

FINANCIAL INFORMATION

You should read this section in conjunction with our consolidated financial information as set out in the Accountants’ Report included as Appendix I to this document and selected historical consolidated financial data, in each case, together with the accompanying notes thereto included elsewhere in this document. The financial information included in the Accountants’ Report has been prepared in accordance with HKFRSs.

The following discussion and analysis contains forward-looking statements that involve risks and uncertainties. These statements are based on assumptions and analysis made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate under the circumstances. However, our actual results may differ significantly from those projected in the forward-looking statements. Factors that might cause future results to differ significantly from those projected in the forward-looking statements include those discussed in the section headed “Risk Factors” in this document.

Any discrepancies in any table or elsewhere in this document between totals and sums of amounts listed herein are due to rounding.

OVERVIEW

We principally engage in the design, manufacture and sale of papermaking felts under the brands of **VANOV** and **Qobear**. Our papermaking felts can be broadly categorised into the following five types: (i) packaging papermaking felts; (ii) specialty papermaking felts; (iii) printing papermaking felts; (iv) household papermaking felts; and (v) pulp papermaking felts. According to the Frost & Sullivan Report, we were one of the top five papermaking felts manufacturers in the PRC market, among which, we ranked fourth and were the only papermaking felts manufacturer headquartered in the PRC, with an approximate market share of 5.8% in terms of revenue in 2020. For further details of our business, please refer to the paragraph headed “Business — Overview” in this document.

Our revenue was approximately RMB159.4 million, RMB167.3 million, RMB182.8 million and RMB76.5 million for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively. Our profit and total comprehensive income for the year/period was approximately RMB37.2 million, RMB35.1 million, RMB41.0 million and RMB14.3 million for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively.

The following discussion and analyses are based on the financial results of our Group during the Track Record Period as presented in the Accountants’ Report contained in Appendix I to this document.

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The historical financial information has been prepared on the historical cost basis. The historical financial information is presented in RMB, which is also the functional currency of our Group.

KEY FACTORS AFFECTING OUR RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Our financial performance and results of operations have been and will continue to be affected by a number of factors, including those set out below and in the section headed “Risk Factors” in this document.

In the event that there are unexpected changes in the demand for machine-made paper and paperboard, especially in the PRC, our business, financial condition and results of operations may be adversely affected.

Production capacity and product range

Our competitiveness depends, to a larger extent, on our ability to expand production capacity and product range, in order to increase our market share. We manufactured our products in our production facilities located in Chengdu and Shanghai, the PRC. The production volumes of our Chengdu Production Site were approximately 547 tonnes, 587 tonnes, 608 tonnes and 276 tonnes and the effective utilisation rates were approximately 92.7%, 88.9%, 92.1% and 83.8% for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively. The production volumes of our Shanghai Production Site were approximately 498 tonnes, 537 tonnes, 603 tonnes and 259 tonnes and the effective utilisation rates were approximately 99.6%, 103.3%, 97.3% and 83.5% for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively. For more information about our production capacity, utilisation rates and seasonality, please refer to the paragraphs headed “Business — Production — Our production capacity and utilisation rate” and “Business — Seasonality” in this document. Given the high effective utilisation rates as mentioned above, our Directors believe that it is critical to expand our production capacity in order to capture the expected growth in total sales volume and sales value of papermaking felts in the PRC as stated in the Frost & Sullivan Report.

We will continue to expand our production capacity and product range to capture market opportunities. For details of our future expansion plans, please refer to the section headed “Future Plans and [REDACTED]” in this document.

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Our business strategies are subject to significant business, economic and competitive uncertainties and contingencies in the market, many of which are beyond our control and may delay or increase the costs of implementation. Such uncertainties and contingencies may include, inability to finance or obtain capital to finance our expansion plans, delays in the delivery and installation of manufacturing equipment, labour shortage and related issues, raw materials and other cost increases or the promulgation of new laws and regulations related to environmental protection, delays or failure in securing the necessary governmental approvals and further downturn in the economy. If we are unable to further expand our production capacity and develop our product range, we may lose our competitiveness in the market, which could materially and adversely affect our financial condition and results of operations, as well as the growth of our revenue and profits.

Fluctuation in our cost of sales

Our cost of sales include: (i) raw materials; (ii) direct labour costs; (iii) manufacturing overhead; (iv) utilities; (v) depreciation; and (vi) provision for warranty. We engage suppliers mainly in the PRC where we mainly purchase raw materials like monofilaments and fibre from them. Please refer to the paragraph headed “Business — Our suppliers and raw materials” in this document for more information.

The following sensitivity analysis illustrates the impact of hypothetical fluctuations of the major components of our cost of sales, namely, costs of raw materials and direct labour, on our profit before income tax during the Track Record Period. The hypothetical fluctuation rate for nylon monofilaments and fibre, which are the major raw materials used in our production, is set at 3.0%, being the CAGR of its import price from 2016 to 2020 as stated in the Frost & Sullivan Report and are therefore considered reasonable for the purpose of this sensitivity analysis. The hypothetical fluctuation rate for direct labour costs is set at 7.7%, being the CAGR of the average monthly salary of employed persons in the manufacturing industry from 2016 to 2020 as stated in the Frost & Sullivan Report and are therefore considered reasonable for the purpose of this sensitivity analysis. Please refer to the paragraph headed “Industry overview — Overview of papermaking felts manufacturing industry in the PRC — Cost structure analysis” in this document for more information.

Hypothetical fluctuations in costs of raw materials	-3.0%	+3.0%
	<i>RMB'000</i>	<i>RMB'000</i>
Increase/(decrease) in profit before income tax^{Note}		
For the year ended 31 December 2018	1,594.1	(1,594.1)
For the year ended 31 December 2019	1,474.2	(1,474.2)
For the year ended 31 December 2020	1,545.9	(1,545.9)
For the six months ended 30 June 2021	618.4	(618.4)

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Hypothetical fluctuations in direct labour costs	-7.7%	+7.7%
	RMB'000	RMB'000
Increase/(decrease) in profit before income tax^{Note}		
For the year ended 31 December 2018	849.1	(849.1)
For the year ended 31 December 2019	909.2	(909.2)
For the year ended 31 December 2020	991.9	(991.9)
For the six months ended 30 June 2021	544.0	(544.0)

Note: Our profit before income tax was approximately RMB43.5 million, RMB41.5 million, RMB48.5 million and RMB16.5 million for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively.

Market Competition

According to the Frost & Sullivan Report, the papermaking felts manufacturing industry is featured with several foreign invested market participants with strong capability in research and development and demonstrate premium product quality. Foreign invested papermaking felts manufacturers are highly competitive in the high-speed and high-performance segment of papermaking felts. In contrast, domestic market participants in the papermaking felts manufacturing industry are relatively competitive in terms of pricing and service level. From 2016 to 2020, the sales volume of papermaking felts in the PRC grew from approximately 12,820.1 tonnes to approximately 17,487.9 tonnes, representing a CAGR of approximately 8.1%. Driven by the expected growth of domestic paper production and strong demand for papermaking felts in Southeast Asia, the sales volume of papermaking felts has seen a rapid growth from 2016 onwards, with the improvement in quality, the growth is set to maintain at a CAGR of approximately 6.3% during 2021 to 2025. Similarly, the sales value of papermaking felts in the PRC has achieved an overall growth from approximately RMB2,189.9 million in 2016 to approximately RMB3,166.1 million in 2020, representing a CAGR of approximately 9.7%. With the expanding production of high-speed papermaking felts among local enterprises, the sales value of papermaking felts is expected to increase at a CAGR of approximately 7.6% during 2021 to 2025.

Our Directors consider that we are able to compete in terms of our customer base, cost control, research and development capabilities and the quality of our products. If we fail to maintain our competitive strengths or the competition in the papermaking felts manufacturing industry is intensified unexpectedly, our operation and financial results will be adversely affected.

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BASIS OF PRESENTATION

Pursuant to the Reorganisation as further explained in the paragraph headed “History, Reorganisation and Corporate Structure — Reorganisation” in this document, our Company became the holding company of the companies now comprising our Group on 13 August 2019 as an exempted company with limited liability under the Companies Act. The companies now comprising our Group were under the common control of our Controlling Shareholders throughout the Track Record Period. Accordingly, for the purpose of the preparation of our Group’s historical financial information, our Company has been considered as the holding company of the companies now comprising our Group throughout the Track Record Period. Our Group comprising our Company and its subsidiaries resulting from the Reorganisation is regarded as a continuing entity.

The consolidated statements of profit or loss and other comprehensive income, the consolidated statements of changes in equity and the consolidated statements of cash flows for the years ended 31 December 2018 and 2019, which include the financial performance, changes in equity and cash flows of all the companies now comprising our Group have been prepared using the principles of merger accounting under the Hong Kong Accounting Guideline 5 “Merger Accounting for Common Control Combinations” issued by the HKICPA as if the current group structure had been in existence throughout the Track Record Period, or since their respective dates of incorporation, where it is a shorter period. The consolidated statement of financial position of our Group as at 31 December 2018 have been prepared to present the assets and liabilities of the companies now comprising our Group as if the current group structure had been in existence as at those respective dates.

BASIS OF PREPARATION

The historical financial information has been prepared in accordance with HKFRSs which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the HKICPA effective for the accounting period beginning from 1 January 2020 and our Group has early adopted amendments to HKFRS 16 “COVID-19-Related Rent Concessions” and “COVID-19-Related Rent Concessions beyond 30 June 2021” throughout the Track Record Period. The historical financial information also complies with the applicable disclosure provisions of the Listing Rules.

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AMENDMENTS TO HKFRS 16 “COVID-19-RELATED RENT CONCESSIONS”

Amendments to HKFRS 16 only apply to lessee accounting and have no effect on lessor accounting. The amendments provide a practical expedient that allows a lessee to by-pass the need to evaluate whether certain qualifying rent concessions occurring as a direct consequence of the COVID-19 are lease modification and, instead, account for those rent concessions as if they were not lease modifications.

AMENDMENT TO HKFRS 16 “COVID-19-RELATED RENT CONCESSIONS BEYOND 30 JUNE 2021”

The amendment extends the availability of the practical expedient in paragraph 46A of HKFRS 16 so that it applies to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2022, provided the other conditions as stated in paragraph 46B of HKFRS 16 for applying the practical expedient are met (please also refer to the conditions stated in Amendment to HKFRS 16 “Covid-19-Related Rent Concessions” above).

Our Group has elected to early adopt the above amendments and applies the practical expedient to all qualifying COVID-19-related rent concessions granted to our Group throughout the Track Record Period.

Consequently, rent concessions received have been recognised RMB387,000 for the year ended 31 December 2020 and nil for the six months period ended 30 June 2021 as negative variable lease payments in profit or loss in the period in which the event or condition that triggers those payments occurred.

Please refer to the paragraph headed “Notes to the historical financial information — 2 Summary of significant accounting policies — 2.1 Basis of preparation” in Appendix I to this document for details of the amendments to HKFRS 16 “COVID-19-Related Rent Concessions” and “COVID-19-Related Rent Concessions beyond 30 June 2021”.

CRITICAL ACCOUNTING POLICIES, ESTIMATES AND JUDGMENTS

We have identified certain accounting policies that are significant to the preparation of our audited consolidated financial statements in accordance with HKFRSs. In the application of our accounting policies, our management is required to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. These significant accounting policies, estimates and assumptions are important for an understanding of the financial condition and results of operation of our Group. Our estimates and other associated assumptions are based on historical experience and other factors that our management believes that

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are considered to be relevant and reasonable under the circumstances. Actual results may however differ from these estimates and assumptions under different conditions. These estimates and assumptions are subject to change in the future, if necessary, for accommodating different conditions which will be closely monitored by our management on an ongoing basis. The following include our critical accounting policies, estimates and judgments applied in the preparation of our financial information:

Revenue recognition

Revenue is recognised to depict the transfer of promised goods and services to customers in an amount that reflect the consideration to which our Group expects to be entitled in exchange for those goods and services. Our Group recognises revenue when (or as) a performance obligation is satisfied, i.e. when “control” of the goods or services underlying the particular performance obligation is transferred to the customer. Control of the goods or services may be transferred over time or at a point in time.

Revenue from sales of papermaking felts products are recognised at a point in time when the legal title of the finished good is transferred and our Group has present right to payment and the collection of the consideration is probable. This is usually taken as the time when the goods are delivered and the customer has accepted the goods.

Sales-related warranties associated with papermaking felts cannot be purchased separately and are served as an assurance that the products sold comply with agreed-upon specifications (i.e. assurance-type warranties). Accordingly, our Group accounts for warranties in accordance with HKAS 37 “Provisions, Contingent Liabilities and Contingent Assets”.

Impairment of trade and other receivables

Our Group follows the guidance of HKFRS 9 to determine when a receivable is impaired. In making this estimation and judgement, our Group evaluate, among other factors, the ageing analysis of receivables, the financial healthiness and collection history of the individual debtors and expected future change of credit risks, including the consideration of factors such as general economy measure, change in macro-economic indicators, etc.

The carrying amount of our Group’s trade and other receivables as at 31 December 2018, 2019 and 2020 and 30 June 2021 amounted to approximately RMB107.1 million, RMB123.6 million, RMB135.5 million and RMB119.6 million, respectively, and allowance of expected credit loss as at 31 December 2018, 2019 and 2020 and 30 June 2021 amounted to approximately RMB8.1 million, RMB4.3 million, RMB5.7 million and RMB6.0 million, respectively. Please refer to note 16 of the Accountants’ Report in Appendix I to this document for details.

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Provision for inventories

Our Group reviews the carrying amount of inventories based on consideration of obsolescence of raw materials and the net realisable value of finished goods. The identification of inventory obsolescence and estimated selling price in the ordinary course of business require the use of judgement and estimates. Where the expectation is different from the original estimate, such difference will impact the carrying amount of inventories in the period in which such estimate has been changed. Provision for inventories of approximately RMB0.1 million, RMB42,000, RMB0.8 million (reversal) and RMB0.2 million were recognised during the years ended 31 December 2018, 2019 and 2020 and the six months ended 30 June 2021, respectively. Please refer to note 15 of the Accountants’ Report in Appendix I to this document for details.

SUMMARY OF RESULTS OF OPERATIONS

The following table sets out the selected information extracted from our consolidated statements of profit or loss and other comprehensive income relating to the results of operation of our Group during the Track Record Period, details of which are set out in the Accountant’s Report in Appendix I to this document:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
				(unaudited)	
Revenue	159,356	167,314	182,759	66,205	76,515
Cost of sales	(81,472)	(77,985)	(83,140)	(31,351)	(37,438)
Gross profit	77,884	89,329	99,619	34,854	39,077
Other income	8,083	4,761	6,025	1,527	1,264
Selling and distribution expenses . . .	(12,587)	(14,855)	(17,764)	(6,340)	(7,083)
Administrative and other operating expenses	(22,437)	(31,088)	(32,145)	(12,142)	(12,998)
Finance costs	(7,483)	(6,669)	(7,241)	(3,640)	(3,803)
Profit before income tax	43,460	41,478	48,494	14,259	16,457
Income tax expense	(6,254)	(6,401)	(7,481)	(2,747)	(2,171)
Profit and total comprehensive income for the year/period	<u>37,206</u>	<u>35,077</u>	<u>41,013</u>	<u>11,512</u>	<u>14,286</u>
Profit and total comprehensive income attributable to					
Equity holders of the Company	34,366	34,633	40,517	11,379	14,134
Non-controlling interest	2,840	444	496	133	152
	<u>37,206</u>	<u>35,077</u>	<u>41,013</u>	<u>11,512</u>	<u>14,286</u>

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NON-HKFRS MEASURES

We recognised non-recurring items such as [REDACTED] during the Track Record Period and therefore we also present the adjusted profit and total comprehensive income for the year, which is a non-HKFRS measure, to supplement our consolidated financial information which are presented in accordance with HKFRS.

We present such additional financial measure as it was used by our management to evaluate our financial performance by eliminating the impact of [REDACTED], which are with one-off nature and were considered not indicative for evaluation of the actual performance of our business. Our Directors believe that such non-HKFRS measure provides additional information to investors and others in understanding and evaluating our results of operations in the same manner as our management and in comparing financial results across accounting periods and to those of our peer companies.

The following table sets forth our adjusted profit and the total comprehensive income for each respective year/period during the Track Record Period:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Profit for year/period . . .	37,206	35,077	41,013	11,512	14,286
Add: [REDACTED] . . .	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Adjusted profit and total comprehensive income for the year/period	<u>40,988</u>	<u>43,828</u>	<u>47,407</u>	<u>12,946</u>	<u>14,756</u>

DISCUSSION OF MAJOR ITEMS FROM THE CONSOLIDATED STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

Revenue

We generated our revenue from the design, manufacturing and sales of various types of papermaking felts during the Track Record Period. Our revenue increased during the Track Record Period, which were approximately RMB159.4 million, RMB167.3 million and RMB182.8 million for the three years ended 31 December 2020, respectively, and approximately RMB66.2 million and RMB76.5 million for the six months ended 30 June 2020 and 2021, respectively. Our revenue is generally affected by the selling price and sales volume of our products.

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Revenue breakdown by type of papermaking felts

The table below sets forth the breakdown of our revenue, sales volume, average selling price, gross profit and gross profit margin by type of papermaking felts during the Track Record Period:

	Year ended 31 December																	
	2018					2019					2020							
	Sales		Average selling price		% of total revenue	Sales		Average selling price		% of total revenue	Sales		Average selling price		% of total revenue			
	(RMB'000)	(tonnes)	(RMB per tonne)	(RMB'000)		(RMB'000)	(tonnes)	(RMB per tonne)	(RMB'000)		(tonnes)	(RMB per tonne)	(RMB'000)	(tonnes)		(RMB per tonne)	(RMB'000)	(tonnes)
Packaging papermaking felts	106,027	728.9	145,000	52,991	50.0	114,670	68.6	744.5	154,000	61,764	53.9	124,863	68.3	821.3	152,000	67,609	54.1	
Specialty papermaking felts	25,755	169.0	152,000	13,580	52.7	26,951	16.1	168.5	160,000	15,178	56.3	32,090	17.6	191.8	167,000	18,674	58.2	
Printing papermaking felts	14,859	130.8	114,000	6,147	41.4	11,451	6.8	93.3	123,000	5,272	46.0	10,732	5.9	87.0	123,000	4,996	46.6	
Household papermaking felts	9,975	94.2	106,000	3,775	37.8	10,600	6.3	88.7	120,000	5,085	48.0	9,490	5.2	71.4	133,000	5,095	53.7	
Pulp papermaking felts	2,740	1.7	19.0	144,000	1,391	50.8	3,642	2.2	22.5	162,000	2,030	55.7	5,584	3.0	31.8	176,000	3,245	58.1
Total	159,356	1,141.9	140,000	77,884	48.9	167,314	100.0	1,117.5	150,000	89,329	53.4	182,759	100.0	1,203.3	152,000	99,619	54.5	

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Six months ended 30 June

	2020				2021							
	RMB'000 (unaudited)	% of total revenue	Sales Volume (tonnes)	Average selling price (RMB per tonne)	Gross Profit (RMB'000)	Margin (%)	Gross Profit (RMB'000)	Gross Profit Margin (%)				
Packaging papermaking felts	44,017	66.5	292.0	151,000	23,114	52.5	52,661	68.8	348.4	151,000	27,390	52.0
Specialty papermaking felts	11,496	17.4	68.1	169,000	6,484	56.4	12,709	16.6	76.2	167,000	6,903	54.3
Printing papermaking felts	4,193	6.3	34.1	123,000	1,791	42.7	4,958	6.5	41.3	120,000	1,991	40.2
Household papermaking felts	4,225	6.4	32.3	131,000	2,161	51.1	4,364	5.7	36.4	120,000	1,914	43.9
Pulp papermaking felts	2,274	3.4	11.5	198,000	1,304	57.3	1,823	2.4	12.0	152,000	879	48.2
Total	66,205	100	438.0	151,000	34,854	52.6	76,515	100.0	514.3	149,000	39,077	51.1

Notes:

1. The slightly higher sales volume than the actual production volume in 2018 was due to the sales of prior year inventories.
2. Certain amounts and percentage figures included in this table have been subject to rounding adjustments, or have been rounded to one decimal place. Any discrepancies between totals and sums of amount listed therein are due to rounding.

