLIGHTS

RMB' million (unless otherwise specified)

	Year ended 31 December 2018	Year ended 31 December 2017	Change
Revenue	**5,021.5**	3,898.4	28.8%
Gross profit	**660.9**	498.5	32.6%
Net profit attributable to equity shareholders of the Company	**258.8**	169.1	53.1%
Basic earnings per share *(RMB)*	**0.106**	0.076	39.5%
Gross profit margin	**13.2%**	12.8%	0.4 ppt
Margin of profit attributable to equity shareholders of the Company	**5.2%**	4.3%	0.9 ppt
Net Assets	**4,823.0**	4,303.0	12.1%
Net Debt (1)	**1,418.6**	2,032.1	(30.2%)
Net Gearing (2)	**29.4%**	47.2%	(17.8ppt)

Notes:

(1) Net debt equal to total bank borrowings less pledged deposits, time deposits and cash and cash equivalents.

(2) Net gearing is measured as net debt to equity.

The board of directors (the "Board") of Tiangong International Company Limited (the "Company") is pleased to announce the audited consolidated statement of profit or loss and the consolidated statement of profit or loss and other comprehensive income of the Company and its subsidiaries (collectively the "Group") for the year ended 31 December 2018 and the consolidated statement of financial position of the Group as at 31 December 2018, together with the comparative figures for the same period of 2017 as follows:

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2018

	Note	2018 RMB'000	2017 RMB'000 (Note)
Revenue	4	**5,021,546**	3,898,443
Cost of sales		**(4,360,619)**	(3,399,980)
Gross profit		**660,927**	498,463
Other income	5	**42,467**	64,614
Distribution expenses		**(105,000)**	(85,800)
Administrative expenses		**(155,475)**	(140,357)
Other expenses	6	**(40,755)**	(2,210)
Profit from operations		**402,164**	334,710
Finance income		**7,233**	5,795
Finance expenses		**(142,071)**	(118,205)
Net finance costs	7(a)	**(134,838)**	(112,410)
Share of profits/(losses) of associates		**2,349**	(4,805)
Share of profits of joint ventures		**10,893**	602
Profit before taxation	7	**280,568**	218,097
Income tax	8	**(13,598)**	(43,396)
Profit for the year		**266,970**	174,701
Attributable to:			
Equity shareholders of the Company		**258,835**	169,099
Non-controlling interests		**8,135**	5,602
Profit for the year *(RMB)*		**266,970**	174,701
Basic		**0.106**	0.076
Diluted		**0.106**	0.076

Note: The Group has initially applied IFRS 15 and IFRS 9 at 1 January 2018. Under the transition methods chosen, comparative information is not restated. See Note 3.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

For the year ended 31 December 2018

	2018	2017
	RMB'000	*RMB'000*
		Note (i)
Profit for the year	**266,970**	174,701
Other comprehensive income for the year (after tax and reclassification adjustment)		
Items that will not be reclassified to profit or loss:		
Equity investments at fair value through other comprehensive income — net movement in fair value reserve (net of tax of RMB841,000) (non-recycling)	**(8,045)**	–
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translation of:		
— financial statements of entities with functional currencies other than RMB	**(3,562)**	4,825
Available-for-sale securities: net movement in the fair value reserve (net of nil tax) (2017: net of tax of RMB3,420,000) (recycling) *(Note (ii))*	**–**	(19,380)
Other comprehensive income for the year	**(11,607)**	(14,555)
Total comprehensive income for the year	**255,363**	160,146
Attributable to:		
Equity shareholders of the Company	**247,228**	154,544
Non-controlling interests	**8,135**	5,602
Total comprehensive income for the year	**255,363**	160,146

Notes:

(i) The Group has initially applied IFRS 15 and IFRS 9 at 1 January 2018. Under the transition methods chosen, comparative information is not restated. See Note 3.

(ii) This amount arose under the accounting policies applicable prior to 1 January 2018. As part of the opening balance adjustments as at 1 January 2018, the balance of this reserve has been reclassified to fair value reserve (non-recycling) and will not be reclassified to profit or loss in any future periods. See Note 3(b).

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Note	2018 RMB'000	2017 RMB'000 (Note)
Non-current assets			
Property, plant and equipment		**3,597,069**	3,520,344
Lease prepayments		**93,628**	70,875
Goodwill		**21,959**	21,959
Interest in associates		**51,905**	49,372
Interest in joint ventures		**33,813**	26,263
Other financial assets		**100,024**	88,900
Deferred tax assets		**25,195**	23,954
		3,923,593	3,801,667
Current assets			
Trading securities		**1,482**	–
Inventories		**1,994,287**	1,896,864
Trade and other receivables	*10*	**2,351,841**	2,044,171
Pledged deposits		**464,500**	241,380
Time deposits		**717,414**	500,000
Cash and cash equivalents		**583,235**	219,798
		6,112,759	4,902,213
Current liabilities			
Interest-bearing borrowings		**2,284,602**	2,170,279
Trade and other payables	*11*	**1,911,451**	1,302,982
Current taxation		**117**	4,164
Deferred income		**5,279**	5,499
		4,201,449	3,482,924
Net current assets		**1,911,310**	1,419,289
Total assets less current liabilities		**5,834,903**	5,220,956

	2018	2017
	RMB'000	*RMB'000*
		(Note)
Non-current liabilities		
Interest-bearing borrowings	**899,177**	823,013
Deferred income	**50,498**	37,777
Deferred tax liabilities	**62,268**	57,201
	1,011,943	917,991
Net assets	**4,822,960**	4,302,965
Capital and reserves		
Share capital	**45,242**	40,477
Reserves	**4,626,262**	4,119,167
Total equity attributable to equity shareholders of the Company	**4,671,504**	4,159,644
Non-controlling interests	**151,456**	143,321
Total equity	**4,822,960**	4,302,965

Note: The Group has initially applied IFRS 15 and IFRS 9 at 1 January 2018. Under the transition methods chosen, comparative information is not restated. See Note 3.

NOTES

1 REPORTING ENTITY

The Company was incorporated in the Cayman Islands on 14 August 2006 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961 as consolidated and revised) of the Cayman Islands. The consolidated financial statements of the Company as at and for the year ended 31 December 2018 comprise the Group and the Group's interests in associates and joint ventures. The Company's shares have been listed on the Main Board of the Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 26 July 2007.

2 BASIS OF PREPARATION

The annual results set out in the announcement do not constitute the Group's financial statements for the year ended 31 December 2018 but are extracted from those financial statements.

These financial statements have been prepared in accordance with all applicable International Financial Reporting Standards ("IFRSs"), which collective term includes all applicable individual International Financial Reporting Standards, International Accounting Standards ("IASs") and Interpretations issued by the International Accounting Standards Board ("IASB"). This announcement also complies with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"). In addition, this announcement has been reviewed by the Company's Audit Committee.

The figures in respect of this announcement of the Group's results for the year ended 31 December 2018 have been compared by the Company's auditor, KPMG, Certified Public Accountants, to the amounts set out in the Group's financial statements for the year and the amounts were found to be in agreement. The work performed by KPMG in respect of this announcement was limited and did not constitute an audit, review or other assurance engagement and consequently no assurance has been expressed by the auditor on this announcement.

3 CHANGES IN ACCOUNTING POLICIES

(a) Overview

The IASB has issued a number of new IFRSs and amendments to IFRSs that are first effective for the current accounting period of the Group. Of these, the following developments are relevant to the Group's financial statements:

- IFRS 9, *Financial instruments*
- IFRS 15, *Revenue from contracts with customers*
- IFRIC 22, *Foreign currency transactions and advance consideration*

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period, except for the amendments to IFRS 9, *Prepayment features with negative compensation* which have been adopted at the same time as IFRS 9.

(b) IFRS 9, Financial instruments, including the amendments to IFRS 9, *Prepayment features with negative compensation*

IFRS 9 replaces IAS 39, *Financial instruments: recognition and measurement*. It sets out the requirements for recognising and measuring financial assets, financial liabilities and certain contracts to buy or sell non-financial items.

The Group has applied IFRS 9 retrospectively to items that existed at 1 January 2018 in accordance with the transition requirements. The Group has recognised the cumulative effect of initial application as an adjustment to opening equity at 1 January 2018. Therefore, comparative information continues to be reported under IAS 39.

