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

CLARIFICATION ANNOUNCEMENT

This is a voluntary announcement made by Tiangong International Company Limited (the "**Company**").

Reference is made to the clarification announcement dated 16 February 2022 of the Company (the "**Announcement**") in respect of certain allegations in a report (the "**Report**") issued by a financial research company, namely Emerson Analytics Co., Ltd, on 15 February 2022. Unless otherwise defined, capitalised terms used in this announcement shall have the same meanings as set out in the Announcement.

As set out in the Announcement, further announcement will be made by the Company to clarify and address other negative statements/comments concerning the Group as raised in the Report.

A. FURTHER CLARIFICATIONS

1. Overstatement of DS Production Volume

(A) The Report stated that:

- *"The production of DS and High Speed Steel is undertaken by Tiangong Aihe Special Steel Co., Ltd. and Jiangsu Tiangong Tools New Materials Co., Ltd., respectively"#.*

  # Chinese names and definitions are omitted from the quotation to avoid confusion

- *"Tiangong Lies to Investors but Not to Industry Association"*

- *"our investigation shows that it has consistently overstated its DS production volume, with 2020 real output at about 100k tons rather than the reported 181,7k tons"*

The Company would clarify that:

(i) The Company did not reported 181.7k tons of DS production volume in its annual reports for 2020; the figure was estimated by the Report based on its assumptions and "investigation";

(ii) TG Aihe did report 84k tonnes of production of DS products in 2019 to SSEA. As confirmed by SSEA, the 84k tonnes DS products figure is that of TG Aihe and does not cover other members of the Group (whether TG Tools New Materials or Jurong Tiangong New Materials Company Limited ("**Jurong TG New Materials**");

(iii) both TG Aihe and TG Tools New Materials owned smelting production facilities at the relevant time and have been dynamically allocated to produce DS and HSS according to market demand;

(iv) the allegation as set out in the Report against the Group of total production volume was partly based on production volume "investigation" as set out in the Report with reference to the inter-provincial (city) transfer of solid waste plan (固體廢物跨省(市)轉移實施方案 submitted by TG Aihe and TG Tools New Materials pursuant to the Law on the Prevention and Control of Environmental Pollution by Solid Waste of the PRC (中華人民共和國固體廢物污染環境防治法) for 2020.

The Company is of the view that:

(a) the focus of these plans should be on the solid waste to be transferred;

(b) the planned production of 100k tonnes of DS and 50k tonnes of HSS as submitted by TG Aihe and TG Tools New Materials should not be regarded as the only production of DS and HSS by these subsidiaries; and

(c) the planned production was for the calculation of solid waste that would be transferred to other provincial/city as required under the sub-section entitled "Status of Products and Waste produced" (產品和產生廢物的情況) of the Part 1 headed "Basic information on waste to be transferred" (擬轉移廢物基本情況) and should not be regarded as the total actual production of DS and HSS nor the actual amount of waste produced by the Group. Other solid waste was disposed by the Group locally in Jiangsu Province, which was not required to report in the inter-provincial (city) transfer declaration;

(v) in addition to TG Aihe, TG Tools New Materials and Jurong TG New Materials were engaged in the production of DS products at the relevant time and will continue to be so engaged;

(vi) while the sewage waste permit of Jurong TG New Materials indicates that Jurong TG New Materials was engaged in steel processing, the sewage waste permit of each of TG Aihe and TG Tools New Materials indicate that TG Aihe and TG Tools New Materials were engaged in ferrous metal melting and processing and were not restricted to DS smelting and processing DS products;

(vii) Jurong TG New Materials has been and will be supplied with smelted steel ingots for its production of DS and HSS products by TG Aihe and to a smaller extent, by TG Tools New Materials; and

(viii) TG Tools New Materials mainly makes use of its owned smelted steel ingots for its production of DS and HSS products but will process DS and HSS ingots from TG Aihe into DS and HSS products at small quantity.

(B) The Report also relied on the Report on the Construction Project for the 300k-t/a Die Steel Technological Upgrade (年產30萬噸高合金工模具新材料技改提升項目建設項目環境影響報告表) dated 2 July 2021 of TG Aihe ("**300k-t/a DS Upgrade Technological Report**") to allege overstatement of output based on the consumption of major raw materials in 2020.

