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 2019

FINANCIAL HIGHLIGHTS

RMB' million (unless otherwise specified)

	Year ended 31 December 2019	Year ended 31 December 2018 (Restated)	Change
Revenue	**5,369.9**	5,021.5	6.9%
Gross profit	**1,019.7**	864.5	17.9%
Net profit attributable to equity shareholders of the Company	**395.1**	258.8	52.7%
Basic earnings per share *(RMB)*	**0.156**	0.106	47.2%
Gross profit margin	**19.0%**	17.2%	1.8 ppt
Margin of profit attributable to equity shareholders of the Company	**7.4%**	5.2%	2.2 ppt
Net Assets	**5,203.1**	4,823.0	7.9%
Net Debt [(1)]	**1,743.3**	1,418.6	22.9%
Net Gearing [(2)]	**33.5%**	29.4%	4.1 ppt

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 2019 and the consolidated statement of financial position of the Group as at 31 December 2019, together with the comparative figures for the same period of 2018 as follows:

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
For the year ended 31 December 2019

	Note	**2019** **RMB'000**	2018 *RMB'000* (Restated) *(Note)*
Revenue	*4*	**5,369,873**	5,021,546
Cost of sales		**(4,350,214)**	(4,157,004)
Gross profit		**1,019,659**	864,542
Other income	*5*	**55,895**	42,467
Distribution expenses		**(97,554)**	(105,000)
Administrative expenses		**(129,363)**	(132,551)
Research and development expenses		**(259,078)**	(226,539)
Other expenses	*6*	**(1,990)**	(40,755)
Profit from operations		**587,569**	402,164
Finance income		**26,450**	7,233
Finance expenses		**(156,636)**	(142,071)
Net finance costs	*7(a)*	**(130,186)**	(134,838)
Share of (losses)/profits of associates		**(544)**	2,349
Share of (losses)/profits of joint ventures		**(6,468)**	10,893
Profit before taxation	*7*	**450,371**	280,568
Income tax	*8*	**(46,353)**	(13,598)
Profit for the year		**404,018**	266,970
Attributable to:			
Equity shareholders of the Company		**395,146**	258,835
Non-controlling interests		**8,872**	8,135
Profit for the year		**404,018**	266,970
Earnings per share *(RMB)*	*9*		
Basic		**0.156**	0.106
Diluted		**0.155**	0.106

Note: The Group has initially applied IFRS 16 at 1 January 2019 using the modified retrospective approach. Under this approach, the comparative information is not restated. See Note 3(a).

Details of dividends payable to equity shareholders of the Company attributable to the profit for the year are set out in Note 12(b).

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
For the year ended 31 December 2019

	2019	2018
	RMB'000	*RMB'000*
		(Note)
Profit for the year	**404,018**	266,970
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 RMB2,466,000 (2018: RMB841,000)) (non-recycling)	**12,480**	(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 (net of nil tax (2018: nil))	**1,826**	(3,562)
Other comprehensive income for the year	**14,306**	(11,607)
Total comprehensive income for the year	**418,324**	255,363
Attributable to:		
Equity shareholders of the Company	**409,452**	247,228
Non-controlling interests	**8,872**	8,135
Total comprehensive income for the year	**418,324**	255,363

Note: The Group has initially applied IFRS 16 at 1 January 2019 using the modified retrospective approach. Under this approach, the comparative information is not restated. See Note 3(a).

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2019

	Note	2019 RMB'000	2018 RMB'000 (Note)
Non-current assets			
Property, plant and equipment		**3,866,888**	3,597,069
Lease prepayments		**113,353**	93,628
Goodwill		**21,959**	21,959
Interest in associates		**53,466**	51,905
Interest in joint ventures		**27,638**	33,813
Other financial assets		**141,500**	100,024
Deferred tax assets		**37,109**	25,195
		4,261,913	3,923,593
Current assets			
Trading securities		**2,765**	1,482
Inventories		**1,734,664**	1,994,287
Trade and other receivables	*10*	**2,708,618**	2,351,841
Pledged deposits		**610,400**	464,500
Time deposits		**500,000**	717,414
Cash and cash equivalents		**398,017**	583,235
		5,954,464	6,112,759
Current liabilities			
Interest-bearing borrowings		**2,612,845**	2,284,602
Trade and other payables	*11*	**1,600,858**	1,911,451
Current taxation		**28,122**	117
Deferred income		**6,509**	5,279
		4,248,334	4,201,449
Net current assets		**1,706,130**	1,911,310
Total assets less current liabilities		**5,968,043**	5,834,903

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (continued)
As at 31 December 2019

	2019	2018
	RMB'000	*RMB'000*
		(Note)
Non-current liabilities		
Interest-bearing borrowings	**638,888**	899,177
Deferred income	**51,369**	50,498
Deferred tax liabilities	**74,652**	62,268
	764,909	1,011,943
Net assets	**5,203,134**	4,822,960
Capital and reserves		
Share capital	**45,766**	45,242
Reserves	**4,990,581**	4,626,262
Total equity attributable to equity shareholders of the Company	**5,036,347**	4,671,504
Non-controlling interests	**166,787**	151,456
Total equity	**5,203,134**	4,822,960

Note: The Group has initially applied IFRS 16 at 1 January 2019 using the modified retrospective approach. Under this approach, the comparative information is not restated. See Note 3(a).

NOTES

1. REPORTING ENTITY

Tiangong International Company Limited (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 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.

The Company and its subsidiaries are collectively referred to as the "Group".

2. BASIS OF PREPARATION

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"). These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Company. Note 3(a) provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these financial statements.

3. CHANGES IN ACCOUNTING POLICIES AND PRESENTATION AND DISCLOSURES

(a) Changes in accounting policies

The IASB has issued a new IFRS, IFRS 16, Leases, and a number of amendments to IFRSs that are first effective for the current accounting period of the Group.