The following is a summary of the impact of transition to IFRS 9 on retained earnings and reserves and the related tax impact at 1 January 2018.

	RMB'000
Retained earnings	
Recognition of additional expected credit losses:	
— Interest in associates	(409)
— Interest in joint ventures	(2,083)
— Trade and other receivables	(34,871)
Related tax	5,466
Net decrease in retained earnings at 1 January 2018	(31,897)
Fair value reserve (recycling)	
Transferred to fair value reserve (non-recycling) relating to equity securities now measured at FVOCI and decrease in fair value reserve (recycling) at 1 January 2018	(53,975)
Fair value reserve (non-recycling)	
Transferred from fair value reserve (recycling) relating to equity securities now measured at FVOCI and increase in fair value reserve (non-recycling) at 1 January 2018	53,975

Further details of the nature and effect of the changes to previous accounting policies and the transition approach are set out below:

(i) *Classification of financial assets and financial liabilities*

IFRS 9 categories financial assets into three principal classification categories: measured at amortised cost, at fair value through other comprehensive income (FVOCI) and at fair value through profit or loss (FVPL). These supersede IAS 39's categories of held-to-maturity investments, loans and receivables, available-for-sale financial assets and financial assets measured at FVPL. The classification of financial assets under IFRS 9 is based on the business model under which the financial asset is managed and its contractual cash flow characteristics.

The following table shows the original measurement categories for each class of the Group's financial assets under IAS 39 and reconciles the carrying amounts of those financial assets determined in accordance with IAS 39 to those determined in accordance with IFRS 9.

	IAS 39 carrying amount at 31 December 2017	**Reclassification**	**Remeasurement**	**IFRS 9 carrying amount at 1 January 2018**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Financial assets carried at amortised cost				
Trade and other receivables	2,044,171	—	(34,871)	2,009,300
Pledged deposits	241,380	—	—	241,380
Time deposits	500,000	—	—	500,000
Cash and cash equivalents	219,798	—	—	219,798
	3,005,349	—	(34,871)	2,970,478
Financial assets measured at FVOCI (non-recyclable)				
Equity securities not held for trading *(Note)*	—	88,900	—	88,900
Financial assets classified as available-for-sale under IAS 39 *(Note)*	88,900	(88,900)	—	—

Note: Under IAS 39, equity securities not held for trading were classified as available-for-sale financial assets. These equity securities are classified at FVPL under IFRS 9, unless they are eligible for and designated at FVOCI by the Group. At 1 January 2018, the Group designated its investment in Bank of Jiangsu, Xiamen Chuangfeng Yizhi Investment Management Partnership and Nanjing Xiaomuma Technology Co., Ltd. at FVOCI (non-recycling), as the investments are held for strategic purposes.

For an explanation of how the Group classifies and measures financial assets and recognises related gains and losses under IFRS 9.

The measurement categories for all financial liabilities remain the same. The carrying amounts for all financial liabilities (including financial guarantee contracts) at 1 January 2018 have not been impacted by the initial application of IFRS 9.

The Group did not designate or de-designate any financial asset or financial liability at FVPL at 1 January 2018.

(ii) Credit losses

IFRS 9 replaces the "incurred loss" model in IAS 39 with the "expected credit loss" (ECL) model. The ECL model requires an ongoing measurement of credit risk associated with a financial asset and therefore recognises ECLs earlier than under the "incurred loss" accounting model in IAS 39.

The Group applies the new ECL model to the following items:

— financial assets measured at amortised cost (including cash and cash equivalents, pledged deposits, time deposits and trade and other receivables)

The following table reconciles the closing loss allowance for trade and other receivables determined in accordance with IAS 39 as at 31 December 2017 with the opening loss allowance determined in accordance with IFRS 9 as at 1 January 2018.

	RMB'000
Loss allowance at 31 December 2017 under IAS 39	38,359
Additional credit loss recognised at 1 January 2018 on:	
— Trade and other receivables	34,871
Loss allowance at 1 January 2018 under IFRS 9	73,230

(iii) Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below:

— Information relating to comparative periods has not been restated. Differences in the carrying amounts of financial assets resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 continues to be reported under IAS 39 and thus may not be comparable with the current period.

— The following assessments have been made on the basis of the facts and circumstances that existed at 1 January 2018 (the date of initial application of IFRS 9 by the Group):

  — the determination of the business model within which a financial asset is held; and

  — the designation of certain investments in equity instruments not held for trading to be classified as at FVOCI (non-recycling).

— If, at the date of initial application, the assessment of whether there has been a significant increase in credit risk since initial recognition would have involved undue cost or effort, a lifetime ECL has been recognised for that financial instrument.

(c) IFRS 15, *Revenue from contracts with customers*

IFRS 15 establishes a comprehensive framework for recognising revenue and certain costs from contracts with customers. IFRS 15 replaces IAS 18, *Revenue*, which covered revenue arising from sale of goods and rendering of services, and IAS 11, *Construction contracts*, which specified the accounting for construction contracts.

IFRS 15 also introduces additional qualitative and quantitative disclosure requirements which aim to enable users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

The Group has elected to use the cumulative effect transition method and no significant cumulative effect of initial application shall be recognised as an adjustment to the opening balance of equity at 1 January 2018. Therefore, comparative information has not been restated and continues to be reported under IAS 18.

Further details of the nature and effect of the changes on previous accounting policies are set out below:

(i) Timing of revenue recognition

Previously, revenue arising from construction contracts and provision of services was recognised over time, whereas revenue from sale of goods was generally recognised at a point in time when the risks and rewards of ownership of the goods had passed to the customers.

Under IFRS 15, revenue is recognised when the customer obtains control of the promised good or service in the contract. This may be at a single point in time or over time. IFRS 15 identifies the following three situations in which control of the promised good or service is regarded as being transferred over time:

A. When the customer simultaneously receives and consumes the benefits provided by the entity's performance, as the entity performs;

B. When the entity's performance creates or enhances an asset (for example work in progress) that the customer controls as the asset is created or enhanced;

C. When the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

If the contract terms and the entity's activities do not fall into any of these 3 situations, then under IFRS 15 the entity recognises revenue for the sale of that good or service at a single point in time, being when control has passed. Transfer of risks and rewards of ownership is only one of the indicators that is considered in determining when the transfer of control occurs.

The adoption of IFRS 15 does not have a material impact on when the Group recognises revenue from sales of goods.

(ii) Significant financing component

IFRS 15 requires an entity to adjust the transaction price for the time value of money when a contract contains a significant financing component, regardless of whether the payments from customers are received significantly in advance of revenue recognition or significantly deferred.

Previously, the Group only applied such a policy when payments were significantly deferred, which was not common in the Group's arrangements with its customers. The Group did not apply such a policy when payments were received in advance.

This change in accounting policy had no material impact on opening balances as at 1 January 2018.

(iii) Sales commissions payable related to sales contracts

The Group previously recognised sales commissions payable related to sales contracts as distribution expenses when they were incurred. Under IFRS 15, the Group is required to capitalise these sales commissions as costs of obtaining contracts when they are incremental and are expected to be recovered, unless the expected amortisation period is one year or less from the date of initial recognition of the asset, in which case the sales commissions can be expensed when incurred. Capitalised commissions are charged to profit or loss when the revenue from the related sale is recognised and are included as distribution expenses at that time.

This change in accounting policy had no material impact on opening balances as at 1 January 2018.

(iv) Presentation of contract assets and liabilities

Under IFRS 15, a receivable is recognised only if the Group has an unconditional right to consideration. If the Group recognises the related revenue before being unconditionally entitled to the consideration for the promised goods and services in the contract, then the entitlement to consideration is classified as a contract asset. Similarly, a contract liability, rather than a payable, is recognised when a customer pays consideration, or is contractually required to pay consideration and the amount is already due, before the Group recognises the related revenue. For a single contract with the customer, either a net contract asset or a net contract liability is presented. For multiple contracts, contract assets and contract liabilities of unrelated contracts are not presented on a net basis.

Previously, contract liabilities relating to sales contracts were presented in the consolidated statement of financial position under "trade and bills payables" included in trade and other payables. To reflect these changes in presentation, the Group has made the following adjustment at 1 January 2018, as a result of the adoption of IFRS 15:

— Advances received amounting to RMB36,717,000, which were previously recorded under "trade and bills payables" are now presented under "contract liabilities" included in trade and other payables.