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Packaging papermaking felts

Our revenue generated from packaging papermaking felts increased during the Track Record Period, from approximately RMB106.0 million for the year ended 31 December 2018 to approximately RMB114.7 million for the year ended 31 December 2019, further to approximately RMB124.9 million for the year ended 31 December 2020, and from approximately RMB44.0 million for the six months ended 30 June 2020 to approximately RMB52.7 million for the six months ended 30 June 2021. In particular, the revenue growth from 2018 to 2019 was mainly due to the increase in its average selling price from approximately RMB145,000 per tonne to approximately RMB154,000 per tonne, resulting from more high speed products were sold in 2019. The revenue growth from 2019 to 2020 and from the six months ended 30 June 2020 to the six months ended 30 June 2021 were mainly due to the increase of sale volume, resulting from the growing demand for packaging paper with the surge in e-commerce due to the change in consumption pattern of the public which bolstered the demand for packaging paper in the PRC. The gross profit generated from such type of papermaking felts generally consistent with the trend of its revenue during the Track Record Period.

Our gross profit margin generated from packaging papermaking felts remained relatively stable at 50.0%, 53.9% and 54.1% during the three years ended 31 December 2018, 2019 and 2020, respectively, and 52.5% and 52.0% during the six months ended 30 June 2020 and 2021, respectively.

Specialty papermaking felts

Our revenue generated from specialty papermaking felts increased during the Track Record Period, from approximately RMB25.8 million for the year ended 31 December 2018 to approximately RMB27.0 million for the year ended 31 December 2019, further to approximately RMB32.1 million for the year ended 31 December 2020, and from approximately RMB11.5 million for the six months ended 30 June 2020 to approximately RMB12.7 million for the six months ended 30 June 2021. In particular, the revenue growth from 2018 to 2019 was mainly due to the increase in its average selling price from approximately RMB152,000 per tonne to approximately RMB160,000 per tonne, mainly due to the increase in revenue generated from the sales of our high-speed specialty papermaking felts which generally command a relatively higher selling price during the period. The revenue growth from 2019 to 2020 mainly due to the increase of sale volume from 168.5 tonnes to 191.8 tonnes, resulting from our business focus on products of specialty papermaking felts and our prioritisation of our production capacity on such business. The slightly increase of revenue from the six months ended 30 June 2020 to the six months ended 30

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June 2021 were mainly due to increase of sale volume from 68.1 tonnes to 76.2 tonnes, resulting from the same reason as mentioned above. The gross profit generated from such type of papermaking felts generally consistent with the trend of its revenue during the Track Record Period.

Our gross profit margin generated from specialty papermaking felts increased from approximately 52.7% for the year ended 31 December 2018 to 56.3% for the year ended 31 December 2019, and further to 58.2% for the year ended 31 December 2020, mainly due to the increase in revenue generated from the sales of our high-speed specialty papermaking felts which generally command a relatively higher selling price during the period. Our gross profit margin decreased slightly from approximately 56.4% for the six months ended 30 June 2020 to approximately 54.3% for the six months ended 30 June 2021 mainly due to temporary change in our product mix which the proportion of the products with lower gross profit margin increased slightly.

Printing papermaking felts

The decrease in revenue generated from printing papermaking felts from approximately RMB14.9 million the year ended 31 December 2018 to approximately RMB11.5 million the year ended 31 December 2019, and further to approximately RMB10.7 million the year ended 31 December 2020, was mainly due to the decrease of sale volume from 130.8 tonnes in 2018, to 93.3 tonnes in 2019, and further to 87.0 tonnes in 2020, resulting from our business focus on products of packaging papermaking felts and specialty papermaking felts and our prioritisation of our production capacity on such business given our utilisation rates had reached maximum capacity. Our revenue generated from printing papermaking felts slightly increased from approximately RMB4.2 million for the six months ended 30 June 2020 to approximately RMB5.0 million for the six months ended 30 June 2021, mainly due to the slightly increase of sale volume from 34.1 tonnes in the six months ended 30 June 2020 to 41.3 tonnes in the six months ended 30 June 2021. The gross profit generated from such type of papermaking felts generally consistent with the trend of its revenue during the Track Record Period.

Our gross profit margin generated from printing papermaking felts increased from approximately 41.4% for the year ended 31 December 2018 to 46.0% for the year ended 31 December 2019, and further to 46.6% for the year ended 31 December 2020, mainly due to the increase in revenue generated from the sales of our high-speed printing papermaking felts which generally command a relatively higher selling price during the period. Our gross profit margin decreased slightly from approximately 42.7% for the six months ended 30 June 2020 to approximately 40.2% for the six months ended 30 June 2021 mainly due to the temporary change in our product mix which the proportion of the products with lower gross profit margin increased slightly.

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Household papermaking felts

Our revenue generated from household papermaking felts remained relatively stable at approximately RMB10.0 million, RMB10.6 million, RMB9.5 million, RMB4.2 million and RMB4.4 million respectively during the Track Record Period. Notwithstanding that our sale volume recorded a decrease from 94.2 tonnes in 2018, to 88.7 tonnes in 2019, and further to 71.4 in 2020, we can maintained a similar level of revenue as the average selling price increased from approximately RMB106,000 per tonne in 2018, to approximately RMB120,000 per tonne in 2019, and further to approximately RMB133,000 per tonne in 2020, as more high speed products were sold during the periods. The gross profit generated from such type of papermaking felts generally consistent with the trend of its revenue during the Track Record Period.

Our gross profit margin generated from household papermaking felts increased from approximately 37.8% for the year ended 31 December 2018 to 48.0% for the year ended 31 December 2019, and further to 53.7% for the year ended 31 December 2020, mainly due to the increase in revenue generated from the sales of our high-speed household papermaking felts which generally command a relatively higher selling price during the period. Our gross profit margin decreased from approximately 51.1% for the six months ended 30 June 2020 to approximately 43.9% for the six months ended 30 June 2021 mainly due to the decrease in the average selling prices of high-speed and low-speed papermaking felts during the same period as we provided competitive price to our existing customers in respect of our new types of papermaking felts products and new customers to attract them to purchase our products.

Pulp papermaking felts

Our revenue generated from pulp papermaking felts increased during from approximately RMB2.7 million for the year ended 31 December 2018 to approximately RMB3.6 million for the year ended 31 December 2019, further to approximately RMB5.6 million for the year ended 31 December 2020. Both the sale volume and the average selling price increased from 19.0 tonnes and RMB144,000 per tonne in 2018, to 22.5 tonnes and RMB162,000 per tonne in 2019, and further to 31.8 tonnes and RMB176,000 per tonne in 2020, mainly due to the increase in revenue generated from the sales of our high-speed pulp papermaking felts which generally command a relatively higher selling price during the period. Our revenue generated from pulp papermaking felts slightly decreased from approximately RMB2.3 million for the six months ended 30 June 2020 to approximately RMB1.8 million for the six months ended 30 June 2021 mainly due to the decreased of average selling price from RMB198,000 per tonne in the six months ended 30 June 2020 to RMB152,000 per tonne in the six months ended 30 June 2021. The gross profit generated from such type of papermaking felts generally consistent with the trend of its revenue during the Track Record Period.

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Our gross profit margin generated from pulp papermaking felts increased from approximately 50.8% for the year ended 31 December 2018 to 55.7% for the year ended 31 December 2019, and further to 58.1% for the year ended 31 December 2020, mainly due to the increase in revenue generated from the sales of our high-speed pulp papermaking felts which generally command a relatively higher selling price during the period. Our gross profit margin decreased from approximately 57.3% for the six months ended 30 June 2020 to approximately 48.2% for the six months ended 30 June 2021 mainly due to the decrease in the average selling prices of high-speed and low-speed papermaking felts during the same period as we provided competitive price to our existing customers in respect of our new types of papermaking felts products and new customers to attract them to purchase our products.

During the Track Record Period, our papermaking felts can mainly be categorised into (i) high-speed papermaking felts; (ii) medium-speed papermaking felts; and (iii) low-speed papermaking felts. According to our Directors, high-speed papermaking felts are generally applied in papermaking machine with operating speed of 700 metres or above per minute for packaging papermaking felts and printing papermaking felts and 600 metres or above per minute for our other products; while low-speed papermaking felts are generally applied in papermaking machine with operating speed of 300 metres or below per minute for packaging papermaking felts and printing papermaking felts and 200 metres or below per minute for our other products. Medium-speed papermaking felts are generally applied in papermaking machine with operating speed other than high-speed and low-speed. As advised by Frost & Sullivan, regarding the classification of papermaking felts by speed, there is no standard threshold for the respective category of the speed of papermaking machine due to large variations of paper types by weight and the threshold of the respective speed category may increase along with technological advancement. The categorisation of speed is different based on paper types and papermaking machine. In view of the aforesaid reasons and considering the advancement of papermaking technology with higher speed for certain paper categories such as printing and packaging paper, higher speed papermaking machines have been developed and the range and threshold for speed categories for these paper types could be higher. The development and variation in the product mix of our Group can also be better reflected through the aforesaid categorisation. The following table sets out a breakdown of our revenue, sales volume, average selling price and gross profit of our papermaking felts during the Track Record Period based on the operating speed of the applicable papermaking machine:

	Year ended 31 December														
	2018				2019					2020					
	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit
<i>RMB</i> <i>'000</i>		<i>(tonnes)</i>	<i>(RMB'000 per tonne)</i>	<i>RMB</i> <i>'000</i>	<i>RMB</i> <i>'000</i>		<i>(tonnes)</i>	<i>(RMB'000 per tonne)</i>	<i>RMB</i> <i>'000</i>	<i>RMB</i> <i>'000</i>		<i>(tonnes)</i>	<i>(RMB'000 per tonne)</i>	<i>RMB</i> <i>'000</i>	
High-speed papermaking felts	31,770	20.0	160.8	198	19,709	39,093	23.4	177.9	220	25,772	54,952	30.1	256.5	214	36,208
Medium-speed papermaking felts	90,433	56.7	622.5	145	43,895	92,940	55.5	599.2	155	48,958	91,429	50.0	623.5	147	46,635
Low-speed papermaking felts	37,153	23.3	358.6	104	14,280	35,281	21.1	340.4	104	14,599	36,378	19.9	323.3	113	16,776
Total	159,356	100.0	1,141.9		77,884	167,314	100.0	1,117.5		89,329	182,759	100.0	1,203.3		99,619

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	Six months ended 30 June									
	2020					2021				
	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit	Revenue	% of total revenue	Sales volume	Average selling price	Gross profit
<i>RMB</i> <i>'000</i>		<i>(tonnes)</i>	<i>(RMB'000 per tonne)</i>	<i>RMB</i> <i>'000</i>	<i>RMB</i> <i>'000</i>		<i>(tonnes)</i>	<i>(RMB'000 per tonne)</i>	<i>RMB</i> <i>'000</i>	
(unaudited)										
High-speed papermaking felts	18,338	27.7	82.2	223	11,964	23,709	31.0	113.9	208	15,184
Medium-speed papermaking felts	32,222	48.7	214.8	150	16,043	36,914	48.2	252.5	146	17,832
Low-speed papermaking felts	15,645	23.6	141.0	111	6,847	15,892	20.8	147.9	107	6,061
Total	<u>66,205</u>	<u>100.0</u>	<u>438.0</u>		<u>34,854</u>	<u>76,515</u>	<u>100.0</u>	<u>514.3</u>		<u>39,077</u>

Among the five types of products, revenue generated from sales of our packaging papermaking felts accounted for approximately 66.5%, 68.6% and 68.3% of our total revenue for the three years ended 31 December 2020, respectively, and approximately 66.5% and 68.8% of our total revenue for the six months ended 30 June 2020 and 2021, respectively, being our largest contributing product type. Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our revenue during the Track Record Period.

The average selling prices of our papermaking felts generally increased from the year ended 31 December 2018 to the year ended 31 December 2020 which was mainly due to the increase in the production and sales volume of high-speed papermaking felts. The average selling price of our papermaking felts decreased from the six months ended 30 June 2020 to the six months ended 30 June 2021 which was mainly due to (i) the decrease in the average selling prices of high-speed and low-speed papermaking felts during the same period as we provided competitive price to our existing customers in respect of our new types of papermaking felts products and new customers to attract them to purchase our products; and (ii) the temporary change in our product mix, especially the increase in sales of household papermaking felts and pulp papermaking felts with lower average selling prices. According to the Frost & Sullivan Report, papermaking felts are commonly classified into high-speed, medium-speed and low-speed based on the operating speed of papermaking machine and high-quality papermaking felts are generally required for high-speed papermaking machine. The prices of medium-speed and high-speed papermaking felts are relatively higher as they are of better quality. As our Group has allocated more resources to focus on enhancing research and development and production capacity to produce high-speed papermaking felts, both our production volume and sales volume of high-speed papermaking felts increased during the Track Record Period.

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Revenue breakdown by customer types

The following table sets forth the revenue breakdown by our customer types during the Track Record Period:

	Year ended 31 December									Six months ended 30 June					
	2018			2019			2020			2020			2021		
	RMB'000	%	No. of customers	RMB'000	%	No. of customers	RMB'000	%	No. of customers	RMB'000	%	No. of customers	RMB'000	%	No. of customers
(unaudited)															
Paper and paper products manufacturers															
— The PRC	138,232	86.7	437	140,396	83.9	411	157,825	86.4	409	54,924	83.0	312	64,646	84.5	316
— Overseas	541	0.4	5	639	0.4	7	957	0.5	9	511	0.8	6	523	0.7	7
	<u>138,773</u>	<u>87.1</u>	<u>442</u>	<u>141,035</u>	<u>84.3</u>	<u>418</u>	<u>158,782</u>	<u>86.9</u>	<u>418</u>	<u>55,435</u>	<u>83.8</u>	<u>318</u>	<u>65,169</u>	<u>85.2</u>	<u>323</u>
Trading companies															
— The PRC ^(Note)	15,153	9.5	47	19,314	11.5	45	17,346	9.5	50	7,634	11.5	36	8,166	10.7	42
— Overseas	5,430	3.4	9	6,965	4.2	10	6,631	3.6	15	3,136	4.7	8	3,180	4.1	6
	<u>20,583</u>	<u>12.9</u>	<u>56</u>	<u>26,279</u>	<u>15.7</u>	<u>55</u>	<u>23,977</u>	<u>13.1</u>	<u>65</u>	<u>10,770</u>	<u>16.2</u>	<u>44</u>	<u>11,346</u>	<u>14.8</u>	<u>48</u>
Total:	<u>159,356</u>	<u>100.0</u>	<u>498</u>	<u>167,314</u>	<u>100.0</u>	<u>473</u>	<u>182,759</u>	<u>100.0</u>	<u>483</u>	<u>66,205</u>	<u>100.0</u>	<u>362</u>	<u>76,515</u>	<u>100.0</u>	<u>371</u>

Note: To the best knowledge of our Directors, the PRC trading companies will further sell our products to third parties paper and paper products manufacturers overseas.

During the Track Record Period, we derived a significant portion of our revenue from the sales of papermaking felts to the PRC and overseas paper and paper products manufacturers, which accounted for approximately 87.1%, 84.3% and 86.9% of our total revenue for the three years ended 31 December 2020, respectively, and approximately 83.8% and 85.2% of our total revenue for the six months ended 30 June 2020 and 2021, respectively.

Revenue generated from the PRC and overseas trading companies increased during the Track Record Period, which accounted for approximately 12.9%, 15.7% and 13.1% of our total revenue for the three years ended 31 December 2020, respectively, and approximately 16.2% and 14.8% of our total revenue for the six months ended 30 June 2020 and 2021, respectively.

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Revenue breakdown by geographical location of our customers

The following table sets forth information on the geographical locations of our revenue determined based on geographical region of our customers during the Track Record Period:

	Year ended 31 December						Six months ended 30 June			
	2018		2019		2020		2020		2021	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
	(unaudited)									
PRC										
— North China ^(Note 1)	50,030	31.4	49,980	29.9	63,491	34.8	19,472	29.4	28,042	36.6
— East China ^(Note 2)	50,532	31.7	56,936	34.0	60,159	32.9	22,724	34.3	22,112	28.9
— South China ^(Note 3)	36,670	23.0	37,404	22.4	31,513	17.2	12,290	18.6	13,355	17.5
— West China ^(Note 4)	10,529	6.6	11,123	6.7	11,496	6.3	4,608	7.0	6,334	8.3
— North-East China ^(Note 5)	4,378	2.8	2,212	1.3	5,539	3.0	2,402	3.6	1,873	2.4
— North-West China ^(Note 6)	1,246	0.8	2,054	1.2	2,973	1.6	1,062	1.6	1,096	1.4
Sub-total	153,385	96.3	159,709	95.5	175,171	95.8	62,558	94.5	72,812	95.1
Overseas ^(Note 7)	5,971	3.7	7,605	4.5	7,588	4.2	3,647	5.5	3,703	4.8
Total	159,356	100.0	167,314	100.0	182,759	100.0	66,205	100.0	76,515	100.0

Notes:

1. North China includes Henan, Hebei, Shandong, Shanxi, Tianjin, Beijing and Inner Mongolia.
2. East China includes Hubei, Anhui, Jiangsu, Zhejiang and Shanghai.
3. South China includes Hunan, Jiangxi, Fujian, Guangxi and Guangdong.
4. West China includes Sichuan, Chongqing, Guizhou and Yunnan.
5. North-East China includes Heilongjiang, Jilin and Liaoning.
6. North-West China includes Shaanxi, Ningxia, Gansu and Xinjiang.
7. Overseas mainly include Singapore, Brazil, Pakistan, Colombia, India and Uzbekistan.

During the Track Record Period, we derived a significant portion of our revenue from the sales of papermaking felts in the PRC, which accounted for approximately 96.3%, 95.5% and 95.8% of our revenue for the three years ended 31 December 2020, respectively, and approximately 94.5% and 95.1% of our revenue for the six months ended 30 June 2020 and 2021, respectively.

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Revenue generated from overseas increased by approximately RMB1.6 million or 27.4% from approximately RMB6.0 million for the year ended 31 December 2018 to approximately RMB7.6 million for the year ended 31 December 2019 because according to our Directors, we devoted more resources to promote our brands overseas and remained stable at approximately RMB7.6 million for the year ended 31 December 2020. Revenue generated from overseas remained stable at approximately RMB3.7 million for the six months ended 30 June 2021 as compared with approximately RMB3.6 million for the six months ended 30 June 2020.

Cost of sales

Our cost of sales consisted of raw materials, direct labour costs, manufacturing overhead, utilities, depreciation and provision for warranty. The following table sets forth a breakdown of our cost of sales during the Track Record Period:

	Year ended 31 December						Six months ended 30 June			
	2018		2019		2020		2020		2021	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
	(unaudited)									
Raw materials										
— Monofilaments	20,232	24.8	17,301	22.2	17,734	21.3	6,386	20.4	7,915	21.1
— Fibre	29,716	36.5	28,233	36.2	30,235	36.4	10,265	32.7	10,848	29.0
— Other raw materials	3,187	3.9	3,605	4.6	3,561	4.3	835	2.7	1,849	4.9
Direct labour costs	11,827	14.5	11,808	15.1	12,882	15.5	5,987	19.1	7,065	18.9
Manufacturing overhead.	6,082	7.5	6,405	8.2	6,482	7.8	3,031	9.6	3,386	9.0
Utilities	3,436	4.2	3,625	4.7	3,679	4.4	1,721	5.5	2,092	5.6
Depreciation	3,876	4.8	4,645	6.0	4,639	5.6	2,310	7.4	2,270	6.1
Provision for warranty	3,116	3.8	2,363	3.0	3,928	4.7	816	2.6	2,013	5.4
Total	81,472	100.0	77,985	100.0	83,140	100.0	31,351	100.0	37,438	100.0

- (a) raw materials included monofilaments, fibre and other raw materials. Other raw materials mainly include other raw materials used in our production, such as packaging materials, ancillary materials like machinery consumables and semi-finished products purchased from suppliers;
- (b) direct labour costs consisted of wages and benefits of our workers directly engaged in the production facilities;
- (c) manufacturing overhead mainly consisted of equipment maintenance costs, transportation costs in relation to the delivery of raw materials and other overhead costs incurred in the production of our products;

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- (d) utilities represented the electricity and water costs of our Chengdu Production Site and Shanghai Production Site and fuel for our machinery;
- (e) depreciation represented the depreciation expenses of property, plant and equipment in relation to the depreciation of our plant and machinery and right-of-use assets; and
- (f) provision for warranty represented management’s best estimate of our liability under 45 to 120 days warranty granted on papermaking felts, based on prior experience and industry averages for defective products. Please refer to note 19 of the Accountants’ Report in Appendix I to this document for details.

Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operation” in this section for the reasons of the fluctuations in our cost of sales during the Track Record Period.