None of the developments have had a material effect on how the Group's results and financial position for the current or prior periods have been prepared or presented. The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

IFRS 16, Leases

IFRS 16 replaces IAS 17, Leases, and the related interpretations, IFRIC 4, Determining whether an arrangement contains a lease, SIC 15, Operating leases — incentives, and SIC 27, Evaluating the substance of transactions involving the legal form of a lease. It introduces a single accounting model for lessees, which requires a lessee to recognise a right-of-use asset and a lease liability for all leases, except for leases that have a lease term of 12 months or less ("short-term leases") and leases of low-value assets. The lessor accounting requirements are brought forward from IAS 17 substantially unchanged. IFRS 16 also introduces additional qualitative and quantitative disclosure requirements which aim to enable users of the financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.

The Group has initially applied IFRS 16 from 1 January 2019. The Group has elected to use the modified retrospective approach and has therefore recognised the cumulative effect of initial application as an adjustment to the opening balance of equity at 1 January 2019. Comparative information has not been restated and continues to be reported under IAS 17. The adoption of IFRS 16 does not have a significant impact on the Group's results and financial position because the Group does not have material lease contracts.

(b) Changes in presentation and disclosures

The Ministry of Finance of the PRC issued Notice on Revision of the 2018 Illustrative Financial Statements (Caikuai [2018] No.15) and related interpretation in 2018. The PRC subsidiaries of the Group, which compose the majority of operating entities within the Group, have applied this revised regulation and interpretation since 1 January 2018 in their separate financial statements. Caikuai [2018] No.15 requires the presentation of research and development expenses as a separate line item in the statement of profit or loss. In order to provide a more comparable and consistent presentation with other companies in the industry that the Group operates, the Group has adjusted the related presentation in the consolidated financial statements accordingly. The board of directors consider that the revised presentation is more appropriate and relevant to the economic decision making needs of users of the financial statements. The Group has applied such presentation and disclosures retrospectively by restating the comparative figures in the consolidated statement of profit or loss.

Affected items in the consolidated statement of profit or loss for the year ended 31 December 2018:

	For the year ended 31 December 2018		
	Before adjustment	**Adjustment**	**After adjustment**
	RMB'000	*RMB'000*	*RMB'000*
Cost of sales	4,360,619	(203,615)	4,157,004
Administrative expenses	155,475	(22,924)	132,551
Research and development expenses	–	226,539	226,539
Total		–	

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:

	2019	2018
	RMB'000	*RMB'000*
DS	**2,215,337**	2,098,110
HSS	**791,116**	782,015
Cutting tools	**657,094**	581,232
Titanium alloy	**321,709**	245,155
Trading of goods	**1,384,617**	1,315,034
	5,369,873	5,021,546

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 (2018: one customer) with whom transactions have exceeded 10% of the Group's revenue. In 2019 revenue from trading of goods to this customer amounted to RMB1,252,362,000 (2018: RMB1,272,964,000) 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

The Group has applied the practical expedient in paragraph 121 of IFRS 15 to its sales contracts for products such that the above information does not include information about revenue that the Group will be entitled to when it satisfies the remaining performance obligations under the contracts for sales of products that had an original 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 2019 and 2018 is set out below.

	Year ended and as at 31 December 2019					
	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	**2,215,337**	**791,116**	**657,094**	**321,709**	**1,384,617**	**5,369,873**
Inter-segment revenue	**–**	**298,218**	**–**	**–**	**–**	**298,218**
Reportable segment revenue	**2,215,337**	**1,089,334**	**657,094**	**321,709**	**1,384,617**	**5,668,091**
Reportable segment profit (adjusted EBIT)	**335,737**	**190,807**	**94,338**	**41,554**	**591**	**663,027**
Reportable segment assets	**4,395,412**	**2,109,329**	**1,288,469**	**587,360**	**8**	**8,380,578**
Reportable segment liabilities	**1,064,492**	**299,393**	**179,385**	**92,578**	**–**	**1,635,848**

	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) (Restated)	272,394	138,095	60,423	35,743	327	506,982
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

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

	2019	2018
	RMB'000	*RMB'000*
Revenue		
Reportable segment revenue	**5,668,091**	5,264,070
Elimination of inter-segment revenue	**(298,218)**	(242,524)
Consolidated revenue *(Note 4(a))*	**5,369,873**	5,021,546

	2019	2018
	RMB'000	*RMB'000*
		(Restated)
Profit		
Reportable segment profit	**663,027**	506,982
Net finance costs	**(130,186)**	(134,838)
Share of (losses)/profits of associates	**(544)**	2,349
Share of (losses)/profits of joint ventures	**(6,468)**	10,893
Unallocated head office and corporate expenses	**(75,458)**	(104,818)
Consolidated profit before taxation	**450,371**	280,568

	2019	2018
	RMB'000	*RMB'000*
Assets		
Reportable segment assets	**8,380,578**	8,010,481
Interest in associates	**53,466**	51,905
Interest in joint ventures	**27,638**	33,813
Other financial assets	**141,500**	100,024
Deferred tax assets	**37,109**	25,195
Trading securities	**2,765**	1,482
Pledged deposits	**610,400**	464,500
Time deposits	**500,000**	717,414
Cash and cash equivalents	**398,017**	583,235
Unallocated head office and corporate assets	**64,904**	48,303
Consolidated total assets	**10,216,377**	10,036,352

	2019	2018
	RMB'000	*RMB'000*
Liabilities		
Reportable segment liabilities	**1,635,848**	1,942,422
Interest-bearing borrowings	**3,251,733**	3,183,779
Current taxation	**28,122**	117
Deferred tax liabilities	**74,652**	62,268
Unallocated head office and corporate liabilities	**22,888**	24,806
Consolidated total liabilities	**5,013,243**	5,213,392

(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.