(d) IFRIC 22, *Foreign currency transactions and advance consideration*

This interpretation provides guidance on determining "the date of the transaction" for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) arising from a transaction in which an entity receives or pays advance consideration in a foreign currency.

The Interpretation clarifies that "the date of the transaction" is the date on initial recognition of the non-monetary asset or liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance of recognising the related item, the date of the transaction for each payment or receipt should be determined in this way.

The adoption of IFRIC 22 does not have any material impact on the financial position and the financial result of the Group.

4 REVENUE AND SEGMENT REPORTING

(a) Revenue

Revenue represents mainly the sales value of high alloy steel, (including die steel ("DS") and high speed steel ("HSS")), cutting tools, titanium alloy and trading of goods after eliminating intercompany transactions. Further details regarding the Group's revenue are disclosed in Note 4(b).

(i) Disaggregation of revenue

Disaggregation of revenue from contracts with customers by products divisions is as follows:

	2018	2017
	RMB'000	*RMB'000*
		(Note)
DS	**2,098,110**	1,686,470
HSS	**782,015**	654,440
Cutting tools	**581,232**	530,212
Titanium alloy	**245,155**	168,164
Trading of goods	**1,315,034**	859,157
	5,021,546	3,898,443

Note: The Group has initially applied IFRS 15 using the cumulative effect method. Under this method, the comparative information is not restated and was prepared in accordance with IAS 18 (see Note 3(c)).

The Group's revenue from contracts with customers was recognised at point in time. Disaggregation of revenue from contracts with customers by geographic markets is disclosed in Notes 4(b)(iii).

The Group's customer base is diversified and includes only one customer (2017: one customer) with whom transactions have exceeded 10% of the Group's revenue. In 2018 revenue from trading of goods to these customers, amounted to RMB1,272,964,000 (2017: RMB841,500,000) and arose in the PRC in which trading of goods segment is active.

(ii) Revenue expected to be recognised in the future arising from contracts with customers in existence at the reporting date

As at 31 December 2018, the Group has applied the practical expedient in paragraph 121 of IFRS 15 to its sales contracts for goods, such that information about revenue expected to be recognised in the future is not disclosed in respect of revenue that the Group will be entitled to when it satisfies the remaining performance obligations under the contracts for sales of goods that had an expected duration of one year or less.

(b) Segment reporting

The Group has five reportable segments, as described below, which are the Group's product divisions. For each of the product divisions, the Chairman (the chief operating decision maker) reviews internal management reports on at least a monthly basis. No operating segments have been aggregated to form the following reportable segments. The following summary describes the operations in each of the Group's reportable segments:

— *DS*	The DS segment manufactures and sells materials that are used in the die set manufacturing industry.
— *HSS*	The HSS segment manufactures and sells materials that are used in the tools manufacturing industry.
— *Cutting tools*	The cutting tools segment manufactures and sells HSS and carbide cutting tools to the tooling industry.
— *Titanium alloy*	The titanium alloy segment manufactures and sells titanium alloys to the titanium industry.
— *Trading of goods*	The trading of goods segment sells general carbon steel products that are not within the Group's production scope.

(i) Segment results, assets and liabilities

For the purposes of assessing segment performance and allocating resources between segments, the Chairman (the chief operating decision maker) monitors the results, assets and liabilities attributable to each reportable segment on the following basis:

Segment assets include all tangible, intangible assets and current assets with the exception of interest in associates, interest in joint ventures, other financial assets, pledged deposits, time deposits, cash and cash equivalents, deferred tax assets and other head office and corporate assets. Segment liabilities include bills payable, trade and non-trade payables, deferred income and accrued expenses attributable to the manufacturing and sales activities of the individual segments with the exception of interest-bearing borrowings, current taxation, deferred tax liabilities and other head office and corporate liabilities.

Revenue and expenses are allocated to the reportable segments with reference to sales generated by those segments and the expenses incurred by those segments or which otherwise arise from the depreciation or amortisation of assets attributable to those segments.

The measure used for reporting segment profit is "adjusted EBIT", i.e. "adjusted earnings before interest and taxes", where "interest" is regarded as net finance costs. To arrive at adjusted EBIT, the Group's earnings are further adjusted for items not specifically attributed to individual segments, such as share of profits less losses of associates and joint ventures and other head office or corporate administration costs.

In addition to receiving segment information concerning adjusted EBIT, management is provided with segment information concerning revenue (including inter-segment revenue) generated by the segments in their operations. Inter-segment revenue is priced with reference to prices charged to external parties for similar orders.

Information regarding the Group's reportable segments as provided to the Chairman (the chief operating decision maker) for the purposes of resource allocation and assessment of segment performance for the years ended 31 December 2018 and 2017 is set out below.

	Year ended and as at 31 December 2018					
	DS	**HSS**	**Cutting tools**	**Titanium alloy**	**Trading of goods**	**Total**
	RMB'000	***RMB'000***	***RMB'000***	***RMB'000***	***RMB'000***	***RMB'000***
Revenue from external customers	**2,098,110**	**782,015**	**581,232**	**245,155**	**1,315,034**	**5,021,546**
Inter-segment revenue	**–**	**242,524**	**–**	**–**	**–**	**242,524**
Reportable segment revenue	**2,098,110**	**1,024,539**	**581,232**	**245,155**	**1,315,034**	**5,264,070**
Reportable segment profit (adjusted EBIT)	**283,514**	**145,499**	**64,823**	**35,743**	**327**	**529,906**
Reportable segment assets	**3,895,601**	**2,182,621**	**1,369,391**	**562,837**	**31**	**8,010,481**
Reportable segment liabilities	**1,343,658**	**363,104**	**179,345**	**56,315**	**–**	**1,942,422**

	Year ended and as at 31 December 2017 *(Note)*					
	DS	HSS	Cutting tools	Titanium alloy	Trading of goods	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Revenue from external customers	1,686,470	654,440	530,212	168,164	859,157	3,898,443
Inter-segment revenue	–	109,355	–	–	–	109,355
Reportable segment revenue	1,686,470	763,795	530,212	168,164	859,157	4,007,798
Reportable segment profit (adjusted EBIT)	216,646	112,469	58,584	23,623	1,824	413,146
Reportable segment assets	3,234,273	2,302,430	1,404,979	543,472	10	7,485,164
Reportable segment liabilities	786,721	308,703	176,268	52,702	–	1,324,394

Note: The Group has initially applied IFRS 15 using the cumulative effect method. Under this method, the comparative information is not restated and was prepared in accordance with IAS 18 (see Note 3(c)).

(ii) Reconciliations of reportable segment revenue, profit or loss, assets and liabilities

	2018	2017
	RMB'000	*RMB'000*
Revenue		
Reportable segment revenue	**5,264,070**	4,007,798
Elimination of inter-segment revenue	**(242,524)**	(109,355)
Consolidated revenue *(Note 4(a))*	**5,021,546**	3,898,443

	2018	2017
	RMB'000	*RMB'000*
Profit		
Reportable segment profit	**529,906**	413,146
Net finance costs	**(134,838)**	(112,410)
Share of profits/(losses) of associates	**2,349**	(4,805)
Share of profits of joint ventures	**10,893**	602
Unallocated head office and corporate expenses	**(127,742)**	(78,436)
Consolidated profit before taxation	**280,568**	218,097

	2018	2017
	RMB'000	*RMB'000*
Assets		
Reportable segment assets	**8,010,481**	7,485,164
Interest in associates	**51,905**	49,372
Interest in joint ventures	**33,813**	26,263
Other financial assets	**100,024**	88,900
Deferred tax assets	**25,195**	23,954
Trading securities	**1,482**	–
Pledged deposits	**464,500**	241,380
Time deposits	**717,414**	500,000
Cash and cash equivalents	**583,235**	219,798
Unallocated head office and corporate assets	**48,303**	69,049
Consolidated total assets	**10,036,352**	8,703,880

	2018	2017
	RMB'000	*RMB'000*
Liabilities		
Reportable segment liabilities	**1,942,422**	1,324,394
Interest-bearing borrowings	**3,183,779**	2,993,292
Current taxation	**117**	4,164
Deferred tax liabilities	**62,268**	57,201
Unallocated head office and corporate liabilities	**24,806**	21,864
Consolidated total liabilities	**5,213,392**	4,400,915

(iii) Geographical information

The Group's business is managed on a worldwide basis, but participates in four principal economic geographies, the PRC, North America, Europe and Asia (other than the PRC).