Gross profit and gross profit margin

Our gross profit and gross profit margin during the Track Record Period are set out below:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
				(unaudited)	
Revenue (RMB’000)	159,356	167,314	182,759	66,205	76,515
Gross profit (RMB’000)	77,884	89,329	99,619	34,854	39,077
Gross profit margin	48.9%	53.4%	54.5%	52.6%	51.1%

Our gross profit was approximately RMB77.9 million, RMB89.3 million and RMB99.6 million for the three years ended 31 December 2020, respectively, and approximately RMB34.9 million and RMB39.1 million for the six months ended 30 June 2020 and 2021, respectively. Our gross profit margin was approximately 48.9%, 53.4% and 54.5% for the three years ended 31 December 2020, respectively, and approximately 52.6% and 51.1% for the six months ended 30 June 2020 and 2021, respectively.

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During the Track Record Period, our overall gross profit margin was affected by the following: (i) the type of products sold; (ii) costs of raw materials; (iii) the demand in paper industries and overall product’s market trend; (iv) the prevailing market prices of products; and (v) the bargaining power of our customers. For the reasons of the fluctuations in our gross profit and gross profit margin during the Track Record Period, please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operation” in this section.

Other income

The table below sets forth a breakdown of our other income during the Track Record Period:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB’000</i>	<i>RMB’000</i>	<i>RMB’000</i>	<i>RMB’000</i>	<i>RMB’000</i>
				(unaudited)	
Bank interest income	75	105	191	63	89
Sale of scrap materials	1,551	1,465	1,836	733	873
Government subsidies	5,934	2,865	3,509	310	133
Exchange gains	282	—	—	140	—
Rental income	—	149	—	—	—
Rent concessions	—	—	387	231	—
Sundry income	241	177	102	50	169
Total	8,083	4,761	6,025	1,527	1,264

- (a) sale of scrap materials was in relation to the sale of raw materials which were mainly the leftover materials scrapped from our finished goods as a result of customising the sizes of our papermaking felts according to customers’ requirements;

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(b) government subsidies represented government subsidies in the form of various non-recurring subsidies and incentives received from local governmental authorities for the purpose of supporting our operations, in particular, for the recognition of our research projects. All of the government subsidies are subject to the discretion of the relevant governmental authorities and are provided typically on a one-off basis. The table below sets forth a breakdown of our government subsidies:

Project	Governmental authority	Nature of government grants	Conditions for obtaining government subsidy	Year ended 31 December			Six months ended 30 June
				2018	2019	2020	2021
				RMB'000	RMB'000	RMB'000	RMB'000
High-tech Achievements Transformation Project Supporting Fund* (高新技術成果轉化項目扶持資金) — the government subsidy for the years ended 31 December 2018, 2019 and 2020 resulted in the registration of seven patents, as set out in the paragraph headed “Statutory and General Information — B. Further information about the business — 2. Intellectual property rights” in Appendix V to this document.	Shanghai Jinshan District Finance Bureau* (上海市金山區財政局)	Municipal financial support funds	The subsidy was to support research and development projects being recognised as Shanghai High-tech Achievement Transformation Project* (上海市高新技術成果轉化項目認定). The subsidy was issued to us based on our production of high-speed and high-resistance multi-axial stam papermaking felts products* (高車速高抗壓多軸向接縫造紙毛毯) by using our technology that was being recognised as Shanghai High-tech Achievement Transformation Project* on 4 August 2017.	2,825	2,175	1,082	—
Sichuan Action Special Fund* (四川行動資金) — the government subsidy in the year ended 31 December 2018 resulted in the registration of two patents and the application for registration of seven patents, as set out in the paragraph headed “Statutory and General Information — B. Further information about the business — 2. Intellectual property rights” in Appendix V to this document.	Chengdu Wenjiang District Economic and Information Technology Bureau* (成都市溫江區經濟和信息化局)	Provincial financial support funds	The subsidy was to support transformation, upgrading, innovation and development of industrial enterprises pursuant to Made in China 2025 Sichuan Action Plan* (中國製造2025四川行動計劃). The subsidy was issued to us based on our research project on multi-axial and multi-ply papermaking felts technology* (多軸向多層造紙毛毯技術研究與產業化).	1,400	—	—	—
Financial Support Funds* (財政扶持資金)	Shanghai Jinshan District Finance Bureau* (上海市金山區財政局)	Financial support funds	The amount of subsidy is a certain percentage of tax paid. Selected enterprises shall submit application to the government authorities for subsidy. We received subsidy from Shanghai Jinshan District Finance Bureau* as we are able to satisfy the financial requirements.	—	212	—	—

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Project	Governmental authority	Nature of government grants	Conditions for obtaining government subsidy	Year ended 31 December			Six months ended 30 June
				2018	2019	2020	2021
				RMB'000	RMB'000	RMB'000	RMB'000
Special Funds for Industrial and Information Projects in Wenjiang District* (溫江區工業和信息化項目專項資金)	Chengdu National Strait Liang'an Technology Industrial Park Management Committee* (成都海峽兩岸科技產業開發園管委會)	Municipal financial support funds	The subsidy was to support industrial enterprises which are located and subject to taxation in Chengdu Wenjiang District pursuant to Certain Policies Regarding the Acceleration of Industrial Transformation and Upgrade of the Development of High-end and Green Technologies* (關於進一步加快工業提質增效轉型升級步伐實現高端綠色科技發展的若干政策措施). The subsidy was issued to us based on our technical transformation and participation in industrial exhibitions.	—	371	150	—
First batch of provincial science technology plan project in 2020* (2020年第一批省級科技計畫專案)	Chengdu Wenjiang District New Economy and Technology Bureau* (成都市溫江區新經濟和科技局)	Provincial financial support	The subsidy was issued based on our research project on multi-axial and multi-ply papermaking felts key technology achievement transformation project* (多軸向多層造紙毛毯關鍵技術成果轉化項目).	—	—	800	—
Little Giant of Technology Enterprises* (科技小巨人企業)	Shanghai Jinshan District Finance Bureau* (上海市金山區科財政局) and/or Shanghai Municipal Finance Bureau* (上海市市級科財政局)	Municipal and/or district level financial support	The subsidies were issued since we were recognised as Little Giant of Technology Enterprises* (科技小巨人企業) and subsequently evaluated as good performance by Shanghai Science and Technology Commission* (上海科學技術委員會).	240	—	960	—
Others	Various governmental authorities			1,469	107	517	133
Total:				<u>5,934</u>	<u>2,865</u>	<u>3,509</u>	<u>133</u>

(c) rental income was generated from the rental of a part of the production facility on our Chengdu Production Site to Sichuan Huanlong New Material Ltd.* (四川環龍新材料有限公司). Please refer to note 30 of the Accountants' Report set out in Appendix I to this document for more information.

(d) rent concessions represented concessions of rental expenses of our Shanghai Production Site by our landlord due to the outbreak of COVID-19.

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Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our other income during the Track Record Period.

Selling and distribution expenses

The following table sets forth a breakdown of our selling and distribution expenses during the Track Record Period:

	Year ended 31 December						Six months ended 30 June			
	2018		2019		2020		2020		2021	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
	(unaudited)									
Salaries and benefits	4,589	36.5	4,158	28.0	4,938	27.8	1,513	23.9	2,205	31.1
Travel and entertainment expenses	2,341	18.6	2,977	20.0	3,073	17.3	993	15.7	1,891	26.7
Logistics expenses	1,739	13.8	1,903	12.8	2,035	11.5	864	13.6	934	13.2
Agency service fees	3,268	26.0	4,911	33.1	7,165	40.3	2,779	43.8	1,949	27.5
Others	650	5.1	906	6.1	553	3.1	191	3.0	104	1.5
Total	12,587	100.0	14,855	100.0	17,764	100.0	6,340	100.0	7,083	100.0

- (a) salaries and benefits were mainly the salaries and benefits and contributions to defined contribution retirement plans of our sales and marketing staff;
- (b) travel and entertainment expenses were the costs incurred for our sales and marketing activities;
- (c) logistics expenses were mainly the costs incurred in relation to the delivery of our products to our customers;
- (d) agency service fees generally represented fees incurred for services in relation to customers’ matters such as receiving purchase orders, handling export tax rebate applications, promoting our brands and identifying potential customers. Please refer to the paragraph headed “Business — Our business model” in this document for more information; and
- (e) others mainly included depreciation of furniture and fixtures in relation to our sales and marketing department, exhibition and advertising expenses and telecommunication expenses incurred by our sales and marketing staff.

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Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our selling and distribution expenses during the Track Record Period.

Administrative and other operating expenses

The following table sets forth a breakdown of our administrative and other operating expenses during the Track Record Period:

	Year ended 31 December						Six months ended 30 June			
	2018		2019		2020		2020		2021	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
	(unaudited)									
Research and development costs . . .	5,438	24.2	7,292	23.5	5,681	17.7	1,777	14.6	3,006	23.1
Staff costs	3,892	17.3	4,092	13.2	4,377	13.6	1,922	15.8	3,059	23.5
Depreciation and amortisation	3,111	13.9	3,539	11.4	4,509	14.0	2,239	18.4	2,431	18.7
Provision of allowance on										
receivables and inventories	2,385	10.6	1,381	4.4	1,793	5.6	2,032	16.7	736	5.7
Legal and professional fee	1,100	4.9	2,582	8.3	3,514	10.9	1,135	9.4	1,151	8.9
Office and motor vehicle expenses . .	654	3.0	686	2.2	589	1.9	208	1.7	309	2.4
[REDACTED].	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Professional bodies membership fees.	279	1.2	158	0.5	102	0.3	16	0.1	70	0.5
Others	1,796	8.0	2,607	8.4	5,186	16.1	1,379	11.5	1,766	13.6
Total	<u>22,437</u>	<u>100.0</u>	<u>31,088</u>	<u>100.0</u>	<u>32,145</u>	<u>100.0</u>	<u>12,142</u>	<u>100.0</u>	<u>12,998</u>	<u>100.0</u>

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- (a) research and development costs were mainly our costs incurred on product development, mainly including raw materials consumed and staff costs. Please refer to the paragraph headed “Business — Research and development” in this document for more information in relation to our research and development achievements. The table below sets forth a breakdown of our research and development costs during the Track Record Period:

	Year ended 31 December			Six months ended 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Registered patents ^(note 1)	4,348	566	1,432	1,034
Patents under application for registration ^(note 2)	—	1,023	1,023	1,081
Others ^(note 3)	1,090	5,703	3,225	891
	5,438	7,292	5,681	3,006

Notes:

1. Such costs represent the costs incurred in the research and development for the respective year or period where, as at the last date of the Track Record Period (i.e. 30 June 2021), a patent has been registered.
2. Such costs represent the costs incurred in the research and development for the respective year or period where, as at the last date of the Track Record Period (i.e. 30 June 2021), an application for registration of a patent has been made as a result.
3. Others represents costs incurred in the continuing research and development projects where, as at the respective year or period end date, neither a patent has been registered nor an application for registration of a patent has been made as a result.

- (b) staff costs represented the salaries and benefits and contribution to defined contribution retirement plans of our general administrative staff other than direct labour and sales and marketing staff;

- (c) depreciation and amortisation included the following: (i) lease charges and depreciation expenses of property, plant and equipment in relation to the depreciation of our leasehold improvements, furniture and fixtures, motor vehicles and right-of-use assets; and (ii) the

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- amortisation of prepaid land lease in relation to the land on which our Shanghai Production Site is located and intangible assets^(Note) including our intellectual properties and capitalised research and development costs;
- (d) provision of allowance on receivables and inventories represented our determination of impairment of trade receivables and the identification of inventory obsolescence and estimated selling price in the ordinary course of business based on estimation and judgement. Please refer to note 3.1 of the Accountants’ Report set out in Appendix I to this document for more information;
 - (e) legal and professional fee mainly represented fees paid to tax advisor and property valuer, and the appointment of professional parties in relation to the Proposed PRC Listing and application fee for trademarks and patents;
 - (f) office and motor vehicle expenses were the utility expenses of our offices and the fuel expenses and toll road fees incurred by our administrative staff;
 - (g) **[REDACTED]** were expenses in relation to the **[REDACTED]**;
 - (h) professional bodies membership fees represented membership fees paid to associations like the China Nonwovens & Industrial Textiles Association. Please refer to the paragraph headed “History, Reorganisation and Corporate Structure — Business development — Overview” in this document for more information on our business milestones;
 - (i) others mainly included insurance expense, other tax expenses such as stamp duty, property tax and land tax, incorporate expense representing costs in relation to the incorporation of our companies and provision made for a claim in relation to the dispute on the construction of factory building two. Please refer to the paragraph headed “Business — Legal proceedings and compliance” in this document for more information of the claim.

Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our administrative and other operating expenses during the Track Record Period.

Note: The recoverable amount of the intangible assets has been determined based on value in use calculations, covering a detailed four-year budget plan, followed by an extrapolation of expected cash flows at the average growth rates of 4%. The discount rates applied to the cash flow projections were 13.6%, 12.4%, 13.0% and 12.8% as at 31 December 2018, 2019 and 2020 and 30 June 2021, respectively. The key assumptions for our Group have been determined by our Group’s management based on past performance and our expectations for the industry development. The discount rates used are pre-tax and reflects specific risks relating to the segment. In the opinion of our Directors, there is no reasonably possible change in the key assumptions on which the recoverable amount of the trademarks is based that would cause the carrying amounts to exceed the recoverable amount.

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Finance costs

Finance costs comprised of interest expenses on our discounted bills financing, bank borrowings, other borrowing and lease liabilities. Our finance costs amounted to approximately RMB7.5 million, RMB6.7 million and RMB7.2 million for the three years ended 31 December 2020, respectively, and approximately RMB3.6 million and RMB3.8 million for the six months ended 30 June 2020 and 2021, respectively. We utilised discounted bills financing and bank borrowings in the PRC to maintain the level of our working capital for our business operation.

Please refer to the paragraph headed “Indebtedness — Bank borrowings” in this section for details of our bank borrowings and the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our finance costs during the Track Record Period.

Income tax expense

Taxation represents income tax paid or payable by us at the applicable tax rates in accordance with the relevant laws and regulations in each of the tax jurisdictions that we operate or are domiciled in. We had no tax payable in other jurisdictions other than in the PRC during the Track Record Period. Based on the compliance confirmations issued by the relevant tax authorities in the PRC in respect of our Group’s operating subsidiaries, our PRC Legal Advisers are of the view that each of our PRC operating subsidiaries has completed the necessary tax registrations and the tax rates implemented by it are in compliance with the relevant PRC laws during the Track Record Period. Our PRC Legal Advisers have not revealed any of our PRC operating subsidiaries which is subject to administrative penalties imposed by the relevant tax authorities due to serious violations of the relevant laws and regulations during the Track Record Period. Our PRC subsidiaries have filed tax filing in accordance with the relevant laws and regulations during the Track Record Period and up to the Latest Practicable Date. Our Company confirms that our Group was not subject to any tax investigation, penalties or surcharges in material respect up to the Latest Practicable Date.

Cayman Islands profit tax

Pursuant to the rules and regulations of the Cayman Islands, the Company is not subject to any income tax in the Cayman Islands.

BVI income tax

Lion Courage and Virtuous Way were incorporated in the BVI and have not been subject to any taxation in the BVI.

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Hong Kong

Vanov Tianhe and Marvel Dragon were incorporated in Hong Kong and have not been subject to any taxation in Hong Kong. No provision for Hong Kong profits tax has been provided as our Group did not have any assessable profits derived in Hong Kong during the Track Record Period.

The PRC

Under the Law of the PRC on Enterprise Income Tax (the “EIT Law”) and Implementation Regulation of the EIT Law, PRC EIT is calculated at 25% of the assessable profits for subsidiaries established in the PRC.

Pursuant to the relevant laws and regulations in the PRC, Sichuan Huanlong, our subsidiary in the PRC, was qualified under the development strategy of the PRC’s western region and was able to enjoy a preferential income tax rate of 15% for the three years ended 31 December 2020 and the six months ended 30 June 2021. In 2014, Shanghai Jinxiong, our subsidiary in the PRC, was accredited as a high and new technology enterprise in 2014 and further renewed in 2017 and 2020, and was therefore entitled to a preferential tax rate of 15% during the Track Record Period and up to the year ending 31 December 2022. In addition, both Sichuan Huanlong and Shanghai Jinxiong are eligible for a tax deduction of up to 175%, 175%, 175% and 175% of approved research and development costs incurred for each of the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively.

The following table sets forth the breakdown of our income tax expense of our Group during the Track Record Period:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
				(unaudited)	
Current tax					
PRC EIT	4,818	6,187	7,181	1,913	2,221
Over-provision in prior year	—	—	(253)	—	(40)
	4,818	6,187	6,928	1,913	2,181
Deferred tax					
Current year	1,436	214	553	834	(10)
Income tax expense	6,254	6,401	7,481	2,747	2,171

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Reconciliation between income tax expense and accounting profit at applicable tax rate:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
				(unaudited)	
Profit before income tax.	43,460	41,478	48,494	14,259	16,457
Tax at the applicable income tax of 25%	10,865	10,370	12,124	3,565	4,115
Tax effects of non-deductible expenses ^(note)	1,177	2,801	2,314	454	198
Tax effects of non-taxable income . .	(1,053)	—	—	(44)	(10)
Tax effect of temporary differences previously not recognised	718	—	—	449	18
Utilisation of temporary differences previously not recognised	—	(582)	(92)	—	—
Additional deduction for research and development expenses	(1,803)	(2,200)	(1,291)	(435)	(921)
Over-provision in prior year	—	—	(253)	—	(40)
Effect of income taxed at concessionary rate.	(3,650)	(3,988)	(5,321)	(1,242)	(1,189)
Income tax expenses	<u>6,254</u>	<u>6,401</u>	<u>7,481</u>	<u>2,747</u>	<u>2,171</u>

Note: Tax effects of non-deductible expenses primarily included the tax effects of [REDACTED] of approximately [REDACTED] for the Track Record Period, respectively. The remaining amount was due to other non-deductible of insignificant amount such as certain entertainment expenses that are not deductible as according to the relevant laws, only 60% of the entertainment expenses incurred by the enterprise relating to the production and operation activities, but not higher than 0.5% of the revenue of the relevant year, is deductible, and the expenses incurred by Huanlong Lixin and Huanlong Funeng, as both companies did not generate any assessable income.

Our effective tax rates were approximately 14.4%, 15.4% and 15.4% for the three years ended 31 December 2020, respectively, and approximately 19.3% and 13.2% of our total revenue for the six months ended 30 June 2020 and 2021, respectively. Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our income tax expenses and effective tax rates during the Track Record Period. Please refer to note 8 of the Accountants’ Report set out in Appendix I to this document for more information.

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YEAR TO YEAR COMPARISON OF RESULTS OF OPERATIONS

Year ended 31 December 2020 compared with year ended 31 December 2019

Revenue

Our revenue increased by approximately RMB15.5 million or 9.3% from approximately RMB167.3 million for the year ended 31 December 2019 to approximately RMB182.8 million for the year ended 31 December 2020. This increase was mainly attributable to (i) the increase in revenue generated from the sales of our high-speed papermaking felts which generally command a relatively higher selling price during the period; (ii) the increase in sales volume of high-speed papermaking felts from approximately 177.9 tonnes for the year ended 31 December 2019 to approximately 256.5 tonnes for the year ended 31 December 2020, as a result of the Group allocated more resources to focus on enhancing research and development and production capacity to produce high-speed papermaking felts; and (iii) the growing demand for packaging paper with the surge in e-commerce due to the change in consumption pattern of the public and bolstered the demand for packaging paper in the PRC, as a result of the COVID-19 outbreak.

Cost of sales

Our overall cost of sales increased by approximately RMB5.1 million or 6.5% from approximately RMB78.0 million for the year ended 31 December 2019 to approximately RMB83.1 million for the year ended 31 December 2020, which is generally in line with (i) the increase of revenue for the year ended 31 December 2020; and (ii) the increase in our overall sales volume of our papermaking felts from approximately 1,117.5 tonnes for the year ended 31 December 2019 to 1,203.3 tonnes for the year ended 31 December 2020. Such increase is partially offset by the decrease in the average price of raw material of the Group for the year ended 31 December 2020, which is consistent with the trend of market price in the industry for the years ended 31 December 2019 and 2020.

Gross profit and gross profit margin

Our overall gross profit increased from approximately RMB89.3 million for the year ended 31 December 2019 to approximately RMB99.6 million for the year ended 31 December 2020, representing an increase of approximately RMB10.3 million or 11.5%. The increase in gross profit was mainly due to the increases in our revenue due to the reasons as discussed above. Our gross profit margin increased from approximately 53.4% for the year ended 31 December 2019 to approximately 54.5% for the year ended 31 December 2020 mainly due to the increase in the sale of our high speed papermaking felts which generally command a relatively higher selling price and factored in a higher profit margin.