	2019	2018
	RMB'000	*RMB'000*
Revenue		
The PRC	**3,526,131**	3,249,457
North America	**587,652**	548,031
Europe	**899,628**	882,839
Asia (other than the PRC)	**319,424**	299,530
Others	**37,038**	41,689
Total	**5,369,873**	5,021,546

5 OTHER INCOME

		2019	2018
	Note	***RMB'000***	*RMB'000*
Government grants	*(i)*	**29,577**	33,270
Sales of scrap materials		**2,063**	3,239
Reversal of loss allowance for trade receivables		**11,973**	–
Net foreign exchange gains		**923**	–
Dividend income from listed securities	*(ii)*	**4,200**	1,800
Unrealised fair value changes of financial asset measured at fair value through profit or loss		**6,530**	–
Net gain on disposal of property, plant and equipment		**–**	1,639
Others		**629**	2,519
		55,895	42,467

(i) The subsidiaries of the Group, including Jiangsu Tiangong Tools Company Limited ("TG Tools") and Jiangsu Tiangong Technology Company Limited ("TG Tech"), located in the PRC, collectively received unconditional grants amounting to RMB24,298,000 (2018: RMB27,771,000) 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 RMB5,279,000 (2018: RMB5,499,000) during the year ended 31 December 2019.

(ii) The Group received dividends totalling RMB4,200,000 (2018: RMB1,800,000) from listed equity investments.

6 OTHER EXPENSES

	2019 RMB'000	2018 RMB'000
Provision of loss allowance for trade receivables	–	35,374
Net loss on disposal of property, plant and equipment	217	–
Net foreign exchange losses	–	2,471
Charitable donations	676	1,317
Net realised and unrealised losses on trading securities	420	947
Others	677	646
	1,990	40,755

7 PROFIT BEFORE TAXATION

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

(a) Net finance costs

	2019 RMB'000	2018 RMB'000
Interest income	(26,450)	(7,233)
Finance income	(26,450)	(7,233)
Interest on bank loans	181,904	171,386
Less: interest expense capitalised into property, plant and equipment under construction*	(25,268)	(29,315)
Finance expenses	156,636	142,071
Net finance costs	(130,186)	134,838

* The borrowing costs have been capitalised at a rate of 5.00% per annum (2018: 5.11%).

(b) Staff costs

	2019 RMB'000	2018 RMB'000
Salaries, wages and other benefits	239,735	224,866
Contributions to defined contribution retirement plans	36,101	33,862
Equity-settled share-based payment expenses	4,258	10,063
	280,094	268,791

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

	2019	2018
	RMB'000	*RMB'000*
		(Restated)
Cost of inventories*	**4,350,214**	4,157,004
Depreciation of property, plant and equipment	**239,555**	225,673
Depreciation of lease prepayments (right-of-use assets)#	**2,843**	1,854
(Reversal)/provision of loss allowance for trade receivables	**(11,973)**	35,374
Provision of write-down of inventories	**6,747**	1,002
Total minimum lease payments for leases previously classified as operating leases under IAS 17#	**–**	1,059
Auditor's remuneration		
— audit services	**2,650**	2,650

* Cost of inventories includes RMB369,374,000 (2018: RMB331,580,000 (restated)) 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.

\# The Group has initially applied IFRS 16 using the modified retrospective approach. After initial recognition of right-of-use assets at 1 January 2019, the Group as a lessee is required to recognise the depreciation of right-of-use assets, instead of the previous policy of recognising expenses incurred under operating leases on a straight-line basis over the lease term. Under this approach, the comparative information is not restated. See Note 3(a).

8 INCOME TAX IN THE CONSOLIDATED STATEMENT OF PROFIT OR LOSS

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

	2019	2018
	RMB'000	*RMB'000*
Current tax		
Provision for PRC taxes	**46,489**	3,199
Provision for Hong Kong Profits Tax	**1,860**	245
	48,349	3,444
Deferred tax		
Origination and reversal of temporary differences	**(1,996)**	10,154
	46,353	13,598

(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, Tiangong Aihe Company Limited ("TG Aihe") and TG Tech are subject to a preferential income tax rate of 15% in 2019 available to enterprises which qualify as a High and New Technology Enterprise (2018: 15%).

The statutory corporate income tax rate applicable to the Group's other operating subsidiaries in the PRC is 25% (2018: 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% (2018: 16.5%) on the estimated assessable profits arising in Hong Kong for the year ended 31 December 2019.

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

	2019	2018
	RMB'000	*RMB'000*
Profit before taxation	**450,371**	280,568
Notional tax on profit before taxation, calculated using the PRC statutory tax rate of 25% (2018: 25%)	**112,593**	70,142
Effect of preferential tax rates	**(44,004)**	(16,601)
Effect of different tax rates	**1,302**	(1,872)
Tax effect of unused tax losses not recognised	**3,139**	–
Tax effect of non-deductible expenses	**1,993**	1,075
Tax effect of non-taxable income	**(865)**	(3,586)
Provision/(refund) of withholding tax on dividends	**4,000**	(22,222)
Tax effect of bonus deduction for research and development expenses	**(24,849)**	(13,670)
(Over)/under-provision in respect of prior year	**(6,956)**	332
Actual tax expense	**46,353**	13,598

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 RMB395,146,000 (2018: RMB258,835,000) and the weighted average of 2,539,417,170 ordinary shares (2018: 2,431,907,143 ordinary shares) in issue during the year:

Weighted average number of ordinary shares

	2019	2018
Issued ordinary shares at 1 January	**2,539,050,000**	2,239,050,000
Effect of share allotment	**–**	192,857,143
Effect of exercise of share options	**367,170**	–
Weighted average number of ordinary shares at 31 December	**2,539,417,170**	2,431,907,143

(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 RMB395,146,000 (2018: RMB258,835,000) and the weighted average number of ordinary shares of 2,549,626,341 shares (2018: 2,435,421,765 shares), calculated as follows:

Weighted average number of ordinary shares (diluted)

	2019	2018
Weighted average number of ordinary shares at 31 December	**2,539,417,170**	2,431,907,143
Effect of equity settled share-based transactions	**10,209,171**	3,514,622
Weighted average number of ordinary shares (diluted) at 31 December	**2,549,626,341**	2,435,421,765

10 TRADE AND OTHER RECEIVABLES

	2019	2018
	RMB'000	*RMB'000*
Trade receivables	**1,305,225**	1,193,506
Bills receivables	**948,981**	911,473
Less: loss allowance	**(93,710)**	(105,868)
Net trade and bills receivables	**2,160,496**	1,999,111
Prepayments	**408,771**	250,879
Non-trade receivables	**139,351**	101,851
Less: loss allowance	**–**	–
Net prepayments and non-trade receivables	**548,122**	352,730
	2,708,618	2,351,841

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

The bills receivables held by the Group are achieved by both collecting contractual cash flows and selling financial assets, which are measured at fair value through other comprehensive income.