In presenting geographical information, segment revenue is based on the geographical location of customers. Substantially all of the Group's assets and liabilities are located in the PRC and accordingly, no geographical analysis of segment assets, liabilities and capital expenditure is provided.

	2018	2017
	RMB'000	*RMB'000*
Revenue		
The PRC	**3,249,457**	2,571,367
North America	**548,031**	404,171
Europe	**882,839**	672,417
Asia (other than the PRC)	**299,530**	226,063
Others	**41,689**	24,425
Total	**5,021,546**	3,898,443

5 OTHER INCOME

		2018	2017
	Note	***RMB'000***	*RMB'000*
Government grants	*(i)*	**33,270**	53,815
Sales of scrap materials		**3,239**	256
Net foreign exchange gain		**–**	6,395
Dividend income from listed securities	*(ii)*	**1,800**	1,780
Disposal gain from trading securities		**–**	545
Net gain on disposal of property, plant and equipment		**1,639**	496
Others		**2,519**	1,327
		42,467	64,614

(i) The subsidiaries of the Group, including Jiangsu Tiangong Tools Company Limited ("TG Tools"), Tiangong Aihe Company Limited ("TG Aihe") and Jiangsu Tiangong Technology Company Limited ("TG Tech"), located in the PRC, collectively received unconditional grants amounting to RMB27,771,000 (2017: RMB47,375,000) from the local government to reward their contribution to the local economy and encourage technology innovation. TG Tools and TG Tech also recognised amortisation of government grants related to assets of RMB5,499,000 (2017: RMB6,440,000) during the year ended 31 December 2018.

(ii) The Group received dividends totalling RMB1,800,000 (2017: RMB1,780,000) from a listed equity investment.

6 OTHER EXPENSES

	2018 *RMB'000*	2017 *RMB'000*
Provision of loss allowance for trade receivables	**35,374**	1,049
Net foreign exchange loss	**2,471**	–
Charitable donations	**1,317**	–
Net realised and unrealised losses on trading securities	**947**	–
Others	**646**	1,161
	40,755	2,210

7 PROFIT BEFORE TAXATION

Profit before taxation is arrived at after charging/(crediting):

(a) Net finance costs

	2018 *RMB'000*	2017 *RMB'000*
Interest income	**(7,233)**	(5,795)
Finance income	**(7,233)**	(5,795)
Interest on bank loans	**171,386**	145,860
Less: interest expense capitalised into property, plant and equipment under construction*	**(29,315)**	(27,655)
Finance expenses	**142,071**	118,205
Net finance costs	**134,838**	112,410

* The borrowing costs have been capitalised at a rate of 5.11% per annum (2017: 5.02%).

(b) Staff costs

	2018 *RMB'000*	2017 *RMB'000*
Salaries, wages and other benefits	**224,866**	213,726
Contributions to defined contribution retirement plans	**33,862**	29,893
Equity-settled share-based payment expenses	**10,063**	–
	268,791	243,619

The Group participates in defined contribution pension funds managed by the PRC local government authorities. According to the respective pension fund regulations, the Group is required to pay annual contributions determined by the respective authorities in the PRC. The Group remits all the pension fund contributions to the respective social security offices, which are responsible for the payments and liabilities relating to the pension funds. The Group has no obligation for payment of retirement and other post-retirement benefits of employees other than the contributions described above.

(c) **Other items**

	2018	2017
	RMB'000	*RMB'000*
Cost of inventories*	**4,360,619**	3,399,980
Depreciation of property, plant and equipment	**225,673**	220,167
Amortisation of lease prepayments	**1,854**	1,749
Provision of loss allowance for trade receivables	**35,374**	1,049
Provision/(reversal) of write-down of inventories	**1,002**	(16,804)
Operating lease charges	**1,059**	1,367
Auditor's remuneration		
— audit services	**2,650**	2,500
— other services	**—**	100

* Cost of inventories includes RMB364,341,000 (2017: RMB327,223,000) relating to staff costs, depreciation expenses and write-down of inventories which are also included in the respective total amounts disclosed separately above or in note 7(b) for each of these types of expenses.

8 INCOME TAX IN THE CONSOLIDATED STATEMENT OF PROFIT OR LOSS

(a) **Taxation in the consolidated statement of profit or loss represents:**

	2018	2017
	RMB'000	*RMB'000*
Current tax		
Provision for PRC taxes	**3,199**	31,775
Provision for Hong Kong Profits Tax	**245**	–
	3,444	31,775
Deferred tax		
Reversal of temporary differences	**10,154**	11,621
	13,598	43,396

(i) Pursuant to the rules and regulations of the Cayman Islands and British Virgin Islands, the Group is not subject to any income tax in the Cayman Islands or British Virgin Islands.

(ii) The provision for PRC Income Tax is based on the respective corporate income tax rates applicable to the subsidiaries located in the PRC as determined in accordance with the relevant income tax rules and regulations of the PRC.

TG Tools, TG Aihe and TG Tech are subject to a preferential income tax rate of 15% in 2018 available to enterprises which qualify as a High and New Technology Enterprise (2017: 15%).

The statutory corporate income tax rate applicable to the Group's other operating subsidiaries in the PRC is 25% (2017: 25%).

The income tax law of the PRC and its relevant regulations also impose withholding tax at 10%, unless reduced by a tax treaty/arrangement, on dividend distributions made out of the PRC from earnings accumulated from 1 January 2008. Undistributed earnings generated prior to 1 January 2008 are exempted from such withholding tax.

(iii) Hong Kong Profits Tax has been provided for Tiangong Development Hong Kong Company Limited ("TG Development") at the rate of 16.5% (2017: 16.5%) on the estimated assessable profits arising in Hong Kong for the year ended 31 December 2018.

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2018 ***RMB'000***	2017 *RMB'000*
Profit before taxation	**280,568**	218,097
Notional tax on profit before taxation, calculated using the PRC statutory tax rate of 25% (2017: 25%)	**70,142**	54,524
Effect of preferential tax rates	**(16,601)**	(20,396)
Effect of different tax rates	**(1,872)**	(1,266)
Tax effect of non-deductible expenses	**1,075**	1,300
Tax effect of non-taxable income	**(3,586)**	(555)
(Refund)/provision of withholding tax on distributed dividends	**(22,222)**	22,222
Tax effect of bonus deduction for research and development expenses	**(13,670)**	(6,338)
Reversal of previously over-recognised deductible temporary difference	**–**	2,112
Under/(over)-provision in respect of prior year	**332**	(8,207)
Actual tax expense	**13,598**	43,396

9 EARNINGS PER SHARE

(a) Basic earnings per share

The calculation of basic earnings per share is based on the profit attributable to ordinary equity shareholders of the Company of RMB258,835,000 (2017: RMB169,099,000) and the weighted average of 2,431,907,143 ordinary shares (2017: 2,220,546,288 shares) in issue during the year:

Weighted average number of ordinary shares

	2018	2017
Issued ordinary shares at 1 January	**2,239,050,000**	2,220,080,000
Effect of share allotment	**192,857,143**	—
Effect of exercise of share options	—	466,288
Weighted average number of ordinary shares at 31 December	**2,431,907,143**	2,220,546,288

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on the profit attributable to ordinary equity shareholders of the Company of RMB258,835,000 (2017: RMB169,099,000) and the weighted average number of ordinary shares of 2,435,421,765 shares (2017: 2,226,347,577 shares), calculated as follows:

Weighted average number of ordinary shares (diluted)

	2018	2017
Weighted average number of ordinary shares at 31 December	**2,431,907,143**	2,220,546,288
Effect of equity settled share-based transactions	**3,514,622**	5,801,289
Weighted average number of ordinary shares (diluted) at 31 December	**2,435,421,765**	2,226,347,577

The calculation of diluted earnings per share for the year ended 31 December 2018 did not include the potential effects of 22,147,000 (2017: 22,147,000) shares options during the year as they have anti-dilutive effects on the basic earnings per share for the year.