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Other income

Our other income increased by approximately RMB1.2 million or 25.0% from approximately RMB4.8 million for the year ended 31 December 2019 to approximately RMB6.0 million for the year ended 31 December 2020. Such increase was mainly attributable to the combined effect of (i) the rent concessions of our Shanghai Production Site in relation to the COVID-19 outbreak of approximately RMB0.4 million; (ii) the increase of sales of scrap material by approximately RMB0.4 million; and (iii) the increase in government subsidies by approximately RMB0.6 million for the year ended 31 December 2020.

Selling and distribution expenses

Our selling and distribution expenses increased from approximately RMB14.9 million for the year ended 31 December 2019 to approximately RMB17.8 million for the year ended 31 December 2020, representing an increase of approximately RMB2.9 million or 19.5%. The increase was mainly due to the increase in agency service fees by approximately RMB2.3 million as a result of our devotion of resources to promote our brands and seek cooperation opportunities with the high quality or large-scale potential customers.

Administrative and other operating expenses

Our administrative and other operating expenses increased from approximately RMB31.1 million for the year ended 31 December 2019 to approximately RMB32.1 million for the year ended 31 December 2020, representing an increase of approximately RMB1.0 million or 3.2%. Such increase was mainly due to the provision of legal claims of approximately RMB1.3 million in the consolidated statements of profit or loss for the year ended 31 December 2020 made for a claim in relation to the construction of factory building two. For more information of the claim, please refer to the paragraph headed “Business — Legal proceedings and compliance” in this document.

Finance costs

Our finance cost increased by approximately RMB0.5 million or 7.5% from approximately RMB6.7 million for the year ended 31 December 2019 to approximately RMB7.2 million for the year ended 31 December 2020. This was due to the net effect of the following: (i) the increase of interest expenses on bank borrowings by approximately RMB0.8 million; and (ii) decrease in interest expenses on discounted bills financing by approximately RMB0.2 million mainly due to decrease in the amounts of bills discounted to banks prior to maturity for the year ended 31 December 2020.

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Income tax expense

Our income tax expense increased by approximately RMB1.1 million or 17.2% from approximately RMB6.4 million for the year ended 31 December 2019 to approximately RMB7.5 million for the year ended 31 December 2020, which was mainly due to the increase in our profit before income tax from approximately RMB41.5 million for the year ended 31 December 2019 to approximately RMB48.5 million for the year ended 31 December 2020.

Profit and total comprehensive income for the year and net profit margin

As a result of the foregoing, the profit and total comprehensive income for the year increased from approximately RMB35.1 million for the year ended 31 December 2019 to approximately RMB41.0 million for the year ended 31 December 2020, representing an increase of approximately RMB5.9 million or 16.8% while our net profit margin increased from approximately 21.0% for the year ended 31 December 2019 to approximately 22.4% for the year ended 31 December 2020.

Year ended 31 December 2019 compared with year ended 31 December 2018

Revenue

Our revenue increased by approximately RMB7.9 million or 5.0% from approximately RMB159.4 million for the year ended 31 December 2018 to approximately RMB167.3 million for the year ended 31 December 2019. This increase was mainly attributable to (i) the increase in revenue of our packaging papermaking felts by approximately RMB8.7 million or 8.2% from approximately RMB106.0 million for the year ended 31 December 2018 to approximately RMB114.7 million for the year ended 31 December 2019, mainly due to the increase in its average selling price from approximately RMB145,000 per tonne to approximately RMB154,000 per tonne; and (ii) the increase in revenue generated from the sales of our high-speed papermaking felts which generally command a relatively higher selling price during the period. Despite the decrease in our overall sales volume, our sales volume of high-speed papermaking felts increased which resulted in higher average selling price of our papermaking felts. According to the Frost & Sullivan Report, papermaking felts are commonly classified into high-speed, medium-speed and low-speed based on the operating speed of papermaking machine and high-quality papermaking felts are generally required for high-speed papermaking machine. The prices of medium-speed and high-speed papermaking felts are relatively higher as they are of better quality. As our Group has allocated more resources to focus on enhancing research and development and production capacity to produce high-speed papermaking felts, both our production volume and sales volume of high-speed papermaking felts increased.

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Cost of sales

Although our revenue increased by approximately RMB7.9 million or 5.0% for the year ended 31 December 2019, our overall cost of sales decreased by approximately RMB3.5 million or 4.3% from approximately RMB81.5 million for the year ended 31 December 2018 to approximately RMB78.0 million for the year ended 31 December 2019. In which our raw materials costs decreased by approximately RMB3.5 million due to the net effect of (i) the decrease in cost of monofilaments by approximately RMB2.9 million or 14.4% for the year ended 31 December 2019, which corresponded to the decrease in overall sales volume of our papermaking felts from approximately 1,142 tonnes for the year ended 31 December 2018 to approximately 1,118 tonnes for the year ended 31 December 2019; and (ii) the increase in depreciation of approximately RMB0.7 million or 17.9% for the year ended 31 December 2019 mainly because of the full year effect of depreciation expenses arising from the additions of plant and machinery during the year ended 31 December 2018.

Gross profit and gross profit margin

During the Track Record Period, our overall gross profit and gross profit margin were affected by the following: (i) the type of products sold; (ii) costs of raw materials; (iii) the demand in paper industries and overall product’s market trend; (iv) the prevailing market prices of products; and (v) the bargaining power of our customers. Our overall gross profit increased from approximately RMB77.9 million for the year ended 31 December 2018 to approximately RMB89.3 million for the year ended 31 December 2019, representing an increase of approximately RMB11.4 million or 14.6%. The increase was mainly due to the combined effect of the increase in our revenue and the decrease in our cost of sales during the same period as a result of the reasons as discussed above. Our gross profit margin increased from approximately 48.9% for the year ended 31 December 2018 to approximately 53.4% for the year ended 31 December 2019, which was mainly due to (i) the decrease in our cost of sales as a result of the reasons aforesaid; and (ii) the increase in the production and sales volume of the medium-speed and high-speed papermaking felts with higher gross profit margin by approximately RMB11.1 million or 17.5% from approximately RMB63.6 million for the year ended 31 December 2018 to approximately RMB74.7 million for the year ended 31 December 2019.

Other income

Our other income decreased by approximately RMB3.3 million or 40.7% from approximately RMB8.1 million for the year ended 31 December 2018 to approximately RMB4.8 million for the year ended 31 December 2019. Such decrease was mainly due to the decrease in government subsidies received from various local governmental authorities where according to our Directors, those government subsidies are subject to changes in policies in terms of the types of research

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projects which can be subject to these subsidies. During the year ended 31 December 2019, certain research projects conducted on the development of various papermaking felts including specialty papermaking felts and high-speed papermaking felts did not qualify for the government subsidies from local governmental authorities.

Selling and distribution expenses

Our selling and distribution expenses increased by approximately RMB2.3 million or 18.3% from approximately RMB12.6 million for the year ended 31 December 2018 to approximately RMB14.9 million for the year ended 31 December 2019 which was mainly due to the combined effect of (i) the increase in our agency service fees by approximately RMB1.6 million as a result of our devotion of resources to maintain our sales channels and promote our brands; and (ii) the increase of travel and entertainment expenses by approximately RMB0.6 million for the year ended 31 December 2019.

Administrative and other operating expenses

Our administrative and other operating expenses increased by approximately RMB8.7 million or 38.8% from approximately RMB22.4 million for the year ended 31 December 2018 to approximately RMB31.1 million for year ended 31 December 2019. Such increase was mainly due to the net effect of the following: (i) the increase in research and development costs by approximately RMB1.9 million or 35.2% because of our progress in research and development of papermaking felts and the related technological production process for the year ended 31 December 2019; (ii) the increase of [REDACTED] in connection with the [REDACTED] by approximately [REDACTED] or [REDACTED] for the year ended 31 December 2019; and (iii) the decrease in provision of allowance on receivables and inventories by approximately RMB1.0 million for the year ended 31 December 2019 where according to our Directors, the fluctuations were mainly affected by the changes in the ageing analysis of our trade receivables.

Finance costs

Our finance costs decreased by approximately RMB0.8 million or 10.7% from approximately RMB7.5 million for the year ended 31 December 2018 to approximately RMB6.7 million for the year ended 31 December 2019. This decrease was mainly due to the decrease of interest expenses on bank borrowings by approximately RMB0.7 million for the year ended 31 December 2019, as a result of the decrease of our bank borrowings from RMB122.5 million for the year ended 31 December 2018 to RMB117.0 million for the year ended 31 December 2019.

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Income tax expense

Our income tax expense remained relatively stable at approximately RMB6.3 million for the year ended 31 December 2018 to approximately RMB6.4 million for the year ended 31 December 2019, which the slight increase was mainly due to the net effect of (i) the increase of approximately RMB2.3 million in the tax effects of non-deductible expenses in the year ended 31 December 2019 which mainly resulted from non-deductible [REDACTED] in connection with the [REDACTED]; and (ii) the decrease of approximately RMB1.0 million in the tax effect of temporary differences previously not recognised. Please refer to note 2.21 of the Accountants’ Report set out in Appendix I to this document for more information.

Profit and total comprehensive income for the year and net profit margin

The profit and total comprehensive income for the year decreased by RMB2.1 million or 5.7% from approximately RMB37.2 million for the year ended 31 December 2018 to approximately RMB35.1 million for the year ended 31 December 2019. Our net profit margin decreased from approximately 23.3% for the year ended 31 December 2018 to 21.0% for the year ended 31 December 2019. The decrease of the profit and total comprehensive income for the year and net profit margin were mainly due to the net effect of (i) the increase in gross profit and gross profit margin; (ii) the increase in selling and distribution expenses; and (iii) the increase in administrative and other operating expenses mainly because of the increase of [REDACTED] of approximately [REDACTED].

PERIOD TO PERIOD COMPARISON OF RESULTS OF OPERATION

Six months ended 30 June 2021 compared with six months ended 30 June 2020

Revenue

Our revenue increased by approximately RMB10.3 million or 15.6% from approximately RMB66.2 million for the six months ended 30 June 2020 to approximately RMB76.5 million for the six months ended 30 June 2021. This increase was mainly attributable to (i) the increase in revenue of our packaging papermaking felts by approximately RMB8.7 million or 19.8% from approximately RMB44.0 million for the six months ended 30 June 2020 to approximately RMB52.7 million for the six months ended 30 June 2021, mainly due to the increase in its sales volume from approximately 292.0 tonnes to approximately 348.4 tonnes; (ii) the increase in revenue generated from the sales of our high-speed papermaking felts which generally command a relatively higher selling price during the period; and (iii) the growing demand for packaging paper with the surge in e-commerce due to the change in consumption pattern of the public which bolstered the demand for packaging paper in the PRC.

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Cost of sales

Our overall cost of sales increased by approximately RMB6.0 million or 19.1% from approximately RMB31.4 million for the six months ended 30 June 2020 to approximately RMB37.4 million for the six months ended 30 June 2021. Such increase in overall cost of sales mainly due to (i) increase in raw material and direct labour cost attributable to the business growth; and (ii) the increase in overall sales volume of our papermaking felts.

Gross profit and gross profit margin

During the Track Record Period, our overall gross profit and gross profit margin were affected by the following: (i) the type of products sold; (ii) costs of raw materials; (iii) the demand in paper industries and overall product’s market trend; (iv) the prevailing market prices of products; and (v) the bargaining power of our customers. Our overall gross profit increased from approximately RMB34.9 million for the six months ended 30 June 2020 to approximately RMB39.1 million for the six months ended 30 June 2021. The increase was mainly due to the increase in our revenue during the same period as a result of the reasons as discussed above. Our gross profit margin decreased slightly from approximately 52.6% for the six months ended 30 June 2020 to approximately 51.1% for the six months ended 30 June 2021, which was mainly due to (i) the decrease in the average selling prices of high-speed and low-speed papermaking felts during the same period as we provided competitive price to our existing customers in respect of our new types of papermaking felts products and new customers to attract them to purchase our products; and (ii) the temporary change in our product mix, especially the increase in sales of household papermaking felts and pulp papermaking felts with lower average selling prices.

Other income

Our other income decreased by approximately RMB0.2 million or 13.3% from approximately RMB1.5 million for the six months ended 30 June 2020 to approximately RMB1.3 million for the six months ended 30 June 2021. Such decrease was mainly due to the decrease in government subsidies and the decrease in rent concession received being recognised of approximately RMB231,000 for the six months ended 30 June 2020.

Selling and distribution expenses

Our selling and distribution expenses increased by approximately RMB0.8 million or 12.7% from approximately RMB6.3 million for the six months ended 30 June 2020 to approximately RMB7.1 million for the six months ended 30 June 2021 which was mainly due to the combined effect of (i) the increase in our salaries and benefits by approximately RMB0.7 million; and (ii) the increase of travel and entertainment expenses by approximately RMB0.9 million during the

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period since more business travels for the six months ended 30 June 2021 than the same period in 2020 due to the impact of the outbreak of COVID-19 and our increasing effort on sourcing new customers.

Administrative and other operating expenses

Our administrative and other operating expenses increased by approximately RMB0.9 million or 7.4% from approximately RMB12.1 million for the six months ended 30 June 2020 to approximately RMB13.0 million for six months ended 30 June 2021. Such increase was mainly due to the net effect of the following: (i) the increase in research and development costs by approximately RMB1.2 million because of our progress in research and development of papermaking felts and the related technological production process during the same period; and (ii) the increase in our salaries and benefits offset by the decrease in [REDACTED].

Finance costs

Our finance costs increased slightly by approximately RMB0.2 million or 5.6% from approximately RMB3.6 million for the six months ended 30 June 2020 to approximately RMB3.8 million for the six months ended 30 June 2021, which was relatively stable.

Income tax expense

Our income tax expense decreased by approximately RMB0.5 million or 18.5% from approximately RMB2.7 million for the six months ended 30 June 2020 to approximately RMB2.2 million for the six months ended 30 June 2021, which was mainly due to the high amount of non-deductible expenses for the six months ended 30 June 2020.

Profit and total comprehensive income for the period and net profit margin

As a result of the foregoing, the profit and total comprehensive income for the period increased by RMB2.8 million or 24.3% from approximately RMB11.5 million for the six months ended 30 June 2020 to approximately RMB14.3 million for the six months ended 30 June 2021. Our net profit margin increased from approximately 17.4% for the six months ended 30 June 2020 to 18.7% for the six months ended 30 June 2021.

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NET CURRENT ASSETS

The following table sets forth the breakdown of our current assets and current liabilities as at the dates indicated:

	As at 31 December			As at 30 June	As at 31 August
	2018	2019	2020	2021	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i> (unaudited)
Current assets					
Inventories	12,311	11,263	10,034	11,529	16,512
Trade and other receivables	107,511	128,885	141,111	123,767	120,742
Amounts due from related parties	3,220	3,389	205	99	61
Restricted bank deposit	1,800	1,000	1,000	1,002	1,002
Cash and cash equivalent	14,851	28,439	29,775	37,702	23,516
	139,693	172,976	182,125	174,099	161,833
Current liabilities					
Contract liabilities	737	711	739	1,034	1,034
Trade and other payables	41,850	43,899	47,221	46,484	38,698
Lease liabilities	1,453	1,397	1,545	1,574	1,586
Amounts due to a related party	27	30	27	5	5
Discounted bills financing	500	450	—	—	—
Bank borrowings	122,500	117,000	115,000	115,000	115,000
Other borrowing	—	—	—	7,942	8,374
Income tax payable	3,765	4,642	6,586	4,344	3,872
	170,832	168,129	171,118	176,383	168,569
Net current (liabilities)/assets	(31,139)^(Note 1)	4,847	11,007	(2,284)^(Note 2)	(6,736)

Notes:

- We recorded net current liabilities as at 31 December 2018, which was mainly due to a decrease in current assets attributable to (i) a dividend of RMB20.0 million distributed for the year ended 31 December 2018; (ii) the acquisition of intangible assets of RMB32.5 million; and (iii) the acquisition of land use right of RMB6.7 million.

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2. We recorded net current liabilities as at 30 June 2021, which was mainly due to (i) the other borrowing of approximately RMB7.9 million which will be settled within one year incurred during the six months ended 30 June 2021, which was the sale and leaseback obligation in relation to the acquisition of a set of production machinery under phase one of our production capacity expansion plan; and (ii) the additions to the property, plant and equipment of approximately RMB63.3 million, which was mainly for the construction costs of factory building two.

DISCUSSION OF SELECTED STATEMENT OF FINANCIAL POSITION ITEMS

We recorded net assets of approximately RMB86.3 million as at 31 December 2018, RMB123.3 million as at 31 December 2019, RMB164.3 million as at 31 December 2020 and RMB178.6 million as at 30 June 2021. Such increase was mainly due to the accumulation of net profits throughout the Track Record Period.

We recorded net current assets of approximately RMB4.8 million as at 31 December 2019 as compared to the net current liabilities of approximately RMB31.1 million as at 31 December 2018. Such change in net current assets was mainly due to the net effect of (i) the increase in cash and cash equivalents by approximately RMB13.6 million due to the net effect of the decrease of net cash used in investing activities of RMB20.1 million and the increase of net cash used in financing activities of RMB5.3 million for the year ended 31 December 2019; (ii) increase of trade and other receivables by approximately RMB21.4 million mainly because of the higher revenue at the end of the year ended 31 December 2019 as compared to the year ended 31 December 2018, mainly due to the earlier Chinese New Year holidays in January 2020 when compared to the Chinese New Year holidays of 2019 in February, while our customers generally placed orders prior to the Chinese New Year holidays. It results in the increase of outstanding amount of trade receivables as at 31 December 2019 as we usually grant our customers a credit period of up to 180 days.

We recorded net current assets of approximately RMB11.0 million as at 31 December 2020 compared to that of approximately RMB4.8 million as at 31 December 2019. Such increase was mainly due to (i) the increase in trade and other receivables by approximately RMB12.2 million due to the increase in revenue; and (ii) the increase in cash and cash equivalents by approximately RMB1.3 million.

We recorded net current liabilities of approximately RMB2.3 million as at 30 June 2021 as compared to the net current assets of approximately RMB11.0 million as at 31 December 2020. Such change was mainly due to (i) the other borrowing of approximately RMB7.9 million which will be settled within one year incurred during the six months ended 30 June 2021, which was the sale and leaseback obligation in relation to the acquisition of a set of production machinery under phase one of our production capacity expansion plan; and (ii) the additions to the property, plant and equipment of approximately RMB63.3 million, which was mainly for the construction costs of factory building two.

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We recorded net current liabilities of approximately RMB6.7 million as at 31 August 2021 as compared to the net current liabilities of approximately RMB2.3 million as at 30 June 2021. Such change was mainly due to (i) the decrease in cash and cash equivalent of approximately RMB14.2 million; and (ii) the increase in other borrowing of approximately RMB0.4 million.

Our Directors believe that we have sufficient working capital to meet our present and future cash requirements for at least the next 12 months from the date of publication of this document, taking into account cash flow generated from our business, bank loans and facilities and [REDACTED]. The details of these factors are as follows:

- i. Cash flow generated from our business. We recorded net cash generated from operating activities of approximately RMB45.5 million, RMB42.9 million, RMB54.6 million and RMB35.7 million for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively;
- ii. Bank loans and facilities. Historically, we have been able to refinance our short-term bank borrowings at maturity if needed, and we do not foresee any impediment in continuing to do so in the future. We will continue to maintain relationship with our principal banks so as to timely obtain or renew bank borrowings if so required and on acceptable terms to our Group; and
- iii. [REDACTED]. We expect to receive [REDACTED] of approximately [REDACTED] (equivalent of approximately [REDACTED]) based on the low end of the [REDACTED] range set out in this document and assuming the [REDACTED] is not exercised.

Going forward, we believe our liquidity requirements will be satisfied by using funds from a combination of cash flows from operations, our cash and cash equivalents, bank borrowings and [REDACTED]. As at 31 August 2021, being the latest practicable date for the liquidity disclosures, we had RMB115.0 million available bank facilities, which was fully utilised. Other than the bank borrowings that we may obtain, we do not have any plans for material external debt financing. As such, our Directors believe that the net current liabilities as at 31 December 2018 and 30 June 2021 will not have any adverse effect on the going concern of our Group.

Our Directors confirm that we had no default or delay in payment of our bank borrowings and lease liabilities during the Track Record Period that would have material impact on our business, financial conditions or results of operations. We will keep on monitoring our liquidity position to ensure sufficient working capital is maintained.

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Property, plant and equipment

Property, plant and equipment mainly comprise of buildings, leasehold improvements, plant and machinery, furniture and fixtures, motor vehicles, and construction in progress. As at 31 December 2018, 2019 and 2020 and 30 June 2021, the carrying amount of property, plant and equipment amounted to approximately RMB65.7 million, RMB61.6 million, RMB72.7 million and RMB131.2 million, respectively.