Trade receivables of RMB107,037,000 (2018: RMB151,780,000) 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:

	2019	2018
	RMB'000	*RMB'000*
Within 3 months	**1,606,362**	1,592,295
4 to 6 months	**238,911**	177,310
7 to 12 months	**213,164**	52,609
1 to 2 years	**100,158**	152,084
Over 2 years	**1,901**	24,813
	2,160,496	1,999,111

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

(b) Loss allowance of trade receivables

The Group measures loss allowance for trade receivables at an amount equal to lifetime expected credit losses ("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.

	2019		
	Expected loss rate	**Gross carrying amount**	**Loss allowance**
	%	***RMB'000***	***RMB'000***
Current (not past due)	**1.0%**	**663,841**	**6,461**
1–3 months past due	**4.2%**	**249,281**	**10,370**
4–6 months past due	**7.4%**	**175,082**	**12,966**
7–12 months past due	**10.1%**	**74,562**	**7,523**
1–2 years past due	**19.4%**	**106,805**	**20,736**
More than 2 years past due	**100.0%**	**35,654**	**35,654**
		1,305,225	**93,710**

	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	100.0%	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:

	2019	2018
	RMB'000	*RMB'000*
Balance at 1 January	**105,868**	73,230
Amounts written-off during the year	**(185)**	(2,736)
Loss allowance (reversed)/recognised during the year	**(11,973)**	35,374
Balance at 31 December	**93,710**	105,868

11 TRADE AND OTHER PAYABLES

	2019	2018
	RMB'000	*RMB'000*
Trade and bills payables	**1,370,633**	1,740,593
Contract liabilities	**87,694**	32,434
Non-trade payables and accrued expenses	**142,531**	138,424
	1,600,858	1,911,451

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

	2019	2018
	RMB'000	*RMB'000*
Within 3 months	**750,743**	1,022,521
4 to 6 months	**434,420**	375,682
7 to 12 months	**128,327**	291,150
1 to 2 years	**22,191**	19,427
Over 2 years	**34,952**	31,813
	1,370,633	1,740,593

12 DIVIDENDS

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

	2019	2018
	RMB'000	*RMB'000*
Dividend proposed after the end of the reporting period of RMB0.0545 per ordinary share (2018; RMB0.0357 per ordinary share)	**138,301**	90,592

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

	2019	2018
	RMB'000	*RMB'000*
Dividend in respect of the previous financial year, approved and paid during the year of RMB0.0357 per ordinary share (2018: RMB0.0378 per ordinary share)	**90,684**	100,183

In respect of the final dividend for the year ended 31 December 2018, there is a difference of RMB92,000 (2017: RMB15,633,000) between the final dividend disclosed in the 2018 annual financial statements and amounts approved and paid during the year, which is mainly due to the RMB/HKD exchange rate difference between the fixed middle average exchange rate on the date of the 2018 annual result announcement and the actual exchange rate applied on the date of payment.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

	For the year ended 31 December					
	2019		2018		Change	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*
DS	**2,215,337**	**41.3**	2,098,110	41.8	117,227	5.6
HSS	**791,116**	**14.7**	782,015	15.6	9,101	1.2
Cutting tools	**657,094**	**12.2**	581,232	11.5	75,862	13.1
Titanium alloy	**321,709**	**6.0**	245,155	4.9	76,554	31.2
Trading of goods	**1,384,617**	**25.8**	1,315,034	26.2	69,583	5.3
	5,369,873	**100.0**	5,021,546	100.0	348,327	6.9

DS — accounted for 41.3% of the Group's revenue in FY 2019

	For the year ended 31 December					
	2019		2018		Change	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*
DS						
Domestic	**1,079,521**	**48.7**	944,542	45.0	134,979	14.3
Export	**1,135,816**	**51.3**	1,153,568	55.0	(17,752)	(1.5)
	2,215,337	**100.0**	2,098,110	100.0	117,227	5.6

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.

Revenue generated from DS segment increased to RMB2,215,337,000 (2018: RMB2,098,110,000). Overall increase of 5.6% in revenue of DS segment was attributable to strong market demand in both domestic and overseas markets. Overall sales volume increased by 14.1% due to higher recognition of the Group's products. Nevertheless, average cost of rare metals, which were used as raw materials by the Group, decreased slightly. As a result of the reduction in cost of rare metals, the Group was able to reduce its selling price of DS and therefore the average selling price decreased by 7.5% compared to 2018.

Thanked to the high recognition and reliance on the quality of Group's products by local customers, domestic revenue increased sharply by 14.3%. Domestic sales volume increased significantly by 26.1%, while the average selling price decreased by 9.3% due to the reduced price of rare metals, our major raw materials used in the production.

Compared to the domestic market, overseas markets were relatively steady. Export sales volume increased by 2.5% while average selling price decreased by 3.9%. Overall, the export revenue slightly decreased by 1.5%.

HSS — accounted for 14.7% of the Group's revenue in FY 2019

	For the year ended 31 December					
	2019		2018		Change	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*
HSS						
Domestic	**513,163**	**64.9**	527,517	67.5	(14,354)	(2.7)
Export	**277,953**	**35.1**	254,498	32.5	23,455	9.2
	791,116	**100.0**	782,015	100.0	9,101	1.2

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.

Total sales volume and average selling price were persisted, with movement of less than 1.2%. Accordingly, revenue generated by the HSS segment remained relatively stable at RMB791,116,000 (2018: RMB782,015,000).