- *"TG Aihe fed in 132.7k tons of scrap steel and rare metals in 2020. How could this result in 181.7k tons of sales volume?"*

- *"According to a research paper entitled "Optimized Utilization of Special Steel Scrap and Development of Usable Resources" (特鋼返回鋼優化利用及可利用資源的開發, the Baowu Paper) published by three technical staff at Baowu Special Metallurgy, in-house scrap steel accounts for 15–20% of total raw materials used. Ex-staff E told our investigators that the proportion of in-house scrap steel at TG Aihe exceeds 20% (Audio Evidence 5). According to our estimates below, this proportion is about 20.7%."*

Exhibit 22 – Theoretical calculation of Tiangong's DS products yield

Line	Account	Fresh start	1st recycle	2nd recycle	3rd recycle	4th recycle	Formula
7	Initial input	100.0000					
8	Recycled input		20.6950	4.2828	0.8863	0.1834	$(\text{Line } 11 + 14)_{t-1}$
9	**Total input**	**100.0000**	**20.6950**	**4.2828**	**0.8863**	**0.1834**	**Line 7 + 8**
	Phase 1 – Smelting						
10	Intangible metal loss	6.0000	1.2417	0.2570	0.0532	0.0110	Line 7 or 8 x line 1
11	Tangible metal loss	3.5000	0.7243	0.1499	0.0310	0.0064	Line 7 or 8 x line 2
12	Crude steel output	90.5000	18.7290	3.8760	0.8021	0.1660	Line 7 or 8 x line 3
	Phase 2 – Processing						
13	Intangible metal loss	4.5250	0.9364	0.1938	0.0401	0.0083	Line 10 x line 4
14	Tangible metal loss	17.1950	3.5585	0.7364	0.1524	0.0315	Line 10 x line 5
15	Steel products output	68.7800	14.2340	2.9457	0.6096	0.1262	Line 10 x line 6
	Cumulative data						
	Total input	100.0000	120.6950	124.9778	125.8642	126.0476	line 9
	Steel products output	68.7800	83.0140	85.9598	86.5694	86.6955	line 15

Source: Emerson Analytic

- *"The 100 initial raw materials input amounts to 79.3% of the 126.0 cumulative input, meaning in-house scrap steel is 20.7% of cumulative input."*

The Company would clarify that:

(i) The 300k-t/a DS Technology Upgrade Report was made based on standard form for environmental evaluation and as the Report noted, it refers to the data of the applicant, TG Aihe, only. The Report ignored the other DS production facilities of the Group. The application was accepted by Danyang Ecological Environment Bureau on 13 August 2021 and was approved on 25 August 2021.

(ii) According to the 300k-t/a DS Technology Upgrade Report, the 132.7k tonnes input of raw material was made in 2015 (not 2020). The extract by the Report came from part of the section entitled "Original environmental pollution issues of the Project" (與項目有關的原有環境污染問題) of the standard form. As set out in the introduction paragraph of such section, the original environmental report was made in 2016. As such, the "current" raw material input data were those of 2015.

(iii) Further, the Company does not intend to comment on the adoption of conversion assumptions, which may not be at all applicable to the Group given (a) the breakthrough in its production processes for certain products as more particularly described in paragraph A2 below, which has an impact on both tangible and intangible metal losses savings; (b) Baowu Paper was published in 2005, which might have already become obsoleted; and (c) the Group used induction furnace for smelting, not electric arc furnace as mentioned in the Report. Induction furnace provided a much higher crude steel yield rate.

(iv) According to the production records of the Group, the production of DS finished goods in 2020 was 168k tonnes. Such production volume was contributed by:

Entity	**Volume** *(tonne'000)*
TG Aihe	113
TG Tools New Materials	37
Jurong TG New Materials	18
Total	168

Note: During peak season, the Group outsourced 10,000 tonnes of certain DS products with lower alloy composition, which is less cost effective to manufacture during the relevant time, to satisfy delivery requirements. Such 10,000 tonnes of DS products were not included in the above production volume.

2. Exaggerated DS Gross Profit

(A) The Report alleges:

- *"We reckon that the company exaggerated its DS gross profit by 2.6x and that, all else being equal, real EBIT was only 33% of reported amount for 2020."*

- *"we can see that the gross margin of Tiangong's HSS business was reportedly 3.9 percentage points higher than that of its peer in 2020, while its DS business enjoyed a gross margin that was 19 points higher."*

The Report drew comparison with two "peers" in the PRC, a Shanghai listed company and a non-wholly owned subsidiary of a Shenzhen listed company.

The Company would clarify that:

(i) Based on the audited financial information for the year ended 31 December 2020 of the Company, the gross profit margin of DS and HSS of the Group were 28.1% and 28.1%, respectively and the adjusted EBIT margin of DS being reportable segment profit (adjusted EBIT)/reportable segment revenue should be 17.4% (RMB410,079k/RMB2,351,218k) and the adjusted EBIT margin of HSS should be 22.5% (RMB284,953k/RMB1,268,673k).

(ii) The annual report of the Shanghai listed company for the year ended 31 December 2020 only provides information on gross profit margin, not EBIT margin of DS products. Further, there was a segment named Tools Steel, which according to industrial understanding refers to DS plus HSS. There does not appear to be any segment financial information or expenses allocation for a calculation of DS gross profit margin meaningful for comparison. Given the unknown composition of DS and HSS, the Company would not comment on the gross profit margin figures in the Report in respect of this "peer".