The carrying amount of property, plant and equipment decreased by RMB4.1 million from RMB65.7 million as at 31 December 2018 to RMB61.6 million as at 31 December 2019, mainly due to the depreciation.

The carrying amount of property, plant and equipment increased by RMB11.1 million from RMB61.6 million as at 31 December 2019 to RMB72.7 million as at 31 December 2020, mainly due to the increase of construction in progress of RMB15.3 million primarily from the increase in construction cost of factory building two.

The carrying amount of property, plant and equipment increased by RMB58.5 million from RMB72.7 million as at 31 December 2020 to RMB131.2 million as at 30 June 2021, mainly due to the increase of construction in progress of RMB60.8 million primarily from the acquisition of production machinery and the increase in construction cost of factory building two.

Intangible assets

Our intangible assets mainly included trademarks, computer software, capitalised development costs which arise from research and development costs in respect of papermaking felts production technique after relevant trial operation and inspection, and construction in progress which arise from research and development costs in respect of papermaking felts production technique before relevant trial operation and inspection, and amounted to approximately RMB39.9 million as at 31 December 2018, RMB44.2 million as at 31 December 2019, RMB51.1 million as at 31 December 2020 and RMB55.7 million as at 30 June 2021.

Our intangible assets increase from RMB39.9 million as at 31 December 2018 to RMB44.2 million as at 31 December 2019, mainly due to the increase in (i) the purchase of computer software of RMB0.6 million, (ii) the addition of capitalised development costs, and (iii) the addition of construction in progress. Our intangible assets further increased to RMB51.1 million as at 31 December 2020 and RMB55.7 million as at 30 June 2021, mainly due to the increase in (i) the addition of capitalised development costs, and (ii) the addition of construction in progress.

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The trademarks with indefinite useful lives and the intangible assets under construction in progress which are not yet available for use have been allocated to the relevant cash-generating units (the “CGU”) which is the same for impairment testing. The recoverable amount of the CGU has been determined based on value in use calculations, covering a detailed four-year budget plan, followed by an extrapolation of expected cash flows at the average growth rates of 4%. The discount rates applied to the cash flow projections were 13.6%, 12.4%, 13.0% and 12.8% as at 31 December 2018, 2019, 2020 and 30 June 2021, respectively. The key assumptions for our Group have been determined by our Group’s management based on past performance and its expectations for the industry development. The discount rates used are pre-tax and reflects specific risks relating to the segment. Based on the above key assumptions, the recoverable amount would exceed the carrying amounts of the CGU by not less than approximately RMB32.0 million, RMB46.0 million, RMB57.0 million and 57.1 million as at 31 December 2018, 2019, 2020 and 30 June 2021, respectively. If the growth rate decreased by 1% or the discount rate (pre-tax) increased by 1%, the recoverable amount of the relevant CGU would be dropped by approximately RMB5.0 million and RMB6.5 million as at 31 December 2018, RMB7.3 million and RMB9.2 million as at 31 December 2019, RMB7.8 million and RMB9.8 million as at 31 December 2020 and RMB8.5 million and RMB12.2 million as at 30 June 2021, respectively.

In the opinion of the directors of the Company, a reasonably possible change in key parameters would not cause the carrying amount of the relevant cash-generating unit to exceed the recoverable amount. If the growth rate decreased by 15% or discount rate increased by 8% as at 31 December 2018 or the growth rate decreased by 18% or discount rate increased by 10% as at 31 December 2019 or the growth rate decreased by 25% or discount rate increased by 13% as at 31 December 2020 or the growth rate decreased by 26% or discount rate increased by 13% as at 30 June 2021, the recoverable amount of the relevant CGU would be approximated to its carrying amount.

In the opinion of the directors, there is no reasonably possible change in the key assumptions on which the recoverable amount of the trademarks is based that would cause the carrying amounts to exceed the recoverable amount.

In addition, we acquired ten trademarks since the trademarks are important to our papermaking felts business operated by our operating subsidiary, namely Sichuan Huanlong, under Chengdu Huanlong in 2018 prior to the Reorganisation. We acquired these trademarks from Chengdu Huanlong, which ceased to be the controlling shareholder of our subsidiary after the Reorganisation, due to the importance of the trademarks for our papermaking felts business and the fact that Chengdu Huanlong ceased to be the controlling shareholder of our subsidiary after the Reorganisation. The contract sum of the acquisition of these ten trademarks, being approximately RMB32.5 million (net of VAT), was determined after arm’s length negotiation between the parties and based on normal commercial terms, with reference to a valuation report.

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Inventories

The following table sets forth the breakdown of our inventories as at 31 December 2018, 2019 and 2020 and 30 June 2021:

	As at 31 December			As at 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Raw materials	7,870	7,574	5,448	5,582
Work-in-progress	2,658	2,162	2,922	3,296
Finished goods	3,658	3,444	2,831	4,061
	14,186	13,180	11,201	12,939
Less: provision for inventories (<i>Note</i>)	(1,875)	(1,917)	(1,167)	(1,410)
Total	12,311	11,263	10,034	11,529

Note: Provision for inventories is mainly made on finished goods aged over one year, which is made over 70% of the cost amount.

Our inventory mainly includes raw materials, work-in-progress and finished goods. Our raw material inventories mainly include commonly used raw materials as well as supplemental raw materials such as packaging materials.

As at 31 December 2018, 2019 and 2020 and 30 June 2021, our Group’s inventories of RMB3.9 million, RMB3.1 million, RMB2.4 million and RMB2.8 million are pledged to a bank to secure bank borrowing granted to the Group.

Our inventories decreased by approximately RMB1.0 million or 8.1% to approximately RMB11.3 million as at 31 December 2019 further decreased by approximately RMB1.3 million or 11.5% to approximately RMB10.0 million as at 31 December 2020. Our inventories increased by approximately RMB1.5 million or 15.0% to approximately RMB11.5 million as at 30 June 2021.

The fluctuation of our inventories balances as at the end of each reporting period was because we maintain our inventory level based on the amount of purchase orders received and our projection of the demand from our customers which is made with reference to historical order amounts.

We regularly review our inventory levels for slow moving inventory, obsolescence or declines in market value. Allowance is made when the net realisable value, which is based primarily on the latest market price estimated by management, of inventories falls below the cost of any of the

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inventories is identified as obsolete. Provision or (reversal) for inventories of approximately RMB0.1 million, RMB42,000, RMB(0.8) million and RMB0.2 million were recognised for the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively. Our Directors consider the provision for inventories as at 30 June 2021 is adequate for the reasons that: (i) majority of the inventories of finished goods were aged less than one year and our inventory turnover days during the Track Record Period is only around two months; (ii) for the finished goods aged more than one year, we have made provision of 70% of the cost amount, based on our past experience and taking into account the income from selling them as scraps; and (iii) the finished goods aged over one year are not perishable or fragile products and can maintain saleable value.

The following is an ageing analysis of our Group’s inventories as at the end of each of the year/period comprising the Track Record Period:

	As at 31 December			As at 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
0 to 90 days	8,754	8,040	6,872	8,386
91 days to 180 days	547	850	641	421
181 days to 365 days	1,891	1,214	608	1,422
Over 365 days	2,994	3,076	3,080	2,710
	14,186	13,180	11,201	12,939

The following table sets forth the turnover days of our inventories for the years/period indicated:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>
Inventory turnover days ^(Note)	65.9	55.2	46.9	72.8	52.1

Note: Average inventory turnover days is calculated as the average of the beginning and ending inventory balances for the year/period, divided by the cost of sales of the relevant year/period, multiplied by the number of days in the relevant year/period.

Our inventory turnover days decreased from approximately 65.9 days for the year ended 31 December 2018 to approximately 55.2 days for the year ended 31 December 2019 and further decreased to approximately 46.9 days for the year ended 31 December 2020, which, according to our Directors, was primarily attributable to improvement in managing our inventory level. Our

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inventory turnover days decreased from approximately 72.8 days for the six months ended 30 June 2020 to approximately 52.1 days for the six months ended 30 June 2021. Such decrease in inventory turnover days was mainly due to the improvement of our inventory control measures.

As at the Latest Practicable Date, approximately RMB9.7 million or 74.8% of our inventories as at 30 June 2021 had been used or sold.

Trade and other receivables

As at 31 December 2018, 2019 and 2020 and 30 June 2021, our trade and other receivables amounted to approximately RMB107.5 million, RMB128.9 million, RMB141.1 million and RMB123.8 million, respectively. The following table sets out a breakdown of our trade and other receivables as at the indicated dates:

	As at 31 December			As at 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Trade receivables				
— Third parties	82,069	97,568	110,475	106,417
— Related parties	1,140	847	577	470
Bills receivables	23,719	22,684	27,408	15,786
Less: Loss allowance provision	(8,053)	(4,268)	(5,724)	(5,950)
	<u>98,875</u>	<u>116,831</u>	<u>132,736</u>	<u>116,723</u>
Prepayments	585	2,657	3,004	2,049
Prepaid [REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Other receivables	6,791	6,692	2,230	1,750
	<u>8,636</u>	<u>12,054</u>	<u>8,375</u>	<u>7,044</u>
	<u>107,511</u>	<u>128,885</u>	<u>141,111</u>	<u>123,767</u>

Our trade receivables and bills receivables are derived from sales of our products. Depending on business negotiations, some of our customers pay deposits for their sales order and settle the remaining balance after the delivery of products while some of our customers settle the full transaction amounts in advance. Our customers generally settle the trade receivables by bank acceptance bills or bank remittance. While some of our customers are required to settle payment before delivery of our products, we generally granted a credit period of 30 to 180 days to our customers during the Track Record Period.

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Trade receivables

The following is an ageing analysis of trade receivables presented based on the delivery date as at the respective dates indicated:

	As at 31 December			As at 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Within 90 days	51,827	66,545	73,589	53,344
91 days to 180 days	15,855	14,890	20,472	12,206
181 days to 365 days	6,647	12,072	11,314	35,593
Over 365 days	8,880	4,908	5,677	5,744
	83,209	98,415	111,052	106,887

As at the Latest Practicable Date, approximately RMB81.1 million or 97.5%, RMB96.2 million or 97.8%, RMB91.6 million or 82.5%, and RMB46.7 million or 43.7% of our trade receivables as at 31 December 2018, 2019 and 2020 and 30 June 2021 have been settled, respectively.

Due to the fragmented nature of our Group’s customers base, our Group’s trade receivables during the Track Record Period were attributed by over 300 customers, which did not indicate any material concentration issues. The trade receivables attributed by our five largest debtors was approximately 16.2%, 17.0%, 13.9% and 12.0%, respectively, of our trade receivables as at the year/period ended date of the Track Record Period.

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The trade receivables aged over 180 days as at 30 June 2021, which remained outstanding as at the Latest Practicable Date, amounted to approximately RMB19.2 million. The table below sets out the details of subsequent settlement of our long outstanding trade receivable balances as at 30 June 2021 (namely those aged over 180 days and remained unsettled as at the Latest Practicable Date) by category of customers:

	Trade receivables aged over 180 days as at 30 June 2021	Subsequent settlement up to the Latest Practicable Date	Unsettled balance of trade receivables up to the Latest Practicable Date
	<i>(RMB'000)</i>	<i>(RMB'000)</i>	<i>(RMB'000)</i>
<i>The five largest debtors</i>	7,131	3,809	3,322
<i>The five largest customers during the Track Record Period</i>			
Customer Group A	817	817	—
Customer Group B	2	—	2
Customer Group F	464	464	—
Customer Group G	205	202	3
Customer H	552	552	—
Subtotal	2,040	2,035	5
<i>Other customers</i> ^(note)	32,166	16,307	15,859
Total	<u>41,337</u>	<u>22,151</u>	<u>19,186</u>

Note: There were over 200 customers included in this category and the amount of trade receivables attributed ranged from approximately RMB10,000 to RMB0.9 million with an average of approximately RMB139,000.

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As at the Latest Practicable Date, the subsequent settlements of our Group’s trade receivables by age group as at the end of each of the years/period comprising the Track Record Period are as below:

	Trade receivable as at 31 December 2018	Subsequent settlement up to the Latest Practicable Date	
	<i>RMB'000</i>	<i>RMB'000</i>	%
Within 90 days	51,827	50,993	98.4
91 days to 180 days	15,855	15,469	97.6
181 days to 365 days	6,647	6,157	92.6
Over 365 days	8,880	8,464	95.3
	<u>83,209</u>	<u>81,083</u>	97.4

	Trade receivable as at 31 December 2019	Subsequent settlement up to the Latest Practicable Date	
	<i>RMB'000</i>	<i>RMB'000</i>	%
Within 90 days	66,545	66,116	99.4
91 days to 180 days	14,890	14,636	98.3
181 days to 365 days	12,072	11,543	95.6
Over 365 days	4,908	3,920	79.9
	<u>98,415</u>	<u>96,215</u>	97.8

	Trade receivable as at 31 December 2020	Subsequent settlement up to the Latest Practicable Date	
	<i>RMB'000</i>	<i>RMB'000</i>	%
Within 90 days	73,589	59,844	81.3
91 days to 180 days	20,472	17,961	87.7
181 days to 365 days	11,314	10,207	90.2
Over 365 days	5,677	3,547	62.5
	<u>111,052</u>	<u>91,559</u>	82.4

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	Trade		
	receivable as at 30 June 2021	Subsequent settlement up to the Latest Practicable Date	
	<i>RMB'000</i>	<i>RMB'000</i>	%
Within 90 days	53,344	18,081	33.9
91 days to 180 days	12,206	6,436	52.7
181 days to 365 days	35,593	19,587	55.0
Over 365 days (<i>Note</i>)	5,744	2,564	44.6
	<u>106,887</u>	<u>46,668</u>	43.7

Up to the Latest Practicable Date, the unsettled balances of the trade receivables as at 31 December 2018 and 2019 were approximately RMB2.1 million and RMB2.2 million, respectively. As at 31 December 2018 and 2019, approximately RMB8.1 million and RMB4.3 million of loss allowance provision had been made, respectively, all of which are higher than the latest unsettled balances of the trade receivables in the respective year. As at the Latest Practicable Date, approximately RMB2.3 million trade receivables as at 30 June 2021 were subject to legal proceedings initiated by us against our customers for chasing the trade receivables, of which we have made the provisions of approximately RMB2.2 million.

Up to the Latest Practicable Date, there were approximately RMB60.2 million of trade receivables as at 30 June 2021 remained unsettled. The outstanding amounts as at the Latest Practicable Date are considered recoverable for the reasons that: (i) in respect of the trade receivables aged 180 days or below, the trade receivables under this category are within the general credit period of around 30 to 180 days granted to our customers; (ii) in respect of the trade receivables aged 180 days or above, there were approximately RMB19.2 million unsettled balance. Out of such RMB19.2 million unsettled balance, approximately RMB17.8 million were related to customers who either had made repayment or had or expected to have sales transactions with our Group in 2021; while for the remaining approximately RMB1.4 million, we had made the impairment provision of approximately RMB2.6 million as at 30 June 2021; (iii) we had good and long term business relationships with the relevant customers involved the trade receivables mentioned above and, to the best knowledge of our Directors, we are not aware that such customers had any financial difficulties in repaying the relevant trade receivables as these customers are either listed companies or top players in the papermaking industries or customers which have/will have ongoing and/or potential future business relationship with us; and (iv) based on the historical experience, over 90% of the trade receivables as at 31 December 2018 and 2019 has been eventually settled.

Our trade receivables increased from approximately RMB83.2 million as at 31 December 2018 to approximately RMB98.4 million as at 31 December 2019 and further increased to approximately RMB111.1 million as at 31 December 2020. The increase in trade receivables was

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mainly due to our business growth during the Track Record Period which our revenue increased from approximately RMB159.4 million for the year ended 31 December 2018 to approximately RMB167.3 million for the year ended 31 December 2019 and further increased to approximately RMB182.8 million for the year ended 31 December 2020. In particular, the increase of trade receivables as at 31 December 2019 as compared to 31 December 2018 was mainly because of (i) the increase in revenue; and (ii) the higher revenue at the end of the year ended 31 December 2019 as compared to the year ended 31 December 2018, mainly due to the earlier Chinese New Year holidays in January 2020 when compared to the Chinese New Year holidays of 2019 in February, while our customers generally placed orders prior to the Chinese New Year holidays. The increase of trade receivables as at 31 December 2019 as compared to 31 December 2020 was mainly due to the increase in revenue as mentioned above. Our trade receivables decreased slightly from approximately RMB111.1 million as at 31 December 2020 to approximately RMB106.9 million as at 30 June 2021.

The trade receivables aged 181 days to 365 days amounted to approximately RMB35.6 million as at 30 June 2021. Such higher outstanding amount of trade receivables was mainly due to the following reasons: (i) our sales for the last quarter for each year during the three years ended 31 December 2020 represented approximately 34%, 42% and 42% of our total sales of the relevant year, resulting in the increase in outstanding amount of trade receivables as at the end of the relevant year; and (ii) during the Track Record Period, the amount of trade receivables aged 181 days to 365 days was generally high during the first half of the calendar year and was generally settled during the second half of the calendar year, and based on the understanding of the Directors, such amount of trade receivables aged 181 days to 365 days as at 30 June 2021 will be settled during the second half of the year. The trade receivables aged over 365 days amounted to approximately RMB8.9 million, RMB4.9 million, RMB5.7 million and RMB5.7 million as at 31 December 2018, 2019 and 2020 and 30 June 2021. The reasons for, and the circumstances leading to, the prolonged settlement by our customers in practice are that: (i) since most of our major customers are sizeable companies with good reputation and due to the long-term and good relationship between our Group and its customers, we allow our customers to pay in a longer period in practice despite the credit period as agreed; (ii) taking into account our past experience of transactions with our major customers, our major customers will subsequently settle the outstanding amounts although the settlements are prolonged; (iii) we have continuing business relationship with our major customers and we are able to negotiate with them about the settlement even if the settlement is prolonged after the credit period as agreed; and (iv) the prolonged period of settlements by our customers are in line with the industry norm as it is a common situation in the market for the downstream players with strong bargaining power such as large scale papermaking companies to have prolonged settlement to suppliers of papermaking felts in practice.

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The movement in the loss allowance provision of trade receivables is as follows:

	As at 31 December			As at 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
At the beginning of the year	6,656	8,053	4,268	5,724
Amounts written off	—	(4,587)	—	(93)
Provision of allowance	1,397	802	1,456	319
At the end of the year	<u>8,053</u>	<u>4,268</u>	<u>5,724</u>	<u>5,950</u>

No full provision has been made for trade receivables that are more than 365 days past due as our Group determines the provision for impairment over our trade receivables based on expected credit losses, calculated by using the simplified approach as prescribed by HKFRS 9, which permits the use of the lifetime expected credit loss provision for all trade receivables. To the best knowledge of our Directors, certain of our customers required a longer credit term for settling, and in the opinion of our Directors, there was no imminent collectability or recoverability issues with such outstanding trade receivables which are expected to be fully recoverable, although the trade receivables aged 181 days to 365 days amounted to approximately RMB35.6 million as at 30 June 2021, having considered the following factors: (i) the overall expected growth in the papermaking felts industry in the PRC as stated in the Frost & Sullivan Report; (ii) the background of our customers and noted that the trade receivables balances were due from customers which are either listed companies or top players in the papermaking industries or customers which have/will have ongoing and/or potential future business relationship with us; (iii) historical transaction and repayment pattern of our customers and noted that the trade receivables balances were due from our customers who had sales transactions or made repayment to our Group during the past year and that our trade receivables were generally settled during the second half of the calendar year; (iv) as at the Latest Practicable Date, approximately RMB2.3 million trade receivables as at 30 June 2021 were subject to legal proceedings initiated by us against our customers for chasing the trade receivables, of which we have made the provisions of approximately RMB2.2 million, and no material bad debts record during the Track Record Period; and (v) our Group has implemented various measures to follow up on the trade receivables balances, including introducing incentive measures for sales personnel to increase their effort and motivation in collecting trade receivables. As confirmed by our Directors, we have continuously monitored the payments from those customers and contacted them to follow up on the status of their payments.

While some of our customers are required to settle payment before delivery of our products, we generally grant to our customers a credit period of around 30 to 180 days based on various factors including their years of business relationship with us, their historical payment records and the life span of products they purchase from us. If a customer fails to pay us punctually, we may

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reassess their creditability and adjust credit limits accordingly. We have implemented a system to manage our customers’ credit rating, credit limit and credit term. Our sales and marketing department conducts regular visits to our customers to stay updated about their operation conditions and assess their repayment ability. An assessment is made subsequently by our management team and finance and accounting department as to whether or not a provision for trade receivable should be made. For certain customers, we may request for payment of a deposit and settlement of the remaining balance on a cash-on-delivery basis.