10 TRADE AND OTHER RECEIVABLES

	At 31 December 2018 *RMB'000*	At 1 January 2018 *RMB'000*	At 31 December 2017 *RMB'000*
Trade receivables	**1,193,506**	1,019,779	1,019,779
Bills receivables	**911,473**	726,603	726,603
Less: loss allowance *(Note)*	**(105,868)**	(73,230)	(38,359)
Net trade and bills receivables	**1,999,111**	1,673,152	1,708,023
Prepayments	**250,879**	231,444	231,444
Non-trade receivables	**101,851**	104,704	104,704
Less: loss allowance	**–**	–	–
Net prepayments and non-trade receivables	**352,730**	336,148	336,148
	2,351,841	2,009,300	2,044,171

Note: Upon the adoption of IFRS 9, an opening adjustment as at 1 January 2018 was made to recognise additional ECLs on trade receivables (see Note 3(b)).

Substantially all of the trade and other receivables are expected to be recovered or recognised as an expense within one year.

Trade receivables of RMB151,780,000 (2017: RMB123,200,000) have been pledged to a bank as security for the Group's bank loans.

(a) Ageing analysis

As of the end of the reporting period, the ageing analysis of trade and bills receivables (which are included in trade and other receivables), based on the invoice date and net of loss allowance, is as follows:

	2018	2017
	RMB'000	*RMB'000*
Within 3 months	**1,592,295**	1,521,338
4 to 6 months	**177,310**	117,972
7 to 12 months	**52,609**	44,940
1 to 2 years	**152,084**	13,457
Over 2 years	**24,813**	10,316
	1,999,111	1,708,023

Trade and bills receivables are due from 90 to 180 days from the date of billing.

(b) Loss allowance of trade receivables

The following table provides information about the Group's exposure to credit risk and ECLs, which is calculated using a provision matrix.

The following table provides information about the Group's exposure to credit risk and ECLs for trade receivables as at 31 December 2018.

	Expected loss rate	**Gross carrying amount**	**Loss allowance**
	%	*RMB'000*	*RMB'000*
Current (not past due)	1.0%	687,787	6,966
1–3 months past due	4.0%	187,471	7,454
4–6 months past due	7.4%	52,979	3,942
7–12 months past due	10.0%	119,931	12,034
1–2 years past due	36.0%	109,083	39,217
More than 2 years past due	100%	36,255	36,255
		1,193,506	105,868

Expected loss rates are based on actual loss experience over the past years. These rates are adjusted to reflect differences between economic conditions during the period over which the historic data has been collected, current conditions and the Group's view of economic conditions over the expected lives of the receivables.

Movement in the loss allowance account in respect of trade receivables during the year is as follows:

	2018	2017
	RMB'000	*RMB'000*
Balance at 31 December 2017 under IAS 39	**38,359**	37,310
Impact on initial application of IFRS 9 *(Note 3(b))*	**34,871**	–
Balance at 1 January	**73,230**	37,310
Amounts written off during the year	**(2,736)**	–
Loss allowance recognised during the year	**35,374**	1,049
Balance at 31 December	**105,868**	38,359

11 TRADE AND OTHER PAYABLES

	At 31 December 2018	At 1 January 2018	At 31 December 2017
	RMB'000	*RMB'000*	*RMB'000*
			(Note)
Trade and bills payables	**1,740,593**	1,138,428	1,138,428
Contract liabilities	**32,434**	36,717	–
Non-trade payables and accrued expenses	**138,424**	127,837	164,554
	1,911,451	1,302,982	1,302,982

Note: As a result of the adoption of IFRS 15, advances received are included and disclosed in contract liabilities.

As of the end of the reporting period, the ageing analysis of trade and bills payable (which are included in trade and other payables), based on the invoice date, is as follows:

	2018	2017
	RMB'000	*RMB'000*
Within 3 months	**1,022,521**	474,445
4 to 6 months	**375,682**	334,821
7 to 12 months	**291,150**	286,691
1 to 2 years	**19,427**	14,793
Over 2 years	**31,813**	27,678
	1,740,593	1,138,428

12 DIVIDENDS

(a) Dividends payable to equity shareholders of the Company in respect of the year

	2018	2017
	RMB'000	*RMB'000*
Dividend proposed after the end of the reporting period of RMB0.0357 per ordinary share (2017; RMB0.0378 per ordinary share)	**90,592**	84,550

The final dividend proposed after the end of the reporting period has not been recognised as a liability at the end of the reporting period.

(b) Dividends payable to equity shareholders of the Company in respect of the previous financial year, approved and paid during the year

	2018	2017
	RMB'000	*RMB'000*
Dividend in respect of the previous financial year, approved and paid during the year of RMB0.0378 per ordinary share (2017: RMB0.0100 per ordinary share)	**100,183**	22,130

In respect of the final dividend for the year ended 31 December 2017, there is a difference of RMB15,633,000 (2016: RMB16,000) between the final dividend disclosed in the 2017 annual financial statements and amounts approved and paid during the year, which is mainly due to share allotment during 2018 and the RMB/HKD exchange rate difference between the fixed middle average exchange rate on the date of the 2017 annual result announcement and the actual exchange rate applied on the date of payment.

MANAGEMENT DISCUSSION AND ANALYSIS

Business and Market Review

Revenue

	For the year ended 31 December					
	2018		2017		Change	
	RMB'000	***%***	*RMB'000*	*%*	*RMB'000*	*%*
DS	**2,098,110**	**41.8**	1,686,470	43.3	411,640	24.4
HSS	**782,015**	**15.6**	654,440	16.8	127,575	19.5
Cutting tools	**581,232**	**11.5**	530,212	13.6	51,020	9.6
Titanium alloy	**245,155**	**4.9**	168,164	4.3	76,991	45.8
Trading of goods	**1,315,034**	**26.2**	859,157	22.0	455,877	53.1
	5,021,546	**100.0**	3,898,443	100.0	1,123,103	28.8

DS — accounted for 41.8% of the Group's revenue in FY 2018

	For the year ended 31 December					
	2018		2017		Change	
	RMB'000	***%***	*RMB'000*	*%*	*RMB'000*	*%*
DS						
Domestic	**944,542**	**45.0**	843,822	50.0	100,720	11.9
Export	**1,153,568**	**55.0**	842,648	50.0	310,920	36.9
	2,098,110	**100.0**	1,686,470	100.0	411,640	24.4

DS is manufactured using rare metals including molybdenum, chromium and vanadium, a type of high alloy special steel. DS is mainly used in die and mould casting as well as machining processing. Many different manufacturing industries require moulds, including automotive, high-speed railway construction, aviation and plastic product manufacturing industries.

During the year, revenue generated from DS segment increased by 24.4% to RMB2,098,110,000 (2017: RMB1,686,470,000). The Group's domestic revenue in DS increased by 11.9% to RMB944,542,000 (2017: RMB843,822,000) while export revenue increased by 36.9% to RMB1,153,568,000 (2017: RMB842,648,000).

The increase in revenue in DS segment was attributable to both an increase in market demand and the average selling prices of the products. Overall sales volume increased by 8.2% while average selling prices increased by 15.0%.

For the domestic market, an increase in average selling price was the main contributor to the increased revenue. Driven by the increased price of raw materials during the year, domestic average selling price recorded an increase of 11.4%.

For overseas markets, the continuous strong market demand stimulated an increase of 17.1% in sales volume. At the same time, average selling price increased by 17.0% due to (i) increased price of raw materials used by the Group; and (ii) ability to pass on raw material price increases to the Group's customers.

HSS — accounted for 15.6% of the Group's revenue in FY 2018

	For the year ended 31 December					
	2018		2017		Change	
	RMB'000	%	*RMB'000*	%	*RMB'000*	%
HSS						
Domestic	**527,517**	**67.5**	456,089	69.7	71,428	15.7
Export	**254,498**	**32.5**	198,351	30.3	56,147	28.3
	782,015	**100.0**	654,440	100.0	127,575	19.5

HSS, manufactured using rare metals including tungsten, molybdenum, chromium, vanadium and cobalt, is characterised by greater hardness, heat resistance and durability. These attributes make HSS suited to such applications as cutting tools and in the manufacture of high-temperature bearings, high-temperature springs, internal-combustion engines and roll, with wide usage in specific industrial applications including automotive, machinery manufacturing, aviation, and electronics industries.