In the domestic market, the Group shifted the focus from low-alloyed HSS products to high-alloyed HSS products. Products made with high-alloyed HSS are generally more durable and sold at higher average selling price. With this change in product focus, domestic sales volume decreased by 4.2%, while the average selling price increased by 1.5%. Overall domestic revenue decreased by 2.7%.

In overseas markets, acceptance of the Group's products continued to increase. Export sales volume recorded an increase of 13.7%. Customers of overseas markets favour HSS products with higher composition of rare metals. Due to the reduced price of tungsten in 2019, one of the rare metals specifically used in production of HSS, the average selling price of export sales decreased by 3.9%. Combining both effects, export revenue increased by 9.2%.

Cutting tools — accounted for 12.2% of the Group's revenue in FY 2019

	For the year ended 31 December					
	2019		2018		Change	
	RMB'000	***%***	*RMB'000*	*%*	*RMB'000*	*%*
Cutting tools						
Domestic	**229,192**	**34.9**	219,871	37.8	9,321	4.2
Export	**427,902**	**65.1**	361,361	62.2	66,541	18.4
	657,094	**100.0**	581,232	100.0	75,862	13.1

The 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.

Since 2018, the Group has adopted a policy to avoid any unnecessary price wars with other small scale production companies in the domestic lower-end market. In 2019, the Group continued to focus more on middle-end products in both domestic and overseas markets, which the market environment was less competitive. This has resulted in a reduction in the overall sales volume, but at the same time, an increase in average selling prices.

Overall sales volume of cutting tools products decreased by 13.4%, while the average selling price increased by 30.6%. Revenue of the cutting tools segment consequently increased by 13.1% to RMB657,094,000 (2018: RMB581,232,000).

In the domestic market, the change in policy resulted in a decrease of 20.1% in domestic sales volume. On the other hand, the concentration on middle-end products resulted an increase of 30.5% in average selling price. The policy change successfully brought a 4.2% increase in domestic revenue.

The export business of cutting tools outperformed domestic business. With increased recognition of quality and reliability by overseas customers, orders of one of our major competitors, who was mainly engaged in OEM production of cutting tools for foreign famous brands, were considerably absorbed by the Group. As a result, notwithstanding the change in marketing policy, export sales volume only decreased by 10.3%. With a significant increase of 32.1% in average selling price, export revenue increased by 18.4%.

Titanium alloy — accounted for 6.0% of the Group's revenue in FY 2019

	For the year ended 31 December					
	2019		2018		Change	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*
Titanium alloy						
Domestic	**319,638**	**99.4**	242,492	98.9	**77,146**	**31.8**
Export	**2,071**	**0.6**	2,662	1.1	**(591)**	**(22.2)**
	321,709	**100.0**	245,155	100.0	**76,554**	**31.2**

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.

Tightened environmental requirements have stimulated demand of titanium pipes and containers in chemical industry. Also, the expansion of new customers in 2019 resulted in an overall increase of 16.2% in sales volume. Average selling price of titanium alloy products also increased by 13.0% due to the increased price of titanium sponge, a major raw material. As a result, a significant increase in revenue by 31.2% to RMB321,709,000 (2018: RMB245,155,000) was achieved.

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 52.7% from RMB258,835,000 in 2018 to RMB395,146,000 in 2019. The increase was mainly attributable to (i) the production costs of our four major segments were reduced through the Group's innovative research and development efforts, thereby increased the proportion of higher-end products with higher gross margin; and (ii) the Group has been actively developing various sales channels to increase the proportion of direct sales, where an improvement in profitability was shown.

Revenue

Revenue of the Group for 2019 totalled RMB5,369,873,000, representing an increase of 6.9% as compared with RMB5,021,546,000 in 2018. All the segments of the Group experienced an increase in revenue compared to the prior year.

Cost of sales

The Group's cost of sales was RMB4,350,214,000 in 2019, representing an increase of 4.6% as compared with RMB4,157,004,000 (restated) in 2018, as a result of the increase in sales.

Gross margin

For 2019, the overall gross margin was 19.0% (2018: 17.2% (restated)). Set out below is the gross margin of our five segments in 2019 and 2018:

	2019	2018 (Restated)
DS	**25.9%**	24.5%
HSS	**25.0%**	21.4%
Cutting tools	**16.3%**	13.9%
Titanium alloy	**20.3%**	20.6%
Trading of goods	**0.04%**	0.02%

DS

The gross margin of DS increased from 24.5% (restated) in 2018 to 25.9% in 2019. The Group continuously devoted in development of the direct sales channel. These efforts have started to be realised a in 2019, which allowed the Group to enjoy an improved gross margin.

HSS

The gross margin of HSS increased from 21.4% (restated) in 2018 to 25.0% in 2019. A shift from low-alloyed HSS products focus to high-alloyed HSS products focus resulted in a higher gross margin and profitability to the Group.

Cutting tools

With a change in the Group's marketing policy, focusing more on middle-end products, this has increased the profitability of the cutting tools segment. The gross margin of cutting tools increased from 13.9% (restated) in 2018 to 16.3% in 2019.

Titanium alloy

The sales product mix was similar in both 2018 and 2019. The titanium alloy segment retained a stable gross margin of 20.3% in 2019 (2018: 20.6% (restated)).

Trading of goods

The gross margin of this segment remained stable at 0.04% (2018: 0.02%).

Other income

Other income increased from RMB42,467,000 in 2018 to RMB55,895,000 in 2019. The main reason for the increase were (i) fair value gain recorded for newly invested unlisted investment fund; and (ii) reversal of loss allowance on trade receivable after recovering domestic receivables aged between 1-2 years.

Distribution expenses

Distribution expenses in 2019 were RMB97,554,000 (2018: RMB105,000,000), representing a decrease of 7.1%. The decrease was mainly due to one-off marketing and advertising campaign expenses incurred in 2018. For 2019, distribution expenses as a percentage of revenue was 1.8% (2018: 2.1%).