Our Directors are of the view that any late payments from individual customers would not adversely affect our financial performance as our Directors believe that any concentration risk among our five largest customers was not significant given their respective contributions to our total revenue.

We determine the provision for impairment over our trade receivables based on expected credit losses (the “ECL”), calculated by using the simplified approach as prescribed by HKFRS 9, which permits the use of the lifetime expected loss provision for all trade receivables. Our Group considers a broader range of information when assessing credit risk and measuring ECL, including past events, current conditions, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the trade receivables, in accordance to HKFRS 9 Financial Instruments. Throughout the Track Record Period, the historical credit loss experience of the customers of our Group, the forward-looking factors specific to the debtors and the economic environment remains no significant changes. As such, expected credit loss rate throughout the Track Record Period remains the same. For further details, please refer to notes 2.9 and 33.4 of the Accountants’ Report set out in Appendix I to this document.

As at 31 December 2018, 2019 and 2020 and 30 June 2021, we had loss allowance provision of approximately RMB8.1 million, RMB4.3 million, RMB5.7 million and RMB6.0 million, respectively. Included in the balance of loss allowance provision are individually impaired trade receivables with an aggregate balance of approximately RMB3.4 million, RMB1.9 million, RMB1.7 million and RMB2.2 million as at 31 December 2018, 2019 and 2020 and 30 June 2021, respectively, with reference to the historical experience of these receivables, the collection of these receivables may not be recoverable. We do not hold any collateral over these balances.

Bills receivables

We allow certain customers to settle their purchases by way of bills issued by banks. Such bills are endorsable, unsecured and non-interest bearing. According to the Frost & Sullivan Report, settlement of payment through bills is common in manufacturing industry in the PRC. In particular, such settlement method is commonly adopted by market participants in papermaking industry, including papermaking enterprises and their suppliers such as papermaking felts

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manufacturer with high volume of cash flow involved amongst large number of suppliers. Accordingly, both customers and suppliers of papermaking felts manufacturers generally accept settlement of payment through bills. The number of customers who settled their purchases by way of bills were 229, 209, 197 and 170 during the three years ended 31 December 2020 and the six months ended 30 June 2021, respectively, where each of their respective revenue contributions were approximately RMB115.6 million, RMB109.6 million, RMB128.3 million and RMB43.7 million, and the amount of payments settled by bills were RMB110.4 million, RMB105.5 million, RMB116.6 million and RMB54.6 million, respectively. As at 31 December 2018, 2019 and 2020 and 30 June 2021, our bills receivables amounted to approximately RMB23.7 million, RMB22.7 million, RMB27.4 million and RMB15.8 million, respectively. Among them, bills receivables of approximately RMB0.5 million, RMB0.5 million, nil and nil were discounted to banks with recourse as at 31 December 2018, 2019 and 2020 and 30 June 2021, respectively. Such bills receivables are generally settled by the relevant banks within six to 12 months.

The bills represent promissory notes issued by banks received by our Group from customers who discharge their liabilities to pay our Group for the goods or services invoiced. These bills are endorsable, unsecured, non-interest bearing and generally matured within 1 year.

Included in the balances, bills receivables of RMB0.5 million, RMB0.5 million, nil and nil were discounted with recourse as at 31 December 2018, 2019 and 2020 and 30 June 2021, respectively. These bills receivables were not derecognised as the title of these bills receivables were not transferred to the counterparties. On the other hand, discounted bills financing of RMB0.5 million, RMB0.5 million, nil and nil were recognised for the cash received as at 31 December 2018, 2019 and 2020 and 30 June 2021, respectively. For further details, please refer to note 21 of the Accountants’ Report set out in Appendix I to this document.

The following is an ageing analysis of bills receivables presented based on issue date at the end of the respective dates indicated:

	As at 31 December			As at 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
0 to 90 days	16,453	14,608	12,894	8,959
91 days to 180 days	6,565	7,066	12,395	6,197
181 days to 365 days	701	1,010	2,119	630
	23,719	22,684	27,408	15,786

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Our bills receivables remained relatively stable at approximately RM23.7 million as at 31 December 2018, approximately RMB22.7 million as at 31 December 2019 and increased to approximately RMB27.4 million as at 31 December 2020. The fluctuations in our bills receivables were mainly due to (i) the increase in revenue by approximately RMB15.5 million or 9.3% from approximately RMB167.3 million for the year ended 31 December 2019 to approximately RMB182.8 million for the year ended 31 December 2020; and (ii) fluctuations in the amounts settled by different customers as at the respective reporting dates due to the different statement practices of different customers. Our bills receivables decreased from approximately RMB27.4 million as at 31 December 2020 to approximately RMB15.8 million as at 30 June 2021 mainly due to the reason that we used the bills to settle the payment of part of the production machinery under our production capacity expansion plan and the construction costs of factory building two.

As at the Latest Practicable Date, all of our bills receivables as at 31 December 2018, 2019 and 2020 had been fully settled and approximately RMB9.8 million or 62.4% of our bills receivable as at 30 June 2021 had been settled. For bills receivable to be considered settled, such bills were either endorsed to other suppliers or vendors, discounted to financial institutions, or received cash upon maturity of the bills. During the Track Record Period and up to the Latest Practicable Date, there was no default arising from bills receivables.

Not included in the years/period end balances, during the years ended 31 December 2018, 2019 and 2020 and the six months ended 30 June 2021, our Group has transferred bills receivables amounted to RMB64.2 million, RMB67.8 million, RMB80.2 million and RMB44.5 million to settle our payables through endorsing the bills to the suppliers of raw materials and other vendors of plant and machinery and construction of buildings. Under the bills arrangements which the details are set out under the paragraph headed “Business — Legal proceedings and compliance — Bill arrangements”, our Group has also transferred bills receivables amounted to RMB30.2 million, RMB20.4 million, RMB0.3 million and nil to related parties/Independent Third Party under Bills-To-Cash/Bills Arrangement and to customers under Bills Change Arrangement during the Track Record Period. Our Group has derecognised these bills receivables and trade and other payables in their entirety (for endorsing the bills to the suppliers) and derecognised these bills receivables in their entirety and recognised the corresponding amount of cash and/or endorsed bank acceptance bills of total equal value (for endorsing bills under Bills-To-Cash/Bills Arrangement or Bills Change Arrangement). In the opinion of our Directors, our Group has transferred substantially all the risks and rewards of ownership of these bills to the endorsee. In accordance with the Law of Negotiable Instruments in the PRC, the endorsee of the bills have a right of recourse against the endorser if the issuing banks default. Our Directors are of the view that, although our suppliers that our Group had endorsed bills to, have the right of recourse on our Group, we have the same right towards our customers that had endorsed bills to our Group, in the case of issuing banks default. Also, our Group has limited exposure in respect of the settlement obligation of these bills receivables under relevant PRC rules and regulations should the issuing banks failed to settle the bills on maturity date as our Directors considered the issuing banks of the

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bills are of good credit quality and the risk of non-settlement by the issuing banks on maturity is insignificant. Our Directors confirmed that during the Track Record Period, the issuing banks settled the bills on maturity.

The maximum exposure to loss, which is same as the amount payable by our Group to the endorsee in respect of the endorsed bills, should the issuing banks fail to settle the bills on maturity date amounted to RMB94.4 million, RMB88.2 million, RMB80.5 million and RMB44.5 million as at 31 December 2018, 2019 and 2020 and the six months ended 30 June 2021, respectively. All the bills receivables endorsed have a maturity date of less than one year from the end of the reporting period.

Our Directors confirm that, save for the ordinary course of business as disclosed in this document, each of the customers whom settled their purchases by bills or each of the suppliers that our Group settled our payables through endorsing the bills did not have any other fund flows and financing relationships with our Group, our Controlling Shareholders, our Directors, our senior management, or any of their respective associates.

The following table sets forth the turnover days of our trade receivables for the years indicated:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>
Trade receivables turnover					
days ^(Note)	174.9	198.1	209.7	264.8	257.8

Note: Trade receivables turnover days is calculated as the average of aggregate balance of the trade receivables for the year/period, divided by revenue for the relevant year/period, multiplied by the number of days in the relevant year/period.

Our trade receivables turnover days for each of the three years ended 31 December 2020 and the six months ended 30 June 2021 were approximately 174.9 days, 198.1 days, 209.7 days and 257.8 days, respectively. Our trade receivables turnover days were generally high and increased during the Track Record Period as our revenue is subject to seasonal fluctuations. Our sales order during the months of January and September to December are generally higher than that of other months. In particular, our sales for the last quarter for each year during the three years ended 31 December 2020 represented approximately 34%, 42% and 42% of our total sales of the relevant year, resulting in the increase of outstanding amount of trade receivables as at the end of the relevant year, and thus, contributing to the generally high trade receivables turnover days. Our trade receivables turnover days for the year ended 31 December 2018 were approximate to the range of credit period we granted to our customers, while our trade receivables turnover days for

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the year ended 31 December 2019 increased to approximately 198.1 days and further increased to approximately 209.7 days for the year ended 31 December 2020 mainly due to the increase in revenue from approximately RMB167.3 million for the year ended 31 December 2019 to approximately RMB182.8 million for the year ended 31 December 2020. It results in the increase of outstanding amount of trade receivables as at 31 December 2019 and 2020 as we usually grant our customers a credit period of up to 180 days. The fluctuation of trade receivables turnover days for the six months ended 30 June 2020 and 2021 was due to the same reasons as discussed above and the fact that more customers settled their trade receivables during the second half of the calendar year during the Track Record Period. As confirmed by our Directors, our customers’ payment pattern remained stable and no material delay was revealed during the Track Record Period.

To improve the situation of generally high trade receivables turnover days, our Group has implemented the following measures: (i) established a standard range of credit period to be granted to customers; (ii) strengthened daily supervision of trade receivables and conducted analysis of trade receivables at the beginning of each month to prevent the occurrence of overdue trade receivables; (iii) adopted different collection plan and methods for different situations in collecting trade receivables; and (iv) introduced incentive measures for sales personnel to increase their effort and motivation in collecting trade receivables.

While some of our customers are required to settle payment before delivery of our products, we generally grant to our customers a credit period of around 30 to 180 days. The determination of the credit term to be granted to our customers and circumstances under which a longer credit term may be granted depend on various factors including their years of business relationship with us, their historical payment records and the life span of products they purchase from us. According to the Frost & Sullivan Report, the credit period granted to customers is based on the commercial decisions of papermaking felts enterprises and is subject to various factors such as track record, purchasing amount, lifecycle of papermaking felts and business relationship with key customers. The trade receivable turnover days of the PRC papermaking felts manufacturers generally range from 33 days to 240 days. As such, although our trade receivables turnover days for the first half of the calendar year was generally higher, our trade receivables turnover days during the three years ended 31 December 2020 were in line with general market practice.

Prepayments and other receivables

Our prepayments are mainly prepayments made to raw material suppliers for the purchase of raw materials and agency service fees and amounted to approximately RMB0.6 million as at 31 December 2018, RMB2.7 million as at 31 December 2019, RMB3.0 million as at 31 December 2020 and RMB2.0 million as at 30 June 2021.

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Our other receivables mainly consist of advances to our employees which were approximately RMB6.8 million as at 31 December 2018, RMB6.7 million as at 31 December 2019, RMB2.2 million as at 31 December 2020 and RMB1.8 million as at 30 June 2021. As at 31 December 2018, 2019 and 2020 and 30 June 2021, our advances to our employees were approximately RMB2.4 million, RMB4.2 million, RMB21,000 and RMB0.2 million, respectively. According to our internal control policy, such advances to employees cover expenses for business trips, disbursement expenses, special circumstances such as work injuries and other reasons that comply with our internal rules and regulations. Please refer to the paragraph headed “Business — Internal control” in this document for more information.

Included in the non-current assets, our Group also had the prepayment of acquisition for property, plant and equipment and intangible assets and amounted to approximately RMB3.5 million as at 31 December 2018, RMB3.6 million as at 31 December 2019, RMB22.6 million as at 31 December 2020 and RMB5.0 million as at 30 June 2021. Such amounts remained stable in 2018 and 2019. The increase from 2019 to 2020 was mainly due to our prepayment for plant and machinery in relation to the phase one of our production capacity expansion plan which commenced in fourth quarter of 2020. The decrease from approximately RMB22.6 million as at 31 December 2020 to approximately RMB5.0 million as at 30 June 2021 was mainly due to certain prepayment for the acquisition of production machinery and construction of factory building two which was recorded as property, plant and equipment for the six months ended 30 June 2021.

Amounts due from/(to) related parties

The following table sets forth a summary of the amounts due from/to related parties which are non-trade in nature as at the dates indicated:

	As at 31 December			As at
	2018	2019	2020	30 June
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Amounts due from/(to):				
Sichuan Huanlong New Material Ltd.* (四川環龍新材料有限公司) (“ Huanlong New Material ”) ^(Note 1)	—	155	155	—
Sichuan Xilong Biomass Materials Technology Ltd.* (四川省西龍生物質材料科技有限公司) (formerly known as Sichuan Xilong Paper Ltd.* (四川省西龍紙業有限公司)) (“ Sichuan Xilong ”) ^(Note 2)	3,204	3,204	—	—
Mr. Zhou ^(Note 3)	8	15	25	30
Ms. Shen ^(Note 4)	8	15	25	30
Mr. Xie ^(Note 5)	(27)	(30)	(27)	(5)
Ms. Yuan ^(Note 6)	—	—	—	39

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Notes:

1. As at 31 December 2018, 2019 and 2020, the amounts due from Huanlong New Material were approximately nil, RMB0.2 million and RMB0.2 million, respectively, where such amount due as at 31 December 2019 and 31 December 2020 were rental payments to us in relation to the rental of a part of the production facility at our Chengdu Production Site for a rental period from 1 June 2019 to 31 October 2019.
2. As at 31 December 2018 and 2019, the amounts due from Sichuan Xilong were advances to them for working capital.
3. As at 31 December 2018, 2019 and 2020 and 30 June 2021, the amounts due from Mr. Zhou were RMB8,000, RMB15,000, RMB25,000 and RMB30,000, respectively. According to our Directors, the amounts due as at 31 December 2018, 2019 and 2020 and 30 June 2021 were advances in relation to the company secretarial fees in respect of a BVI company held by Mr. Zhou and Ms. Shen.
4. As at 31 December 2018, 2019 and 2020 and 30 June 2021, the amounts due from Ms. Shen were RMB8,000, RMB15,000, RMB25,000 and RMB30,000, respectively. According to our Directors, the amounts due as at 31 December 2018, 2019 and 2020 and 30 June 2021 were advances in relation to the company secretarial fees in respect of a BVI company held by Mr. Zhou and Ms. Shen.
5. As at 31 December 2018, 2019 and 2020 and 30 June 2021, the amounts due to Mr. Xie were approximately RMB27,000, RMB30,000, RMB27,000 and RMB5,000, respectively. According to our Directors, the amounts due as at 31 December 2018, 2019 and 2020 and 30 June 2021 were mainly reimbursement to Mr. Xie for expenses for business trips and disbursement.
6. As at 31 December 2018, 2019 and 2020 and 30 June 2021, the amounts due from Ms. Yuan were approximately nil, nil, nil, and RMB39,000, respectively, which was advances to Ms. Yuan for expenses for business trips and disbursement.

The above amounts due from/to related parties were non-trade in nature, unsecured, interest-free and repayable on demand. The carrying amounts approximates their fair value and are denominated in RMB.

The amounts due from/to Huanlong New Material, Mr. Zhou, Ms. Shen, Mr. Xie and Ms. Yuan as at 30 June 2021 will be settled by cash prior to the [REDACTED].

Please refer to note 30 of the Accountants’ report set out in Appendix I to this document for more information in relation to our related party transactions and the paragraph headed “Connected Transactions — Non-exempt continuing connected transactions” in relation to our transactions with Sichuan Huanlong New Material Ltd. and Sichuan Huanlong Daily Products Ltd..

Contract liabilities

Our contract liabilities mainly represent amounts received from some of our customers as deposits or advance payments for purchase of our products which will be recognised as revenue upon the delivery of our products. The deposit is recognised as contract liability until the product

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has been delivered to the customer. Our contract liabilities remained stable at approximately RMB0.7 million, RMB0.7 million, RMB0.7 million and RMB1.0 million as at 31 December 2018, 2019 and 2020 and 30 June 2021, respectively.

Trade and other payables

The following table sets out the breakdown of trade and other payables as at the dates indicated:

	As at 31 December			As at 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Trade payables				
Trade payables				
— Third parties	20,027	20,131	19,054	16,718
Other payables				
Other payables	3,870	5,015	3,237	14,410
Accruals	3,527	3,985	4,514	2,963
Accrued [REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Warranty provision	3,279	3,422	3,932	4,161
Provision for legal claims ^(note 1)	—	—	1,903	2,200
Other tax payables	6,292	5,664	6,156	671
	<u>21,823</u>	<u>23,768</u>	<u>28,167</u>	<u>29,766</u>
	<u>41,850</u>	<u>43,899</u>	<u>47,221</u>	<u>46,484</u>

Note:

- Sichuan Huanlong was involved in a claim during the Track Record Period in relation to the construction of factory building two as set out in the paragraph headed “Business — Legal proceedings and compliance — Legal proceedings” in this document.

Trade payables

Trade payables mainly consist of amounts due to our suppliers for the purchase of raw materials. While some of our suppliers require us to settle payment before delivery, other suppliers generally provide us with a credit period of 30 to 90 days. All of the trade payables are expected to be settled within one year or repayable on demand.

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The following table sets forth the ageing analysis of the trade payables of our Group as at the dates indicated, based on invoice dates:

	As at 31 December			As at 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Within 30 days	3,555	10,063	7,961	6,501
31 to 60 days	9,148	2,989	4,646	3,270
61 to 90 days	3,028	1,736	1,920	1,476
91 to 180 days	1,423	2,242	2,087	2,692
181 days to 365 days	1,894	1,580	1,568	1,632
Over 365 days	979	1,521	872	1,147
	20,027	20,131	19,054	16,718

Our trade payables remained relatively stable at approximately RMB20.0 million as at 31 December 2018 and approximately RMB20.1 million as at 31 December 2019, and decreased slightly to approximately RMB19.1 million as at 31 December 2020. Our trade payables further decreased to approximately RMB16.7 million as at 30 June 2021.

Our trade payables aged over 90 days amounted to approximately RMB4.3 million, RMB5.3 million, RMB4.5 million and RMB5.5 million as at 31 December 2018, 2019 and 2020 and 30 June 2021, respectively, representing 21.5%, 26.5%, 23.8% and 32.7% of our Group’s total trade payables outstanding at the end of the respective years/period comprising the Track Record Period. This was primarily due to (i) notwithstanding the credit period as stated in the contracts and/or purchase orders, our suppliers allowed us to pay in a longer period in practice, as a result of the long-term and good relationship between us and our supplier and our good credit history; and (ii) we are one of the leading players in the market with long standing history, strong brand and good reputation. Further, according to Frost & Sullivan, it is a common situation in the market for the downstream players with strong bargaining power such as large scale papermaking companies, to have prolonged settlement to suppliers of papermaking felts in practice. As such, it is also common situation for papermaking felts manufacturers to settle their payments to suppliers in a longer period in practice, as long as the papermaking felts suppliers are creditworthy without history of default. During the course of cooperation between us and our suppliers, there has not been any dispute due to settlement of trade payables. Our Directors also confirmed that there were no other side agreements, arrangements, understanding or fund flows between us and our suppliers during the Track Record Period and up to the Latest Practicable Date.

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The following table sets forth the turnover days of our trade payables for the years/period indicated:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>	<i>(day)</i>
Trade payables turnover days ^(Note) . . .	81.7	94.0	86.3	107.6	86.5

Note: Trade payables turnover days is calculated as the average of aggregate balance of the trade payables for the year/period, divided by the cost of sales for the relevant year/period, multiplied by the number of days in the relevant year/period.

Our trade payables turnover days increased from 81.7 days for the year ended 31 December 2018 to 94.0 days for the year ended 31 December 2019 and decreased to 86.3 days for the year ended 31 December 2020, which was primarily affected by different amounts of raw materials ordered near the end of each financial year. Our trade payables turnover days decreased to approximately 86.5 days for the six months ended 30 June 2021 from approximately 107.6 days for the six months ended 30 June 2020, which was mainly due to the increase in our payment to our suppliers during the six months ended 30 June 2021.

As at the Latest Practicable Date, approximately RMB13.1 million or 78.5% of our trade payables as at 30 June 2021 had been subsequently settled.