Both domestic and export revenue experienced an increase in 2018. The Group's domestic revenue increased by 15.7% to RMB527,517,000 (2017: RMB456,089,000), while export revenue increased by 28.3% to RMB254,498,000 (2017: RMB198,351,000).

Similar to DS, the increase in revenue in HSS was also attributable to both an increase in market demand and the average selling prices of the products. For HSS segment, the magnitude of the increase in average selling price is greater than that of the increase in market demand. The reason behind was that tungsten and cobalt are used in the production of HSS. The increase in price of tungsten and cobalt was more significant during the year. Overall sales volume increased by 5.0% while average selling prices increased by 13.8%.

For the domestic market, an increase of 3.2% was recorded in sales volume while the average selling price increased by 12.1%.

For overseas markets, market demand is relatively strong, which resulted in an increase of 11.1% in sales volume. Average selling price increased by 15.5% together with the increased price of raw materials used by the Group.

Cutting tools — accounted for 11.5% of the Group's revenue in FY 2018

	For the year ended 31 December					
	2018		2017		Change	
	RMB'000	***%***	*RMB'000*	*%*	*RMB'000*	*%*
Cutting tools						
Domestic	**219,871**	**37.8**	246,309	46.5	(26,438)	(10.7)
Export	**361,361**	**62.2**	283,903	53.5	77,458	27.3
	581,232	**100.0**	530,212	100.0	51,020	9.6

Cutting tools segment includes HSS and carbide cutting tools. HSS cutting tools products can be categorised into four major types — twist drill bits, screw taps, end mills and turning tools. All of these are used in industrial manufacturing. The two main types of HSS cutting tools manufactured by the Group are twist drill bits and screw taps. The Group's vertical integration extending from upstream HSS production to downstream HSS cutting tools production brought us a significant cost advantage over our peers. High end carbide tools manufactured by the Group mainly comprised of customised carbide tools.

Overall increase of 9.6% was recorded in the segment revenue of cutting tools. However, the domestic and overseas markets experienced a very different competition atmosphere.

The demand in the domestic market was mainly from the elementary products. Since the production technology was relatively simple, competition from small scale producers was strong. To prevent an unnecessary price war, the Group preferred to focus on the domestic mid-range market and overseas markets.

Domestic sales volume was reduced by 28.4% as a result of the change in the market focus policy. Since the product mix was shifted to mid-range products, the volume reduction was partially offset by an increase of 24.6% in average selling price.

In the overseas markets, since the demand was primarily from mid-range and higher end HSS and carbide cutting tools, production technology was crucial and competition was relatively less keen. The sales volume recorded an increase of 23.8%, which was the main contributor to the increase in export revenue of the segment.

Titanium alloy — accounted for 4.9% of the Group's revenue in FY 2018

	For the year ended 31 December					
	2018		2017		Change	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*
Titanium alloy						
Domestic	**242,492**	**98.9**	165,990	98.7	**76,502**	**46.1**
Export	**2,662**	**1.1**	2,174	1.3	**488**	**22.5**
	245,155	**100.0**	168,164	100.0	**76,991**	**45.8**

The corrosion resistance nature of titanium alloy promoted the extensive applications of titanium alloy in various industries, including aerospace, chemical pipeline equipment, nuclear and ocean industries.

Demand for titanium products remained strong during the year. 37.8% increase in sales volume was recorded. At the same time, the price of sponge titanium increased during the year. As the major raw material of titanium alloy segment, the increased price of sponge titanium was passed on to our customers. Accordingly, average selling price also increased by 5.8% during the year. As a result, segment revenue increased by 45.8% to RMB245,155,000 (2017: RMB168,164,000).

Trading of goods

This segment involves the purchase and sales of general carbon steel products which were not within the Group's production scope. Instead of pursuing profitability, the Group intended to utilise their enriched sourcing resources in the supply chain to maintain the relationship with our existing customers.

Financial Review

Net profit attributable to equity shareholders of the Company increased by 53.1% from RMB169,099,000 in 2017 to RMB258,835,000 in 2018. The increase was mainly attributable to (i) increase in sales volume of the products of the Group's four core segments during the year ended 31 December 2018 due to increased market demand and market share; and (ii) the increased price of major raw materials used by the Group during the year ended 31 December 2018. Since the Group has the ability to pass on raw material price increases to its customers, there was an increase in the average selling price of the products of the Group's four core segments.

Revenue

Revenue of the Group for 2018 totalled RMB5,021,546,000, representing an increase of 28.8% as compared with RMB3,898,443,000 in 2017. All the segments of the Group experienced an increase during the year.

Cost of sales

The Group's cost of sales was RMB4,360,619,000 in 2018, representing an increase of 28.3% as compared with RMB3,399,980,000 in 2017, as a result of an increase in sales.

Gross margin

For 2018, the overall gross margin was 13.2% (2017: 12.8%). Set out below is the gross margin of our five segments in 2018 and 2017:

	2018	2017
DS	**18.2%**	16.3%
HSS	**20.6%**	19.1%
Cutting tools	**13.9%**	13.8%
Titanium alloy	**15.2%**	14.4%
Trading of goods	**0.0%**	0.2%

DS

The gross margin of DS increased from 16.3% in 2017 to 18.2% in 2018. During the year, the increase in the price of raw materials was passed on to our customers. Production utilisation was further enhanced by the increase in market demand. The Group was able to take advantage of the increase in selling price and cost savings. The gross margin was enhanced accordingly.

HSS

Similar to DS, the gross margin of HSS increased from 19.1% in 2017 to 20.6% in 2018. The increase was supported by improvements in both pricing and cost savings.

Cutting tools

The market for cutting tools is relatively mature and stable in recent years. The cutting tools segment retained a stable gross margin at 13.9% in 2018 (2017: 13.8%).

Titanium alloy

The gross margin of titanium alloy increased from 14.4% in 2017 to 15.2% in 2018. The improvement in gross margin of titanium alloy was mainly attributable to the combined effect of increased raw material prices passed on to customers and improved utilisation of production capacity.

Trading of goods

The gross margin of this segment remained stable at 0.0% (2017: 0.2%).

Other income

Other income decreased from RMB64,614,000 in 2017 to RMB42,467,000 in 2018. The main reason for the decrease was the reduced government grant. A total amount of RMB33,270,000, was received in 2018 (2017: RMB53,815,000).

Distribution expenses

Distribution expenses in 2018 were RMB105,000,000 (2017: RMB85,800,000), representing an increase of 22.4%. The increase was mainly attributable to the increase in sales volume and the increase in marketing and advertising expenditures. For 2018, distribution expenses as a percentage of revenue was 2.1% (2017: 2.2%).

Administrative expenses

Administrative expenses increased from RMB140,357,000 in 2017 to RMB155,475,000 in 2018. The increase was mainly due to the cost of the share-based payment expenses incurred during the year for the granting of 60,000,000 share options to the Directors and employees of the Group. For 2018, administrative expenses as a percentage of revenue was 3.1% (2017: 3.6%).

Other expenses

Other expenses increased significantly from RMB2,210,000 in 2017 to RMB40,755,000 in 2018. Due to the implementation of IFRS 9, the new "expected credit loss" model requires an ongoing measurement of credit risk associated with receivables and therefore recognises loss allowances earlier than that under the "incurred loss" model in IAS 39. Significant provision of loss allowance was recognised in 2018 which amounted to RMB35,374,000 (2017: RMB1,049,000). In addition, net foreign exchange losses of RMB2,471,000 was recognised by the Group in 2018 (2017: gain of RMB6,395,000 recognised in other income).

Net finance costs

The Group's finance income was RMB7,233,000 in 2018, representing an increase of RMB1,438,000, primarily due to an increase in the average bank deposit balance. The Group's finance expense was RMB142,071,000 in 2018, representing an increase of 20.2% from RMB118,205,000 in 2017. The increase was due to a higher level of average interest-bearing borrowing balances and increased average borrowing costs.