Administrative expenses

Administrative expenses decreased from RMB132,551,000 (restated) in 2018 to RMB129,363,000 in 2019. The decrease was mainly attributable to the cost allocation of the share option scheme. According to the vesting period of the 60,000,000 share options granted in 2018, a larger portion of the cost of the share option scheme was incurred in 2018. The effect was partially offset by the one-off land appreciation tax incurred for the transfer of land and buildings within the Group. For 2019, administrative expenses as a percentage of revenue was 2.4% (2018 Restated: 2.6%).

Other expenses

Other expenses decreased significantly from RMB40,755,000 in 2018 to RMB1,990,000 in 2019.

As at 31 December 2018, substantial part of the other expenses was the expected credit loss provision on trade receivables. Significant amount of receivables was classified to age with 1-2 years according to their actual time of outstanding. A much higher expected credit loss provision was considered for receivables with 1-2 years aging comparing to its precedent of 7-12 months. Together with other necessary provision, a total of RMB35,374,000 expected credit loss was recognised in the other expenses in 2018.

Major part of these long aged receivables was recovered during 2019. In addition, average aging of trade receivables was more recent comparing to that of 2018. Therefore, expected credit loss provision decreased in current year.

Net finance costs

The Group's finance income was RMB26,450,000 in 2019, representing an increase of RMB19,217,000. With the increased free cash balance, the Group invested in more time deposit during 2019 to capture a higher interest return. The Group's finance expense was RMB156,636,000 in 2019, representing an increase of 10% from RMB142,071,000 in 2018. The increase was due to 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 increased by 241% from RMB13,598,000 in 2018 to RMB46,353,000 in 2019. The increase was the combined effect of (i) increase in taxable operating profit of the Group in 2019; and (ii) one-off withholding tax refund was received in 2018 for reinvesting dividends distribution of one of the Group's PRC subsidiaries by foreign intermediate holding companies.

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 52.7% from RMB258,835,000 in 2018 to RMB395,146,000 in 2019. The margin of profit attributable to equity shareholders of the Company increased from 5.2% in 2018 to 7.4% in 2019.

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

For 2019, total comprehensive income for the year attributable to equity shareholders of the Company was RMB409,452,000 (2018: RMB247,228,000) after taking into account foreign currency translation differences and fair value adjustments on equity investments.

During the year, the Group credited to other comprehensive income a foreign currency translation difference of RMB1,826,000 (2018: debited RMB3,562,000) related to translation of financial statements of Hong Kong subsidiaries and overseas equity accounted investees.

The Group also recognised a fair value gain in the consolidated statement of profit or loss and other comprehensive income of RMB12,480,000 (2018: loss of RMB8,045,000) 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., JM Digital Steel Inc. and Jinan Financial Fosun Weishi Equity Investment Fund. All of these investments were stated at their fair value as at 31 December 2019. The total fair value gain, net of tax, of RMB4,897,000 was recorded in other income (2018: nil) and RMB12,480,000 (2018: loss of RMB8,045,000) was recorded in other comprehensive income during the year.

Trade and bills receivables

Trade and bills receivables increased from RMB1,999,111,000 in 2018 to RMB2,160,496,000 in 2019, which was mainly due to the expansion of sales. During the year, loss allowance of trade receivables decreased by RMB12,158,000, after recovering aged (between 1-2 years) domestic receivables during 2019. The relevant recognised expected credit loss allowance was reversed accordingly.

INDUSTRY REVIEW

In 2019, China's economy ran stably and showed positive signs despite the slowdown of global economic growth. Supply-side reform in the country continued to deepen, driving the economy towards higher-quality development. According to data released by the National Bureau of Statistics, China's GDP increased by 6.1% to hit RMB99.0865 trillion in 2019. National value-added by industrial enterprises above designated size increased by 5.7% over the previous year. Among such firms, those in high-tech manufacturing and strategic emerging industries registered an industrial value-added growth of 8.8% and 8.4% respectively, much higher than the average value-added by industrial enterprises above designated size.

During four years of supply-side reform, the supply structure of the iron and steel industry has undergone constant optimisation. The output of special steel in China has gradually increased. However, special steel still accounts for a low proportion of the country's total steel output. According to monitoring data from LANGE, China's major special steel companies produced about 140 million tonnes of crude special steel in 2019, increased by 6.78% than that of 2018. The output of non-alloy steel increased by 8.44% to 53.34 million tonnes, as compared to 2018. The output of low-alloy steel increased by 11.10% to 48.82 million tonnes than that of 2018. The output of high value-added alloy steel was about 34.09 million tonnes, which increased by 0.13% year-on-year and accounting for only 23.94% of the output of crude special steel from major special steel companies. Statistics show that crude special steel from China's major special steel companies accounted for only 14.29% of the country's total output of crude steel in 2019, far below the level of more than 20% in developed countries such as Japan and Germany, which creates a huge demand for imports. In addition, the output of alloy steel made up only 3.24% of the country's total output of crude steel, while the downstream demand from the likes of the defense industry and high-tech industries kept rising, which resulted in a heavy reliance on imports. There is substantial room for import substitution for China's special steel products, especially the high-end special steel products.

The effort to address overcapacity in the iron and steel industry has shifted the focus and entered a new stage of structural de-overcapacity and systematic optimization, intended to boost quality and efficiency across the industry. Special steel is a determinant factor for the high-quality development of the iron and steel industry. It also represents the direction for the industry development in the future. However, the concentration of China's special steel sector is still relatively low, which necessitates further optimisation of the industrial structure. According to data from the Special Steel Association, the top five special steel producers in China constitute about 35% of the country's total output of special steel, whereas this percentage is over 70% in developed industrial countries. As an important measure of a country's manufacturing strength, special steel products are widely used in high-end equipment manufacturing and strategic emerging industries. They play an extremely important role in transforming and upgrading China's manufacturing industry. Amid increased uncertainty in global trade, the accelerating effort to substitute domestic special steel products, especially the high-end types, for imports has gradually become a clear trend, which spells opportunity for the rapid development of the special steel sector.