Other payables

Other payables mainly include payables for the purchase of machinery, fees for the installation of new machinery, salaries and other accrual expenses which amounted to approximately approximately RMB3.9 million, RMB5.0 million, RMB3.2 million and RMB14.4 million as at 31 December 2018, 2019 and 2020 and 30 June 2021. Such significant increase in other payables by approximately RMB11.2 million from approximately RMB3.2 million as at 31 December 2020 to approximately RMB14.4 million as at 30 June 2021 was mainly due to other payables for the construction costs of factory building two of approximately RMB10.5 million.

Accruals

Accruals mainly included salaries payable to employees, which amounted to approximately RMB3.5 million as at 31 December 2018, RMB4.0 million as at 31 December 2019, RMB4.5 million as at 31 December 2020 and RMB3.0 million as at 30 June 2021.

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Accrued [REDACTED]

Accrued [REDACTED] were expenses in relation to the [REDACTED], which were approximately [REDACTED] as at 31 December 2018, [REDACTED] as at 31 December 2019, [REDACTED] as at 31 December 2020 and [REDACTED] as at 30 June 2021.

Warranty provision

Warranty provision are provision for warranties that we provide to customers on our products. Our warranty provision remained relatively stable at approximately RMB3.3 million as at 31 December 2018, approximately RMB3.4 million as at 31 December 2019, approximately RMB3.9 million as at 31 December 2020 and RMB4.2 million as at 30 June 2021, which is consistent with the overall increase in our revenue during the same periods.

Provision for legal claim

Provision for legal claim refers to the provision made for a claim. Sichuan Huanlong was involved in a claim during the Track Record Period in relation to the construction of factory building two as set out in the paragraph headed “Business — Legal proceedings and compliance — Legal proceedings” in this document.

Other tax payables

Other tax payables mainly include payables of value-added tax in the PRC and was approximately RMB6.3 million as at 31 December 2018, RMB5.7 million as at 31 December 2019, RMB6.2 million as at 31 December 2020 and RMB0.7 million as at 30 June 2021. The decrease from approximately RMB6.3 million as at 31 December 2018 to approximately RMB5.7 million as at 31 December 2019 was consistent with the decrease in the value-added tax rate in the PRC. The increase in other tax payables from approximately RMB5.7 million as at 31 December 2019 to approximately RMB6.2 million as at 31 December 2020 was mainly due to the increase in our revenue. Our other tax payables further decreased to approximately RMB0.7 million as at 30 June 2021 due to the decrease in our VAT payable.

Lease liabilities

Our current lease liabilities are approximately RMB1.5 million as at 31 December 2018, RMB1.4 million as at 31 December 2019, RMB1.6 million as at 31 December 2020 and RMB1.6 million as at 30 June 2021, which were in relation to the leases of two production plants that were part of our Shanghai Production Site during the Track Record Period. Please refer to the paragraph headed “Business — Properties — Leased properties” in this document for more information.

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Amounts due to related parties

Please refer to the paragraph headed “Net current assets — Discussion of selected statement of financial position items — Amounts due from/to related parties” in this section for more information.

Discounted bills financing

Our discounted bills financing amounted to approximately RMB0.5 million as at 31 December 2018, RMB0.5 million as at 31 December 2019, nil as at 31 December 2020 and nil as at 30 June 2021. Please refer to the paragraph headed “Indebtedness — Discounted bills financing” in this section for more information.

Bank borrowings

Our bank borrowings amounted to approximately RMB122.5 million as at 31 December 2018, RMB117.0 million as at 31 December 2019, RMB115.0 million as at 31 December 2020 and RMB115.0 million as at 30 June 2021. Please refer to the paragraph headed “Indebtedness — Bank borrowings” in this section for more information.

Other borrowing

Our other borrowing (current portion) amounted to nil as at 31 December 2018, nil as at 31 December 2019, nil as at 31 December 2020 and approximately RMB7.9 million as at 30 June 2021, which was the sale and leaseback obligation in relation to the acquisition of a set of production machinery under phase one of our production capacity expansion plan. For the details of our production capacity expansion plan, please refer to the paragraph headed “Business — Our business strategies — Expanding our production capacity” in this document. In respect of this sale and leaseback agreement, the leasing company is a national financial leasing institution approved by the China Banking Regulatory Commission, the supplier of the relevant machinery and equipment is a limited liability company which was incorporated in the PRC in 2014 with a registered capital of RMB30.0 million, and the machinery and equipment involved include pre-needling machine, setting machine and other supplemental equipment. The salient terms of the sale and leaseback agreement are summarised below:

Lease term	The lease term is for 36 months, counting from the date when the lessor paid the equipment supplier the purchase price of the machinery and equipment under the purchase agreement
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Purchase price of the leased machinery and equipment	RMB30.0 million (including VAT)
Lease interest rate	Tax-included floating interest rate. The standard lease interest rate is determined by the market quoted interest rate for loans with a maturity of more than five years announced by the People’s Bank of China plus 255 basis points (of which, 1 basis point = 0.01%)
Lease payment, management fee and payment schedule	We shall pay our lease payments of approximately RMB2.8 million every 3 months for a period of 36 months. Management fee of RMB240,000 shall be paid in full within 3 business days upon signing the sale and leaseback agreement
Termination payment	Purchase price of the leased machinery and equipment times 3%
Consideration for buyback	RMB10,000
Insurance	The leased machinery and equipment shall be fully covered by insurance policies, under which the lessor shall be the first beneficiary
Guarantee	Shen Genlian (沈根蓮) and Zhou Jun (周駿), our executive Directors and Controlling Shareholders, shall be the guarantors of the lessee’s obligations, under which the guarantors shall bear joint and several guarantee responsibilities for the lessee’s obligations. Such guarantee will be released upon the [REDACTED]

Income tax payable

Our income tax payable amounted to approximately RMB3.8 million as at 31 December 2018, RMB4.6 million as at 31 December 2019, RMB6.6 million as at 31 December 2020 and RMB4.3 million as at 30 June 2021.

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LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL RESOURCES

Overview

Our primary use of cash is to fund our working capital requirements, property, plant and equipment and to repay loans and related interest expenses. During the Track Record Period, there had been no material changes in our underlying drivers of the sources and uses of cash.

We have funded our business primarily using proceeds from cash generated from our operating activities and bank borrowings. Our sources of liquidity will be satisfied using a combination of cash generated from operating activities, bank loans and the [REDACTED] and other funds raised from the capital markets from time to time upon [REDACTED]. We will closely monitor the level of our working capital, particularly for our future plans which may utilise significant amount of working capital.

Details of the funds necessary to meet our existing operations and to fund our future plans are set out in the section headed “Future Plans and [REDACTED]” in this document.

Capital expenditure

During the Track Record Period, we incurred capital expenditures of approximately RMB16.1 million, RMB4.1 million, RMB20.3 million and RMB63.5 million, respectively.

	Year ended 31 December			Six months ended 30 June
	2018	2019	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Property, plant and equipment				
Buildings	56	1,871	3,686	—
Leasehold improvements	434	156	—	—
Plant and machinery	9,683	5,734	1,203	2,559
Furniture and fixtures	89	57	148	97
Motor vehicles	28	—	—	—
Subtotal	10,290	7,818	5,037	2,656
Construction in progress:				
Additions	14,439	2,017	15,869	63,312
Less: Transfer to other categories of property, plant and equipment	(8,605)	(5,725)	(605)	(2,504)
Subtotal	5,834	(3,708)	15,264	60,808
Total	16,124	4,110	20,301	63,464

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Our capital expenditures for the year ending 31 December 2021 are expected to be approximately RMB72.5 million. Our capital expenditures primarily consisted of purchase of production machinery. Our Directors consider that continued investments in machinery is necessary in order to cope with our business development and increase our overall capacity in manufacturing our products to our customers. As such, we plan to acquire additional machinery in the future, further information of which is disclosed in the paragraph headed “Business — Business strategies” and the section headed “Future Plans and [REDACTED]” in this document. We plan to finance future capital expenditures primarily through the [REDACTED] as well as from cash flows generated from operations.

Cash flow

The following table sets forth a summary of our consolidated cash flows for the years indicated:

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
				(unaudited)	
Cash and cash equivalents at the beginning of the year/period	13,382	14,851	28,439	28,439	29,775
Operating cash flows before working capital changes	63,491	60,669	71,843	26,175	28,666
Change in working capital	(12,298)	(12,479)	(12,228)	939	11,459
Tax paid	(5,666)	(5,310)	(4,984)	(3,941)	(4,423)
Net cash generated from operating activities	45,527	42,880	54,631	23,173	35,702
Net cash used in investing activities.	(28,258)	(8,191)	(38,247)	(8,581)	(19,964)
Net cash used in financing activities	(15,800)	(21,101)	(15,048)	(11,897)	(7,811)
Net increase in cash and cash equivalents	1,469	13,588	1,336	2,695	7,927
Cash and cash equivalents at the end of year/period	<u>14,851</u>	<u>28,439</u>	<u>29,775</u>	<u>31,134</u>	<u>37,702</u>

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Operating activities

We derived our cash flow from operating activities primarily through the receipt of payments from sales of papermaking felts. Our cash outflow for operating activities was primarily attributable to payment for purchase of raw materials and other expenses for our operating activities. A statement of cash flow in relation to our operating activities is set out below.

	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i> (unaudited)	<i>RMB'000</i>
Operating activities					
Profit before income tax	43,460	41,478	48,494	14,259	16,457
Adjustments for:					
Amortisation of intangible assets	280	803	1,261	556	719
Depreciation of property, plant and equipment	7,455	8,242	9,141	4,595	4,649
Amortisation of land lease prepayment	225	338	338	169	169
Loss on disposal of property, plant and equipment	27	37	9	2	86
Provision/(Reversal) of provision for inventories	123	42	(750)	464	243
Provision for legal claims ^(note 1)	—	—	1,303	400	297
Provision of allowance on receivables, net	1,397	802	1,456	1,568	319
Provision of warranty	3,116	2,363	3,928	816	2,013
Interest income	(75)	(105)	(191)	(63)	(89)
Rent concessions	—	—	(387)	(231)	—
Finance costs	7,483	6,669	7,241	3,640	3,803
Operating cash flows before working capital changes	63,491	60,669	71,843	26,175	28,666
Decrease/(Increased) in inventories	4,681	1,006	1,979	(3,017)	(1,738)
(Increase)/Decrease in trade and other receivables	(19,570)	(22,176)	(13,682)	13,011	17,025
Decrease/(Increase) in amounts due from related parties	776	(168)	3,184	—	106
Increase/(Decrease) in trade and other payables	3,047	8,882	(3,734)	(9,084)	(4,207)
(Decrease)/Increase in contract liabilities	(1,177)	(26)	28	54	295
(Decrease)/Increase in amount due to a related party	(55)	3	(3)	(25)	(22)
Cash generated from operations	51,193	48,190	59,615	27,114	40,125
Income tax paid	(5,666)	(5,310)	(4,984)	(3,941)	(4,423)
Net cash generated from operating activities	45,527	42,880	54,631	23,173	35,702

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Note:

1. Sichuan Huanlong, being the defendant, was involved in a claim during the Track Record Period in relation to the dispute on the construction of factory building two as set out in the paragraph headed “Business — Legal proceedings and compliance — Legal proceedings” in this document. Based on the advice of our PRC Legal Advisers, our Directors estimated that the total potential claims payable to the claimant, being the previous constructor, is approximately RMB1.9 million, which included certain site preparation and construction works of approximately RMB0.6 million performed by the claimant (in which the amount have been recognised as part of the additions to the property, plant and equipment for the year ended 31 December 2020) and provision of legal claims of approximately RMB1.3 million recognised in profit or loss for the year ended 31 December 2020. The court made the first-instance judgment on 16 July 2021, according to which Sichuan Huanlong was liable to pay the claimant (i) construction fees in sum of approximately RMB0.7 million together with interest; and (ii) damages in sum of approximately RMB1.3 million. As such, a further provision of legal claims of approximately RMB0.3 million recognised in profit or loss for the six months ended 30 June 2021 and approximately RMB2.2 million in aggregate was recorded as provision for legal claim in the statement of financial position of the Group as at 30 June 2021. No party had lodged an appeal to the court and Sichuan Huanlong settled the amount of approximately RMB2.1 million to the claimant according to the aforesaid judgement on 27 August 2021.

Year ended 31 December 2018

For the year ended 31 December 2018, our net cash generated from operating activities was approximately RMB45.5 million, which was primarily attributable to the profit before income tax of approximately RMB43.5 million, adjusted positively for depreciation of property, plant and equipment of approximately RMB7.5 million and finance costs of approximately RMB7.5 million, and the net effect of the following: (i) increase in trade and other receivables of approximately RMB19.6 million which is consistent with the increase in our revenue during the same period; (ii) increase in trade and other payables of approximately RMB3.0 million mainly due to the accrued [REDACTED] in relation to the [REDACTED]; and (iii) income tax paid of approximately RMB5.7 million.

Year ended 31 December 2019

For the year ended 31 December 2019, our net cash generated from operating activities was approximately RMB42.9 million, which was mainly due to the net effect of (i) the profit before income tax of approximately RMB41.5 million, adjusted positively mainly for the depreciation of property, plant and equipment of approximately RMB8.2 million and finance costs of approximately RMB6.7 million; (ii) the increase in trade and other receivables of approximately RMB22.2 million mainly because of the higher revenue at the end of the year ended 31 December 2019 as compared to the year ended 31 December 2018, mainly due to the earlier Chinese New Year holidays in January 2020 when compared to the Chinese New Year holidays of 2019 in February, while our customers generally placed orders prior to the Chinese New Year holidays;

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(iii) the increase in trade and other payable of approximately RMB8.9 million mainly due to the increase in other payables and accrued [REDACTED] in relation to the [REDACTED]; (iv) income tax paid of approximately RMB5.3 million; and (v) decrease in inventories of approximately RMB1.0 million.

Year ended 31 December 2020

For the year ended 31 December 2020, our net cash generated from operating activities was approximately RMB54.6 million, which was primarily attributable to the profit before income tax of approximately RMB48.5 million, adjusted positively mainly for the depreciation of property, plant and equipment of approximately RMB9.1 million and finance costs of approximately RMB7.2 million and the net effect of the following: (i) the increase trade and other receivables of approximately RMB13.7 million which is consistent with the increase in revenue during the same period; (ii) the decrease in trade and other payables of approximately RMB3.7 million mainly due to the trade payables, accrued [REDACTED] in relation to the [REDACTED] and other tax payables; and (iii) income tax paid of approximately RMB5.0 million.

Six months ended 30 June 2021

For the six months ended 30 June 2021, our net cash generated from operating activities was approximately RMB35.7 million, which was primarily attributable to the profit before income tax of approximately RMB16.5 million, adjusted positively mainly for the depreciation of property, plant and equipment of approximately RMB4.6 million and finance costs of approximately RMB3.8 million and the net effect of the following: (i) the decrease in trade and other receivables of approximately RMB17.0 million; (ii) the decrease in trade and other payables of approximately RMB4.2 million mainly due to the trade payables, accrued [REDACTED] in relation to the [REDACTED] and other tax payables; and (iii) income tax paid of approximately RMB4.4 million.

Investing activities

Our investing activities primarily consisted of acquisition of and deposits paid for acquisition of property, plant and equipment, proceeds from disposal of property, plant and equipment, acquisition of intangible assets, acquisition of land lease prepayment, and restricted bank deposit. A statement of cash flow in relation to our investing activities is set out below.

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<i>Notes</i>	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
				(unaudited)	
Investing activities					
Acquisition of property, plant and equipment	(15,579)	(4,034)	(30,247)	(4,780)	(14,881)
Acquisition of intangible assets	(4,243)	(5,062)	(8,214)	(3,862)	(5,347)
Land lease prepayment	(6,757)	—	—	—	—
Interest received	75	105	191	63	89
Proceeds from disposal of property, plant and equipment	46	—	23	—	177
(Increase)/Decrease in restricted bank deposit	(1,800)	800	(—)	(2)	(2)
Net cash used in investing activities	<u>(28,258)</u>	<u>(8,191)</u>	<u>(38,247)</u>	<u>(8,581)</u>	<u>(19,964)</u>

Year ended 31 December 2018

For the year ended 31 December 2018, our net cash used in investing activities was approximately RMB28.3 million, which was primarily attributable to the following: (i) the acquisition of property, plant and equipment of approximately RMB15.6 million; (ii) the acquisition of intangible assets of approximately RMB4.2 million; (iii) the acquisition of land lease prepayment of approximately RMB6.8 million; and (iv) the increase in restricted bank deposit of approximately RMB1.8 million.

Year ended 31 December 2019

For the year ended 31 December 2019, our net cash used in investing activities was approximately RMB8.2 million, which was primarily attributable to the following: (i) the acquisition of property, plant and equipment of approximately RMB4.0 million; (ii) the acquisition of intangible assets of approximately RMB5.1 million; and (iii) partly offset by the decrease in restricted bank deposit of approximately RMB0.8 million.

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Year ended 31 December 2020

For the year ended 31 December 2020, our net cash used in investing activities was approximately RMB38.2 million, which was primarily attributable to the following: (i) the acquisition of property, plant and equipment of approximately RMB30.2 million; and (ii) the acquisition of intangible assets of approximately RMB8.2 million.

Six months ended 30 June 2021

For the six months ended 30 June 2021, our net cash used in investing activities was approximately RMB20.0 million, which was primarily attributable to the following: (i) the acquisition of property, plant and equipment of approximately RMB14.9 million; and (ii) the acquisition of intangible assets of approximately RMB5.3 million.

Financing activities

Our financing activities consisted of proceeds and prepayment of bank borrowings, interest paid, discounted bills financing and dividends paid. A statement of cash flow in relation to our financing activities is set out below.

<i>Notes</i>	Year ended 31 December			Six months ended 30 June	
	2018	2019	2020	2020	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
				(unaudited)	
Financing activities					
Proceeds of bank borrowings.	123,000	117,000	115,000	92,000	85,000
Repayment of bank borrowings.	(105,500)	(122,500)	(117,000)	(94,000)	(85,000)
Repayment of lease liabilities	(1,388)	(1,453)	(1,282)	(532)	(768)
Interest paid	(7,570)	(6,669)	(7,230)	(3,630)	(3,405)
[REDACTED] paid	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Increase in discounted bills financing	(4,154)	(50)	(450)	(450)	—
Dividends paid	(20,000)	—	—	—	—
Proceeds of capital contributions	—	1,940	—	—	—
Net cash used in from financing activities	(15,800)	(21,101)	(15,048)	(11,897)	(7,811)

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Year ended 31 December 2018

For the year ended 31 December 2018, our net cash used in financing activities was approximately RMB15.8 million, which was the net effect of the following: (i) proceeds of bank borrowings of approximately RMB123.0 million; (ii) repayment of bank borrowings of approximately RMB105.5 million; (iii) interest paid of approximately RMB7.6 million; (iv) decrease in discounted bills financing of approximately RMB4.2 million; and (v) dividends paid of approximately RMB20.0 million.

Year ended 31 December 2019

For the year ended 31 December 2019, our net cash used in financing activities was approximately RMB21.1 million, which was the net effect of the following: (i) proceeds of bank borrowings of approximately RMB117.0 million; (ii) repayment of bank borrowings of approximately RMB122.5 million; (iii) [REDACTED] paid of approximately [REDACTED]; (iv) interest paid of approximately RMB6.7 million; and (v) proceeds of capital contributions of approximately RMB1.9 million.

Year ended 31 December 2020

For the year ended 31 December 2020, our net cash used in financing activities was approximately RMB15.0 million, which was the net effect of the following: (i) proceeds of bank borrowings of approximately RMB115.0 million; (ii) repayment of bank borrowings of approximately RMB117.0 million; (iii) interest paid of approximately RMB7.2 million; and (iv) [REDACTED] paid of approximately [REDACTED].

Six months ended 30 June 2021

For the six months ended 30 June 2021, our net cash used in financing activities was approximately RMB7.8 million, which was the net effect of the following: (i) proceeds of bank borrowings of approximately RMB85.0 million; (ii) repayment of bank borrowings of approximately RMB85.0 million; (iii) interest paid of approximately RMB3.4 million; and (iv) [REDACTED] paid of approximately [REDACTED].

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SUFFICIENCY OF WORKING CAPITAL

Our Directors are of the opinion that, taking into consideration our internal resources, cash generated from our operations, banking facilities presently available to our Group, our existing cash and cash equivalents, and the [REDACTED] to be received by us from the [REDACTED], our Group has sufficient working capital for our present requirements for at least 12 months from the date of this document.