Income tax

As set out in Note 8 of the consolidated statement of profit or loss, the Group's income tax expense decreased by 68.7% from RMB43,396,000 in 2017 to RMB13,598,000 in 2018. The decrease in income tax expenses was mainly due to the exempted arrangement on withholding tax expenses on dividend distributed by the Group's PRC subsidiary in 2017 and 2018. Under new PRC tax rules, withholding tax expenses on dividends distributed by the Group's PRC subsidiary to foreign intermediate holding companies was temporarily exempted if the dividend distributed was reinvested to the PRC subsidiary.

Profit for the year attributable to equity shareholders of the Company

As a result of the factors set out above, the Group's share of profit increased by 53.1% from RMB169,099,000 in 2017 to RMB258,835,000 in 2018. The margin of profit attributable to equity shareholders of the Company increased from 4.3% in 2017 to 5.2% in 2018.

Total comprehensive income for the year attributable to equity shareholders of the Company

For 2018, total comprehensive income for the year attributable to equity shareholders of the Company was RMB247,228,000 (2017: RMB154,544,000) after taking into account foreign currency translation differences and fair value adjustments on equity investments.

During the year, the Group debited to other comprehensive income a foreign currency translation difference of RMB3,562,000 (2017: credited RMB4,825,000) related to translation of financial statements of Hong Kong subsidiaries and overseas equity accounted investees.

The Group also recognised a fair value loss in the consolidated statement of profit or loss and other comprehensive income of RMB8,045,000 (2017: loss of RMB19,380,000) on its equity investments.

Other financial assets

Other financial assets held by the Group included Bank of Jiangsu, Xiamen Chuangfeng Yizhi Investment Management Partnership, Nanjing Xiaomuma Technology Co., Ltd. and JM Digital Steel Inc. All of these investments were stated at their fair value as at 31 December 2018. The total fair value loss, net of tax, of RMB8,045,000 (2017: RMB19,380,000) was recorded in other comprehensive income during the year.

Trade and bills receivables

Trade and bills receivables increased from RMB1,708,023,000 in 2017 to RMB1,999,111,000 in 2018, which was mainly due to the expansion of sales. During the year, loss allowance of trade receivables increased by RMB67,509,000, which was mainly the result of adopting IFRS 9 where estimate of credit losses was required to be recognised earlier than that under IAS 39.

Outlook

Operating Environment

In the past year, although the China-US trade war has been raging, and some of the Group's products have been listed as dutiable items, the revenue of the Group's overseas markets had not been affected at all. The sales volume to the US has not gone down but up, which has fully reflected that the quality of the Group's products is internationally recognised and the Group has gained the trust and support from overseas customers. Therefore, despite the uncertainty in global economic environment, the demand of the customers is still steady.

Product Development Strategy

The Group strives to explore high-end markets to increase profits. After the restructuring of the factory area in Danyang, Jiangsu, the Group is fully committed to develop the powder metallurgy project. The first Powder Metallurgy Institute in Mainland China was established at the end of last year jointly by the Group and China Iron & Steel Research Institute Group. It aims to develop high-quality metal powder products comparable to international advanced level. The Group could enter the high-end market by setting up a powder metallurgy production line to improve the technical level of the Group's products and meet the high specification requirements of aerospace industry and 3D printing etc.

The competition in the high-end market is relatively moderate with fewer competitors. It is conducive to the increase of customers' reliance and the stability of the Group's sales base. By avoiding vicious price competition in the low-end market, the Group would be able to improve the gross profit margin.

With the focus on entering the high-end market, the Group has made efforts to automate its production systems in recent years. Apart from enhancing the precision of products, it also reduces labour cost and speeds up the production process.

Marketing Strategy

The Group has strengthened its direct sales channels to minimise the dependence on distributors used to be in this industry. During the year, the proportion of enterprise customers through direct sales increased. Increasing the direct sales channel would help reduce distribution costs and improve the Group's gross profit margin. Meanwhile, customers would enjoy lower purchase prices. This mutual beneficial cooperation with customers would achieve a win-win situation.

By eliminating the barrier of distributors, the Group could enhance its understanding of customer needs, such as the product specifications and requirements of post-processing. The Group would be able to adjust the products accordingly and ensure that the products would meet market needs. The financial stability of the direct sales customers and their reliance on suppliers are generally higher than distributors. It would be beneficial to the stability of the Group's business environment.

Raw Materials Supply Overview

With the supply-side reform proposed by the PRC government, the overcapacity in rare metals industry has been resolved and small-scale suppliers have been eliminated. By reducing the adverse price competition, the price of rare metals keeps rising steadily. Since the cost of special steel products which rare metals are used as raw material could be passed to customers, the Group would be able to adjust its price and improve the gross margin despite the upward pricing trend of raw materials.

Our Mission

The Group believes that innovation and advancements are the best way to remain competitive and to realise the true value of the Group's businesses.

Last but not least, we re-affirm that maximisation of shareholder value, whilst adhering to the highest standards of corporate governance is always our top priority.

Forward Looking Statements

This management discussion and analysis contains certain forward looking statements with respect to the financial condition, results of operations and business of the Group. These forward looking statements represent the Company's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements.

Forward looking statements involve inherent risks and uncertainties. Readers including shareholders and investors should be cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward looking statement.

Use of Placing Proceeds

The Group invited two strategic investors, BAIC Group Industrial Investment Co., Ltd. and Jiangsu Shagang Group Co., Ltd. to subscribe for an aggregate of 300,000,000 shares. The placing of the 300,000,000 shares was completed on 11 May 2018 with the net proceeds of HK$477.8 million and the proceeds from the placing has been used as follows:

Intended use of proceeds from the placing	Actual use of proceeds (as at 31 December 2018)	Proposed use of the remaining unutilised proceeds (as at 31 December 2018)
(i) Construction of powder metallurgy production facilities	HK$33.1 million was used in acquiring machinery for the metal metallurgy production line	The Group plans to fully utilise the balance of HK$23.6 million for the construction of powder metallurgy production facilities
(ii) Replenishment of Group's working capital to procure raw materials and meet any cashflow requirements that may arise from the daily operations	HK$421.1 million was used as working capital and for daily operation, including payment of electricity, staff salaries and procurement of raw materials	The remaining unutilised proceeds was nil

Liquidity and Financial Resources

As at 31 December 2018, the Group's current assets included cash and cash equivalents of RMB583,235,000, inventories of RMB1,994,287,000, trade and other receivables of RMB2,351,841,000, pledged deposits of RMB464,500,000 and time deposits of RMB717,414,000. As at 31 December 2018, the interest-bearing borrowings of the Group were RMB3,183,779,000 (2017: RMB2,993,292,000), RMB2,284,602,000 of which was repayable within one year and RMB899,177,000 of which was repayable after more than one year. The Group's adjusted net debt-to-equity ratio, which is calculated based on adjusted net debt (defined as total interest-bearing borrowings plus unaccrued proposed dividends, less cash and cash equivalents) divided by adjusted capital (comprising all components of equity, less unaccrued proposed dividends) as at 31 December 2018, was 56.9% (2017: 67.8%).

The increase in borrowings was mainly attributable to the increased cash demand as a result of expansion of production and sales in the DS and HSS segments. As at 31 December 2018, borrowings of RMB2,112,000,000 were in RMB, USD56,705,916 were in USD, EUR66,712,271 were in EUR and HKD181,560,200 were in HKD. The borrowings of the Group were subject to interest payable at rates ranging from 0.90% to 5.22% per annum. There is no seasonality in borrowing requirements of the Group. The Group did not enter into any financial instruments to hedge itself against risks associated with interest rates and foreign currency exchange fluctuations.

During the year, net cash generated from operating activities was RMB810,899,000 (2017: RMB215,006,000). Better utilisation of bills payable enhanced the credit period obtained from the suppliers. The maturity period of the Group's bills payable were six months or twelve months from date of issuance. These lengthened credit periods and better credit control on trade receivables enhanced the net cash generated from operating activities for the year.

Cash Conversion Cycle

The cash conversion cycle, calculated as turnover days over inventory, plus turnover days over trade receivables, minus turnover days of trade payables, attempts to measure the amount of time each net input dollar is tied up in the production and sales process before it is converted into cash through sales to customers. It is important to manufacturers because it measures the efficiency of their capital chain management.