Meanwhile, against the backdrop of transforming China's manufacturing industry and speeding up high-quality development, the government has frequently released favorable policies to support the development of special steel sector. In 2015, the State Council launched the Made in China 2025 strategy, which pushed the endeavor to make a manufacturing power of the country into full swing. Under the banner of Made in China 2025, the government came up with a series of measures to promote the development of new materials, including special steel, from the perspectives of both institutional arrangements and industry policies. In 2018, 39 types of advanced iron and steel materials, including high-performance DS and HSS, were added to the national catalog of new material industries in the Categorization of Strategic Emerging Industries (2018), issued by the National Bureau of Statistics. In October 2019, the National Development and Reform Commission released a revised edition of the Guiding Catalog for Industrial Restructuring (2019), which lists high-performance DS and HSS and high-purity, high-quality alloy powder as government-encouraged products, giving renewed prominence to the importance of special steel. A meeting convened by the Political Bureau of the CPC Central Committee in December 2019 once again stressed the need to speed up the construction of a modern economic system and promote the high-quality development of the manufacturing industry. As China's manufacturing industry enters the stage of high-quality development, the demand for medium and high-end special steel, including the Group's DS and HSS products will be pushed up, and the special steel sector which has tremendous growth potential, will receive more prominent status.

MARKET REVIEW

In 2019, global economic growth slowed down, and global trade got mired in more uncertainty. Despite all this, the replacement of old growth drivers with new ones in China was picking up speed, and the country's industrial economy was still running stably within the reasonable range. The growth rate of industrial investments experienced a steady increase, and the consumption of industrial products continued a streak of stable growth. The Group's main products are DS, HSS, cutting tools, and titanium alloys. DS is renowned as the "mother of industry", and cutting tools are nicknamed the "teeth" of industrial machine tools. These products provide strong support for the stable development of industry and have gained a stable foothold in the market.

Market Position

With a development strategy of transforming the high-end product market and enhancing core competitiveness with diversified products, the Group has pulled off steady sales growth in business of DS and titanium alloys, which has driven up the overall performance. According to the latest report from Steel and Metals Market Research, which is the world's authoritative market research institute for iron, steel, and metal products, the Group's output of DS, HSS of about 175 thousand tonnes, moving from third place to second place in the rankings for DS and HSS companies around the globe. The Group's annual capacity of HSS products has been the highest around the world for 14 consecutive years and the highest in China for 21 consecutive years.

Achievement

The Group's unique products and leading market position across the world have won it multiple honors in the industry and the capital market. We received the Award for the Most Investment-worthy Company in 2019 China Financing Awards, organised by cn "China Financial Market", a well-known financial magazine. TG Tech received a BS EN ISO 9001:2015/EN9100:2018 aviation quality management system certificate from the world-famous inspection and certification body Bureau Veritas. The Group's project of developing and applying key technologies for high-quality DS was awarded the first prize for metallurgy by China Iron and Steel Association, the Chinese Society for Metals, and the Award Committee for Metallurgical Technologies. The Group's DS, HSS and cutting tools received the certificate of China's Trusted-quality Product from China Association for Quality Inspection, and the Group received the certificate for China's Leading Brand of Metal Processing from the same association and the Awards for Zhenjiang Mayor Quality Award from by the Zhenjiang Municipal Government. On 9 March 2020, the Group became a constituent component of the Hang Seng Composite Index, given the Company has not increased its share capital (except share option scheme) in the past 12 months to increase its market capitalisation, this indicated that the Company's development has been recognised by the capital market.

OUTLOOK

Domestic Operating environment

The special steel sector will remain under pressure for the near future amid the double whammy of the Coronavirus disease (COVID-19) outbreak and international trade tensions. Faced with the outbreak, the Group promptly put in place targeted preventive measures and established an emergency response steering Group to take concrete actions and minimise the impact of the outbreak. In fact, the Group's supply chain is extremely flexible, while Hubei accounts for less than 0.1% of supply and sales. Therefore, the ratio of the Group's employees could not return to work because of the outbreak is below 1%. The Group has quickly recovered capacity. 100% of the employees at the headquarters in Zhenjiang have resumed work, with all production lines running fully loaded as at 20 March 2020. So the Coronavirus disease (COVID-19) coronavirus outbreak has had little impact on the Group.

China's manufacturing industry is in an important period of transitioning from medium and low-end to high-end, and the demand for special steel is large. After the Coronavirus disease (COVID-19) outbreak is contained, the government is expected to intensify its counter-cyclical adjustments. Therefore, the future of the special steel sector is still promising. The Coronavirus disease (COVID-19) outbreak will cause a tight supply of rare metals and a rise in their prices for the near future. The Group can pass on the increased cost of rare metal, which was used as raw material of the special steel products, to customers, and therefore the gross profit margin is relatively controllable. In addition, the constantly favorable prices of raw materials will contribute to the Group's overall revenue, which is conducive to the expansion of the Group's business.

In January 2020, it was clearly pointed out at an executive meeting of the State Council that great efforts should be made to improve the business environment and that tax relief and fee reductions focused on manufacturing should remain in place. The Group is expected to continue benefiting from these policy tailwinds.

Overseas expansion strategy

The Group is actively deploying capacity overseas. Its first overseas highly automated cutting tool factory in Thailand, which is expected to start operating in September 2020. That will boost the Group's capacity and efficiency. In addition, the Group has continuously expanded overseas markets and has established jointly controlled/associated sales companies in many countries and territories. TG Special Steel Co., Ltd, the Group's first self-operated sales subsidiary company was formally founded in 2019. Driven by its integrated approach to global production and marketing, the Group will further expand its market share and reduce the uncertainty caused by trade frictions.

Also, the Group will keep searching for acquisition targets in the new material field overseas to provide strong support for steady performance improvements over the long run.

Product development strategy

In recent years, the Group has been committed to explore the market of high-end new materials, aiming to enhance competitiveness in the industry. The Group has made an investment in China's first production line of powder metallurgy for DS and HSS and the first phase of the project was put into operation in November 2019 in order to fill the gap in the domestic market. Construction for the second phase of the project will start depending on the future situation. With solid technical support from China's first research institute of powder metallurgy established by the Group and China Iron & Steel Research Institute Group, the production line of powder metallurgy will help the Group promote competitiveness in the international high-end product market and gradually achieve the transformation from subtractive manufacturing to additive manufacturing (such as 3D printing etc).