INDEBTEDNESS

As at 31 August 2021, being the date for this indebtedness statement, save as disclosed in this section below, we did not have any debt securities, term loans, other borrowing or indebtedness in the nature of borrowing, hire purchase commitments, mortgages, charges, contingent liabilities or guarantees. Our Directors confirm that we had neither experienced any difficulties in obtaining or repaying, nor breached any major covenant or restriction of our bank loans or other bank facilities during the Track Record Period. As at the Latest Practicable Date, there are no material covenants related to our outstanding debts that would materially limit our ability to undertake additional debt or equity financing. Our Directors confirm that there has not been any material change in our indebtedness or contingent liabilities since 31 August 2021 and up to the date of this document. Our Directors confirm that as at the Latest Practicable Date, save as disclosed in the paragraph headed “Financial Information — Recent development and no material adverse change — Progress of our production capacity expansion plan” in this document, we did not have any immediate plan for additional material external debt financing.

Bank borrowings

The following table sets forth our bank borrowings as at the respective dates indicated:

	As at 31 December			As at 30 June	As at 31 August
	2018	2019	2020	2021	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Bank loans, secured					(Unaudited)
— repayable within one year	122,500	117,000	115,000	115,000	115,000

The above bank borrowings were guaranteed by Ms. Shen, Mr. Zhou and one of our related parties, Chengdu Huanlong. Our Directors confirm that such guarantees will be released upon [REDACTED].

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Our bank borrowings during the Track Record Period were carried at amortised cost, secured and repayable within one year and were denominated in RMB. During the Track Record Period, our bank borrowings were generally secured by our property, plant and equipment, intangible assets, inventories, trade receivables, land lease prepayment and restricted bank deposit.

The effective interest rates of the bank borrowings per annum was 5.75%, 6.26%, 6.05% and 6.02% as at 31 December 2018, 2019 and 2020 and 30 June 2021, respectively.

As at 31 August 2021, being the latest practicable date for the liquidity disclosures in this document, we had banking facilities of RMB115.0 million, which was fully utilised.

During the Track Record Period, the bank borrowing agreements were entered into with the lenders under normal standard terms and conditions and do not contain any special restrictive covenants. During the Track Record Period and as of the Latest Practicable Date, none of our lenders have claimed default against us under any of the terms in the bank borrowing agreements. Our Directors confirm that our Group has not experienced any difficulty in obtaining bank borrowings, default in payment on bank borrowings or breach of finance covenants during the Track Record Period and up to the Latest Practicable Date and that they do not foresee any difficulties in obtaining bank borrowing after the Latest Practicable Date.

Discounted bills financing

The balance represents borrowings from banks by discounting, with recourse, bills receivables to the Group. The borrowings arose from discounting, with recourse, of bills receivables from third parties. Our discounted bills financing amounted to approximately RMB0.5 million as at 31 December 2018, RMB0.5 million as at 31 December 2019, nil as at 31 December 2020, nil as at 30 June 2021 and nil as at 31 August 2021. Please refer to note 21 of the Accountants’ Report set out in Appendix I to this document for more information.

Other borrowing

Our other borrowing (current portion) amounted to nil as at 31 December 2018, nil as at 31 December 2019, nil as at 31 December 2020, approximately RMB7.9 million as at 30 June 2021 and approximately RMB8.4 million as at 31 August 2021, which was the sale and leaseback obligation in relation to the acquisition of a set of production machinery under phase one of our production capacity expansion plan.

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Lease commitments

As at 31 December 2018, 2019 and 2020, 30 June 2021 and 31 August 2021, our leased properties are under leases that run for an initial period of one to five years, with an option to renew the lease and renegotiate the terms at the expiry date as mutually agreed between us and our respective landlords. The table below sets forth the lease commitments for short-term leases.

	As at 31 December			As at 30 June	As at 31 August
	2018	2019	2020	2021	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
					(unaudited)
Within one year.	21	25	59	29	20

Capital commitments

As at 31 December 2018, 2019 and 2020, 30 June 2021 and 31 August 2021, we had the following capital commitments:

	As at 31 December			As at 30 June	As at 31 August
	2018	2019	2020	2021	2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
					(unaudited)
Contracted but not provided for — Property, plant and equipment.	2,829	—	44,746	21,170	18,415

Our capital commitments as at 31 December 2018 which were contracted but not provided mainly represented the expected capital expenditure in respect of acquisition of property, plant and equipment, while our capital commitments as at 31 December 2020, 30 June 2021 and 31 August 2021 which were contracted but not provided mainly represented the expected capital expenditure in respect of construction of factory building two.

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Contingent liabilities

Sichuan Huanlong, being the defendant, was involved in a claim in relation to the dispute on the construction of factory building two. Based on the advice of our PRC Legal Advisers, our Directors estimated that the total potential claims payable to the claimant, being the previous constructor, is approximately RMB1.9 million. In this regard, our Group has made adequate provision for the aforesaid claim in the financial statements for the year ended 31 December 2020. The court made the first-instance judgment on 16 July 2021, according to which Sichuan Huanlong was liable to pay the claimant (i) construction fees in sum of approximately RMB0.7 million together with interest; and (ii) damages in sum of approximately RMB1.3 million. As such, a further provision of legal claims of approximately RMB0.3 million recognised in profit or loss for the six months ended 30 June 2021 and approximately RMB2.2 million in aggregate was recorded as provision for legal claim in the statement of financial position of the Group as at 30 June 2021. No party had lodged an appeal to the court and Sichuan Huanlong settled the amount of approximately RMB2.1 million to the claimant according to the aforesaid judgement on 27 August 2021. Please refer to the paragraph headed “Business — Legal proceedings and compliance” in this document for more information.

Save as the aforesaid claim, as at the Latest Practicable Date, no member of our Group was engaged in any claim, litigation or arbitration of material importance and no claim, litigation or arbitration of material importance is known to our Directors to be pending or threatened against any member of our Group.

OFF-BALANCE SHEET ARRANGEMENTS

As at the Latest Practicable Date, we did not have any material off-balance sheet arrangements except as otherwise disclosed.

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KEY FINANCIAL RATIOS

The following table sets out the key financial ratios of our Group during the Track Record Period:

	Year ended or as at 31 December 2018	Year ended or as at 31 December 2019	Year ended or as at 31 December 2020	Six months ended or as at 30 June 2021
Revenue growth	N/A	5.0%	9.3%	15.6%
Net profit growth	N/A	(5.7)%	16.8%	24.3%
Gross profit margin	48.9%	53.4%	54.5%	51.1%
Net profit margin	23.3%	21.0%	22.4%	18.7%
Return on equity	43.7%	28.4%	24.9%	N/A ^(Note 1)
Return on total assets	14.4%	12.0%	12.1%	N/A ^(Note 1)
Current ratio	0.8 times	1.0 times	1.1 times	1.0 times
Quick ratio	0.7 times	1.0 times	1.0 times	0.9 times
Inventory turnover days	65.9 days	55.2 days	46.9 days	52.1 days
Trade receivables turnover days	174.9 days	198.1 days	209.7 days	257.8 days
Trade payables turnover days	81.7 days	94.0 days	86.3 days	86.5 days
Gearing ratio ^(Note 2)	145.9%	96.4%	71.8%	80.4%
Net debt to equity ratio	128.7%	73.3%	53.6%	59.3%
Interest coverage ratio	6.8 times	7.2 times	7.7 times	5.3 times

Notes:

1. The semi-annual number is not meaningful as it is not comparable to annual number.
2. Gearing ratio is calculated as total borrowings (including discounted bills financing, bank borrowings, other borrowing and lease liabilities) divided by the total equity as at the respective reporting dates.

Revenue growth

Revenue growth is calculated as the difference between the revenue of the respective years and the revenue of the previous corresponding years/periods divided by the revenue of previous corresponding years/periods.

Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our revenue.

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Net profit growth

Net profit growth is calculated as the difference between the profit and total comprehensive income of respective years/periods and profit and total comprehensive income of the previous corresponding years/periods divided by the profit and total comprehensive income of previous corresponding years/periods.

Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our profit and total comprehensive income.

Gross profit margin

Gross profit margin is calculated as gross profit divided by revenue.

Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our gross profit and gross profit margin.

Net profit margin

Net profit margin is calculated as profit and total comprehensive income divided by revenue.

Please refer to the paragraphs headed “Year to year comparison of results of operations” and “Period to period comparison of results of operations” in this section for the reasons of the fluctuations in our net profit margin.

Return on equity

Return on equity is calculated as profit and total comprehensive income for the year/period attributable to owners of our Company divided by the ending equity attributable to owners of our Company as at the respective reporting dates.

Our return on equity decreased from approximately 43.7% for the year ended 31 December 2018 to approximately 28.4% for the year ended 31 December 2019 because of the increase in ending equity attributable to owners of our Company from approximately RMB78.6 million as at 31 December 2018 to approximately RMB121.9 million as at 31 December 2019 as a result of retained profits attributable to owners of the Company of approximately RMB34.6 million

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generated by the profit and total comprehensive income for the year while the Group did not declare any dividend for the year ended 31 December 2019 as compared to the dividends of approximately RMB20.0 million for the year ended 31 December 2018.

Our return on equity decreased from approximately 28.4% for the year ended 31 December 2019 to approximately 24.9% for the year ended 31 December 2020 because of an increase in ending equity attributable to equity holders of our Company from approximately RMB121.9 million as at 31 December 2019 to approximately RMB162.4 million as at 31 December 2020 as a result of profit and total comprehensive income during the same period.

Return on total assets

Return on total assets is calculated as profit and total comprehensive income for the year/period divided by the ending total assets as at the respective reporting dates.

Our return on total assets decreased from approximately 14.4% for the year ended 31 December 2018 and approximately 12.0% for the year ended 31 December 2019 mainly due to the increase in total assets mainly because of the increase of trade receivables and cash and cash equivalents.

Our return on total assets remained relatively stable at approximately 12.0% for the year ended 31 December 2019 and approximately 12.1% for the year ended 31 December 2020.

Current ratio

Current ratio is calculated as current assets divided by current liabilities as at the respective reporting dates.

Our current ratio was approximately 0.8 times as at 31 December 2018, approximately 1.0 times as at 31 December 2019, approximately 1.1 times as at 31 December 2020 and approximately 1.0 times as at 30 June 2021, which was generally stable.

Quick ratio

Quick ratio is calculated as current assets minus inventories, then divided by current liabilities as at the respective reporting dates.

Our quick ratio was approximately 0.7 times as at 31 December 2018, approximately 1.0 times as at 31 December 2019, approximately 1.0 times as at 31 December 2020 and approximately 0.9 times as at 30 June 2021, which was generally stable.

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Inventory turnover days

Inventory turnover days is calculated as the average of the beginning and ending inventory balances for the year/period, divided by the cost of sales of the relevant year, multiplied by the number of days in the relevant year/period.

Please refer to the paragraph headed “Analysis of various items of combined statements of financial position — Inventories” in this section for the reasons of the fluctuations in our inventory turnover days.

Trade receivables turnover days

Trade receivables turnover days is calculated based on the average of the beginning and ending balance of trade receivables divided by revenue for the year/period, then multiplied by the number of days of the year/period.

Please refer to the paragraph headed “Analysis of various items of combined statements of financial position — Trade and other receivables” for the reasons of the fluctuations in our trade receivables turnover days.

Trade payables turnover days

Trade payables turnover days is calculated based on the average of the beginning and ending balance of trade payables divided by cost of sales for the year/period, then multiplied by the number of days of the year/period.

Please refer to the paragraph headed “Analysis of various items of combined statements of financial position — Trade and other payables” for the reasons of the fluctuations in our trade payables turnover days.

Gearing ratio

Gearing ratio is calculated as total borrowings (including discounted bills financing, bank borrowings and lease liabilities) divided by the total equity as at the respective reporting dates.

Our gearing ratio decreased from approximately 145.9% as at 31 December 2018 to approximately 96.4% as at 31 December 2019 due to the increase in total equity as a result of retained profits generated from the profit and total comprehensive income for the year of approximately RMB34.6 million while the Group did not declared any dividend for the year ended 31 December 2019 as compared to the dividends of approximately RMB20.0 million for the year

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ended 31 December 2018. Our gearing ratio further decreased to approximately 71.8% as at 31 December 2020 due to the combined effect of (i) the increase in total equity as a result of profit and total comprehensive income during the same period; (ii) the decrease of bank borrowings; and (iii) the decrease of lease liabilities. Our gearing ratio increased to approximately 80.4% as at 30 June 2021 due to the combined effect of (i) the increase in total equity as a result of profit and total comprehensive income during the same period; and (ii) the increase in other borrowing.

Net debt to equity ratio

Net debt to equity ratio is calculated as net debts (i.e. total borrowings, net of cash and cash equivalents) divided by total equity as at the respective reporting dates.

Our net debt to equity ratio decreased from approximately 128.7% as at 31 December 2018 to approximately 73.3% as at 31 December 2019, subsequently decreased to approximately 53.6% as at 31 December 2020, and further increased to approximately 59.3% as at 30 June 2021. The changes were mainly due to the changes in total equity as mentioned above.

Interest coverage ratio

Interest coverage ratio is calculated as profit before finance costs and income tax expense divided by finance costs of the respective reporting years/period.

Our interest coverage ratio increased from approximately 6.8 times as at 31 December 2018 to approximately 7.2 times as at 31 December 2019 mainly because of the decrease in finance costs during the same period. Our interest coverage ratio further increased from approximately 7.2 times as at 31 December 2019 to approximately 7.7 times as at 31 December 2020 mainly due to the increase in profit before income tax from approximately RMB41.5 million for the year ended 31 December 2019 to approximately RMB48.5 million for the year ended 31 December 2020. Our interest coverage ratio decreased to approximately 5.3 times as at 30 June 2021 mainly due to the generally lower profit before income tax during the first half of the year as compared with that of the whole year due to seasonality and the increase in finance costs incurred from other borrowing.

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PROPERTY INTERESTS AND VALUATION

The table below sets forth the reconciliation between the net book value of our owned properties in Sichuan Province as at 30 June 2021 as extracted from the Accountants' Report as set out in the Appendix I to this document and the fair value as at 31 August 2021 as stated in the property valuation report in Appendix III to this document:

	<i>RMB'000</i>
Valuation of our owned properties as at 31 August 2021 as set out in the property valuation report in Appendix III to this document	67,180
Net book value of our owned properties as at 30 June 2021	65,026
Addition of our own properties	1,075
Depreciation and amortisation	(410)
Net book value as of 31 August 2021	65,691
Net valuation surplus	1,489

FINANCIAL RISK AND CAPITAL MANAGEMENT

Financial risk management

We are exposed to a variety of financial risks including market risk (including foreign currency risk and interest rate risk), credit risk and liquidity risk in our ordinary course of operations and in our investment activities. Our overall financial risk management policies focuses on the unpredictability and volatility at financial markets and seeks to minimise potential adverse effects on the financial position, financial performance and cash flows of our Group. For details of our financial risk management and fair value measurements, please refer to note 33 of the Accountants' Report set out in Appendix I to this document.

Capital management

Our capital structure consists of cash and cash equivalents, borrowings and equity, comprising fully paid capital and reserves. We actively and regularly reviews our capital structure and makes adjustments in light of changes in economic conditions. We monitor our capital structure on the basis of the net debt to equity ratio, of which net debt is defined as borrowings less cash and cash equivalents. In order to maintain or adjust the ratio, we may adjust the amount of dividends paid to the equity holders, issue new shares and raise new debt financing. Please also refer to note 34 of the Accountants' Report set out in Appendix I to this document for details of our capital management measures to ensure that we will be able to continue as a going concern.

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UNAUDITED PRO FORMA ADJUSTED NET TANGIBLE ASSETS

For our unaudited pro forma adjusted net tangible assets, please refer to the section headed “Unaudited pro forma financial information” in Appendix II to this document.

[REDACTED]

Our Directors estimate that the total amount of expenses in relation to the **[REDACTED]** is approximately **[REDACTED]** (equivalent to approximately **[REDACTED]**) based on an **[REDACTED]** of **[REDACTED]** per **[REDACTED]** (being the mid-point of the **[REDACTED]** range stated in this document). Out of the amount of approximately **[REDACTED]**, approximately **[REDACTED]** is directly attributable to the issue of the **[REDACTED]** and is expected to be accounted for as a deduction from equity upon **[REDACTED]**. The remaining amount of approximately **[REDACTED]**, which cannot be so deducted, shall be charged to profit or loss. Of the approximately **[REDACTED]** that shall be charged to profit or loss, approximately **[REDACTED]** has been charged during the Track Record Period and approximately **[REDACTED]** is expected to be incurred for the year ending 31 December 2021. Expenses in relation to the **[REDACTED]** are non-recurring in nature. Our financial performance and results of operations for the year ending 31 December 2021 will be adversely affected by the estimated expenses in relation to the **[REDACTED]**.

DIVIDEND

For the three years ended 31 December 2020 and the six months ended 30 June 2021, members of our Group declared dividends of approximately RMB20.0 million, nil, nil and nil, respectively. The RMB20.0 million dividends declared in the year ended 31 December 2018 were settled with funds generated from our business operations.

The declaration and payment of future dividends will be subject to the decision of the Board having regard to various factors, including but not limited to our operation and financial performance, profitability, business development, prospects, capital requirements, and economic outlook. It is also subject to any applicable laws. The historical dividend payments may not be indicative of future dividend trends. We do not have any pre-determined dividend pay-out ratio.

DISTRIBUTABLE RESERVES

Our Company was incorporated on 5 November 2018 and is an investment holding company. As at 31 December 2018, 2019 and 2020 and 30 June 2021, our Company had no reserves available for distribution to our Shareholders.

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DISCLOSURE REQUIRED UNDER THE LISTING RULES

Our Directors confirm that, as at the Latest Practicable Date, they were not aware of any circumstances which, had we been required to comply with Rules 13.13 to 13.19 of the Listing Rules, would have given rise to a disclosure requirement under Rules 13.13 to 13.19 of the Listing Rules.

RELATED PARTY TRANSACTIONS

Our related party transactions during the Track Record Period, which were based on normal commercial terms are summarised in note 30 of the Accountants’ Report set out in Appendix I to this document.

RECENT DEVELOPMENT AND NO MATERIAL ADVERSE CHANGE

Subsequent to 30 June 2021, being the latest date of the consolidated financial information of our Group as set out in Appendix I to this document and up to the Latest Practicable Date, we continued our focus on the design, manufacture and sales of papermaking felts. Our business model, revenue structure, cost structure, and the industry, market and regulatory environment in which we operate remained substantially unchanged since 30 June 2021 and up to the Latest Practicable Date.

Prospective investors should note that our financial results for the year ending 31 December 2021 will be mainly affected by the non-recurring [REDACTED] described above. The financial results for the year ending 31 December 2021 may not be comparable to the financial performance of our Group in the past. Save as disclosed in the paragraphs headed “Recent Development and No Material Adverse Change” and “[REDACTED]” in this section, our Directors confirm that, up to the date of this document, there had been no material adverse change in our financial or trading position or prospects since 30 June 2021, being the date on which our latest audited combined financial information was prepared and there had been no event since 30 June 2021 which would materially affect the information shown in the Accountants’ Report set out in Appendix I to this document.

Impact of outbreak of COVID-19 on our business

The outbreak of pneumonia-like illness named COVID-19 has been spreading globally. COVID-19 is highly infectious and has resulted in deaths in the PRC and other countries. On 30 January 2020, the World Health Organisation declared the outbreak of COVID-19 as a public health emergency of international concern and subsequently characterised COVID-19 as a pandemic on 11 March 2020. The PRC authorities have taken various measures, such as mandatory quarantine for residents and travelers, lockdown of certain cities and postponement of business

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units operation following the Chinese New Year holidays until mid of February 2020. For further details on the impact of outbreak of COVID-19 on our business, please refer to the paragraph “Business — Health and workplace safety — Impact of outbreak of COVID-19 on our business” in this document.

Progress of our production capacity expansion plan

In order to cater for the expected increasing demand in our high-speed papermaking felts, we have a three-phase production capacity expansion plan, of which we have commenced phase one in the fourth quarter of 2020. Such phase one of our production capacity expansion plan involves the acquisition of a set of production machinery including carding machine, cross-forming machine, pre-needling machine, setting machine and other supplemental equipment for our Chengdu Production Site and was financed by internal resources and an other borrowing of approximately RMB41.1 million. For the details of our production capacity expansion plan, please refer to the paragraph headed “Business — Our business strategies — Expanding our production capacity” in this document. As at the Latest Practicable Date, the production machinery acquired under this phase was installed and has commenced operation progressively in September 2021. As at the Latest Practicable Date, we have already contracted for approximately RMB41.1 million on capital expenditure in relation to phase one of our production capacity expansion plan, where we have obtained an other borrowing in an amount of RMB26.5 million from a financial institution in April 2021.