The Group's turnover days of inventory for 2018 was 163 days (2017: 204 days). The relatively long turnover days of inventory is common in the special steel industry due to the complex production process. The improved turnover days of inventory was mainly due to the more effective and efficient control over production cycle and improved technical skills to shorten some specified production processes.

The Group's turnover days of trade receivables for 2018 was 135 days (2017: 144 days). The improved turnover days of trade receivables was mainly due to the strengthened credit control and debts collection policy implemented by the Group during the year.

The Group's turnover days of trade payables for 2018 was 120 days (2017: 113 days). The lengthened turnover days of trade payables was due to the better utilisation of bills for trade payables.

Accordingly, the Group's cash conversion cycle for 2018 was 178 days (2017: 235 days). The improved cash conversion cycle was mainly due to the more effective and efficient control over the inventory production. Please note that the calculation of the aforesaid indexes may not be consistent with those measurement indexes published by other issuers.

Capital Expenditure and Capital Commitments

For 2018, the Group's net increase in property, plant and equipment amounted to RMB76,725,000, which was mainly expenditure on production line of powder metallurgy and were financed by a combination of our internal cash resources, operating cashflows and bank borrowings. As at 31 December 2018, capital commitments were RMB458,597,000 (2017: RMB435,362,000), of which RMB90,265,000 (2017: RMB25,362,000) were contracted for and RMB368,332,000 (2017: RMB410,000,000) were authorised but not contracted for. The majority of the capital commitments related to investment in the production line of powder metallurgy and intelligent facility for cutting tools and will be funded by internal resources and operating cash flows of the Group.

Foreign Exchange Exposure

The Group's revenues were denominated in RMB, USD and EUR, with RMB accounting for the largest portion of 64.7%. 35.3% of total sales and operating profit were subject to exchange rate fluctuations. The Group has put in place measures such as monthly review of product pricing in the light of foreign exchange fluctuations and incentivising overseas customers to settle balances on a more timely basis to minimise the financial impact of exchange rate exposures.

Pledge of Assets

As at 31 December 2018, the Group pledged certain bank deposits amounting to RMB464,500,000 (2017: RMB241,380,000), certain trade receivables amounting to RMB151,780,000 (2017: RMB123,200,000) and other financial assets amounting to nil (2017: RMB73,500,000). The increase in pledged bank deposits was to support the increased banking facilities of the Group for issuance of bank acceptance bills.

Employees' Remuneration and Training

As at 31 December 2018, the Group employed 2,864 employees (2017: 2,951 employees). Total staff costs during the year amounted to RMB268,791,000 (2017: RMB243,619,000). The Group provided employees with remuneration packages comparable to market rates and employees are further rewarded based on their performance according to the framework of the Group's salary, incentives and bonus scheme. In order to enhance the Group's productivity, and further improve the quality of the Group's human resources, the Group provides compulsory continuous training for all of its staff on a regular basis.

Contingent Liabilities

Neither the Group, nor the Company, had any significant contingent liabilities at the end of the reporting period.

FINAL DIVIDEND AND CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed for transfer from 21 May 2019 to 24 May 2019 (both days inclusive), for the purpose of determining shareholders' entitlement to attend and vote at the forthcoming annual general meeting of the Company (the "Annual General Meeting") on 24 May 2019, during which period no transfer of issued shares of the Company will be registered. In order to qualify for attending and voting at the Annual General Meeting, shareholders should ensure that all transfer documents, accompanied by the relevant share certificates, are lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712–1716, 17th Floor, Hopewell Centre, No. 183 Queen's Road East, Wan Chai, Hong Kong, for registration by no later than 4:30 p.m. on 20 May 2019.

The Board has resolved on 18 March 2019 to recommend the payment of a final dividend of RMB0.0357 per share for the year ended 31 December 2018 (2017: RMB0.0378) to shareholders of the Company whose names appear on the register of members of the Company on 29 May 2019. The register of members will be closed from 30 May 2019 to 3 June 2019, both days inclusive, and the proposed final dividend is expected to be paid on or before 14 June 2019. The payment of dividends shall be subject to the approval of the shareholders of the Company at the Annual General Meeting expected to be held on 24 May 2019. In order to qualify for the proposed dividend, shareholders of the Company should ensure that all transfer documents, accompanied by the relevant share certificates, are lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712–1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong, for registration by no later than 4:30 p.m. on 29 May 2019.

SHARE OPTIONS SCHEME

The Company adopted a share option scheme (the "2007 Share Option Scheme") on 7 July 2007.

The 2007 Share Option Scheme expired on 6 July 2017. A total of 35,170,000 shares have been allotted and issued pursuant to the 2007 Share Option Scheme, 34,764,000 options granted under the 2007 Share Option Scheme were cancelled and lapsed and 22,147,000 options granted under the 2007 Share Option Scheme remained outstanding and exercisable until 18 August 2019 according to the terms of grant, notwithstanding the expiry of the 2007 Share Option Scheme. The options were accepted by certain Directors and employees of the Company in respect of their services to the Group. These share options were vested on 19 August 2014 and have an initial exercise price of HKD1.78 per share of USD0.0025 each and an exercise period ranging from 19 August 2014 to 18 August 2019. The closing price of the Company's shares at the date of grant was HKD1.78 per share of USD0.0025 each.

A new share option scheme of the Company was approved by the Company in the Annual General Meeting held on 26 May 2017.

On 11 January 2018, options entitled holders to subscribe for a total of 60,000,000 shares of USD0.0025 each were granted to and accepted by certain Directors, employees and consultants of the Company in respect of their services to the Group. 50% of these share options will be vested on 31 March 2019 if the consolidated audited net profit of the Company for the year ending 31 December 2018 represents an increase of 50% or more as compared to that of the year ended 31 December 2017. The remaining 50% of these share options will be vested on 31 March 2020 if the consolidated audited net profit of the Company for the year ending 31 December 2019 represents an increase of 50% or more as compared to that of the year ended 31 December 2018. All these options have an initial exercise price of HKD1.50 per share of USD0.0025 each and an exercise period commencing from the relevant vesting date and ending on 31 December of the same year as the vesting date. The closing price of the Company's shares at the date of grant was HKD1.29 per share of USD0.0025 each. As there was an increase in audited consolidated net profit of 53.1%, options in relation to 30,000,000 shares will vested on 31 March 2019.

PURCHASE, SALES OR REDEMPTION OF SHARES

During the year ended 31 December 2018, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's shares.

CORPORATE GOVERNANCE

The Company has, so far where applicable, adopted and complied with the principles and code provisions set out in the Corporate Governance Code (the "CG Code") in Appendix 14 of the Listing Rules during the year ended 31 December 2018, except for the following deviation:

Code Provision A.6.7

Code provision A.6.7 of the CG Code stipulates that independent non-executive directors ("INEDs") and other non-executive directors should also attend general meetings. One of the INEDs, Gao Xiang was unable to attend the annual general meeting of the Company held on 14 May 2018 due to health reasons.

AUDIT COMMITTEE

The Audit Committee comprises three INEDs. The Audit Committee held a meeting on 15 March 2019 to consider and review the 2018 annual report and annual financial statements of the Group and to give their opinion and recommendation to the Board. The Audit Committee considered that the 2018 annual report and annual financial statements of the Company have complied with the applicable accounting standards and the Company has made appropriate disclosure thereof.

THE MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS OF LISTED ISSUERS

The Group has adopted a code of conduct governing securities transactions by Directors in compliance with the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix10 of the Listing Rules (the "Model Code"). All of the Directors have confirmed, following specific enquiry by the Company, that they have complied with the required standard set out in the Model Code and the Group's code of conduct governing securities transactions by Directors and employees who may possess or have access to price sensitive information or inside information during the year ended 31 December 2018.

PUBLICATION OF ANNUAL REPORT ON THE STOCK EXCHANGE WEBSITE

The Company's 2018 annual report will be submitted to the Stock Exchange for uploading onto the Stock Exchange's website (www.hkexnews.hk) as well as the Company's website (www.tggj.cn) in due course.

APPRECIATION

The Board would like to take this opportunity to express gratitude to our shareholders, customers, the management and employees for their unreserved support to the Group.

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

Hong Kong, 18 March 2019

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, WANG Xuesong

* *For identification purpose*