Market Strategy

The Group is a world-leading manufacturer of high-end new materials, and its main products are widely used in various industries, such as aviation, automobiles, high-speed trains, and petrochemicals. Our products sell well in Europe, the US, and Asia and have won trust and support from customers. Their bright market prospects will push the Group's market share to a higher level. Meanwhile, the Group is shifting the market focus to the medium and high-end products in order to prevent unnecessary price wars, enhance customer stickiness, and ensure stable profits.

Marketing Strategy

The Group will keep working to increase the proportion of direct sales, gain a better understand of customer needs, and provide high-quality products that are more in line with market demand. It will strive to establish mutually beneficial cooperation relations with customers and further enhance customer stickiness, which will bring about steady performance growth. Considering the rapid development of e-commerce, the Group will develop diversified sales channels via Alibaba, Amazon, eBay, JD and Tmall etc. That entails expanding and strengthening the Group's online sales channels, which will lead to additional sales gains.

In order to implement the vision of globally development with high quality and growth rate, which can be summarised as 'China Tiangong, World-wide Sharing', the Group will promote the overseas production capacity layout and accelerate the development of high-end new materials market. The Group will constantly enhance competitiveness in the industry and boost operating efficiency, which will improve profitability and create more value for shareholders.

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$477,800,000.

The proceeds from the placing was fully utilised by 30 June 2019. For details, please refer to the Company's interim report 2019.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2019, the Group's current assets included cash and cash equivalents of RMB398,017,000, inventories of RMB1,734,664,000, trade and other receivables of RMB2,708,618,000, pledged deposits of RMB610,400,000 and time deposits of RMB500,000,000. As at 31 December 2019, the interest-bearing borrowings of the Group were RMB3,251,733,000 (2018: RMB3,183,779,000), RMB2,612,845,000 of which was repayable within one year and RMB638,888,000 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 2019, was 59.1% (2018: 56.9%).

The increase in borrowings was mainly attributable to the increased cash demand as a result of expansion of production and sales of the Group. As at 31 December 2019, borrowings of RMB1,913,000,000 were in RMB, USD99,437,074 were in USD, EUR65,140,227 were in EUR and HKD151,615,227 were in HKD. The borrowings of the Group were subject to interest payable at rates ranging from 0.70% 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 RMB398,666,000 (2018: RMB810,899,000). The decrease was mainly attributable to: (i) increased proportion of sales during second half of 2019, especially close the third quarter of the year, which in turns, led to an increase in trade receivables balance; and (ii) increased prepayment for raw and auxiliary materials, which was used to secure the production supplies to deal with the increased demand.

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 2019 was 156 days (2018: 171 days (restated)). 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 2019 was 141 days (2018: 135 days). The lengthened turnover days of trade receivables was mainly due to the proportion of sales during second half of 2019 increased.

The Group's turnover days of trade payables for 2019 was 131 days (2018: 126 days (restated)). 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 2019 was 166 days (2018: 180 days (restated)). The improved cash conversion cycle was mainly due to the more effective and efficient control over the inventory production and optimisation of the production processes. It should be noted 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 2019, the Group's net increase in property, plant and equipment amounted to RMB269,819,000, which was mainly due to 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 2019, capital commitments were RMB350,787,000 (2018: RMB458,597,000), of which RMB92,792,000 (2018: RMB90,265,000) were contracted for and RMB257,995,000 (2018: RMB368,332,000) were authorised but not contracted for. The majority of the capital commitments related to investment in the production line of powder metallurgy and medium frequency induction furnace construction 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 65.7%. 34.3% 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 2019, the Group pledged certain bank deposits amounting to RMB610,400,000 (2018: RMB464,500,000) and certain trade receivables amounting to RMB107,037,000 (2018: RMB151,780,000). 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 2019, the Group employed 2,817 employees (2018: 2,864 employees). Total staff costs during the year amounted to RMB280,094,000 (2018: RMB268,791,000). 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 25 May 2020 to 28 May 2020 (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 28 May 2020, 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 22 May 2020.

The Board has resolved on 20 March 2020 to recommend the payment of a final dividend of RMB0.0545 per share for the year ended 31 December 2019 (2018: RMB0.0357) to shareholders of the Company whose names appear on the register of members of the Company on 5 June 2020. The register of members will be closed from 8 June 2020 to 11 June 2020, both days inclusive, and the proposed final dividend is expected to be paid on or before 24 July 2020. 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 28 May 2020. 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 5 June 2020.

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, 56,911,000 options granted under the 2007 Share Option Scheme were cancelled and lapsed and no options granted under the 2007 Share Option Scheme remained outstanding and exercisable.

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 would be vested on 31 March 2019 if the consolidated audited net profit of the Company for the year ending 31 December 2018 represented 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.

Among these 60,000,000 share options, 30,000,000 share options were vested on 31 March 2019. All share options for 30,000,000 shares were exercised between 29 August 2019 to 27 December 2019.

As there was an increase in audited consolidated net profit of 52.7% for the year ended 31 December 2019 as compared to that of 2018, options in relation to the remaining 30,000,000 shares will be vested on 31 March 2020.

PURCHASE, SALES OR REDEMPTION OF SHARES

During the year ended 31 December 2019, 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 2019, 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. Two of the INEDs, Mr. Gao Xiang and Mr. Lee Cheuk Yin, Dannis were unable to attend the annual general meeting of the Company held on 24 May 2019 due to business engagement.

AUDIT COMMITTEE

The Audit Committee comprises three INEDs. The Audit Committee held a meeting on 19 March 2020 to consider and review the 2019 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 2019 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 2019.

PUBLICATION OF ANNUAL REPORT ON THE STOCK EXCHANGE WEBSITE

The Company's 2019 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, 20 March 2020

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*