(iii) In respect of the non-wholly owned subsidiary of a listed Shenzhen company, it would appear that HSS products have been grouped with welding materials with a composite gross profit margin. The annual report of the listed company does not provide sufficient data for the Company to draw any inference on the HSS gross profit margin. As such, the Company would not comment on the gross profit margin calculation made in the Report in respect of this "peer".

(B) The Report has also drawn inference from an article published on Mysteel.com in respect of the hot-work DS product price listed in the Suzhou market on 30 December 2021 and concluded that given the price of the Group's product is lower than a peer, the Group could not have achieved its higher gross profit margin in DS products.

"Could Tiangong sell similar products at higher prices than its peers because of better quality? From the market price comparison below, the answer is again negative."

The Company would clarify that:

(i) The price of DS quoted in the Suzhou market was just a single price for a range of dimensions: (30–70mm*205–810mm) for the Group's DS finished products and a single price for a range of dimensions: (25–90 mm*151–305 mm) of the peer selected by the Report. Price of different specification was greatly different.

(ii) As the price quoted by Mysteel.com article did not specify the dimension of the DS products of the Company and the selected peer, the Company is not in a position to comment on the price of the products of the Company and the selected peer by the Report. For a more comprehensive reference, the Company has checked its completed sales invoice of January 2022 and noted that the average selling price per tonne of the "H13" product with the same range of dimensions as the Company's brand in the article was around RMB18,593, ranging from RMB17,000 to RMB20,700. Given the range of dimensions involved, the listing price as set out in the article should not be regarded as the actual price of all products of the Group.

(C) The Report queries the Group could achieve its gross profit margins and EBIT ratios based on its analysis of input/output ratios (and thus the costs of production) referred in paragraph 1 above and the investigations indicating the Group's products have a lower listing price as referred to in this paragraph.

As the Company is not in a position to comment on the cost control of our "peers" on DS and HSS production based on the limited financial information referred to in the Report, the Company considers it might be better to disclose its own cost control direction.

(i) Raw Material:

Alloy formed a very significant part of the cost of products and could be obtained from either alloyed scrap or pure alloy. While pure alloy is easier to manage during the manufacturing process, alloyed scrap provided a more cost-effective source. The Company used a high portion of alloyed scrap in the manufacturing process to achieve a better cost control.

In addition to using the alloyed scrap collected from the Company's own production process, the Group purchased alloyed scrap from recycle companies. The Company had tight control on testing the alloy composition in the alloyed scrap to ensure the content was rich and cost-effective. Moreover, the Company is at an advantage of accessing these alloyed scrap resource since downstream moulding and cutting tools manufacturers are concentrated in Yangtze River Delta region and Pearl River Delta region. The costs of transportation will be significantly reduced with purchases of alloyed scrap from nearby sources. The Company notes that the selected "peers" by the Report are located in Hebei Province and Liaoning Province in the northern part of China, respectively, which may have different access to pure and alloyed scrap. Given the difference in proportion of the alloyed scrap (if any, and its

content) and pure alloy applied by these companies and the Company is not aware of the source of their respective alloyed scrap, the Company is not in a position to comment on such cost and efficiency (if not waste or loss).

Given the volume of DS and HSS production, the Group is in a position to purchase a substantial portion of the materials required including alloyed scrap and pure alloy in bulk with bulk purchase discount.

(ii) Electricity charges:

While the Group does use LNG in part of its production processing, a substantial part of its fuel charges is electricity charge. The work schedule of the Group has been planned so that the processes including smelting which consume the most electricity are arranged to be carried out during the off-peak electricity hours. Therefore, the Company benefited from the lower price of off-peak electricity as a saving of electricity charges in the cost of manufactured.

(iii) Technology upgrade to reduce metal loss, fuel charges, labour cost and other related overheads:

The traditional forging and rolling processes involve the heating up of the DS material before each of the processes and a cooling process thereafter. Such heating up and cooling involves not only significant fuel charges to maintain quality of the final product but also costs metal loss. The Group has recently succeeded in an improvement of the process in respect of certain DS products to reduce metal loss and fuel charges. The idea of the improved process was to optimize the pouring temperature and speed. The solidification shrinkage of molten steel at the outlet of the pouring ingot was controlled. Therefore, the internal quality of the ingot was improved, the yield was increased, and the processing cost, including the labour costs and other related overheads of the subsequent processes was reduced.

(iv) Equipment upgrade and streamlined production line:

The Group procured new production equipment and optimized the production line in the recent past years to streamline the production process and to improve the production efficiency. These newly acquired machinery not only have been used to replace certain labour-intensive production process to reduce the labour cost, but also lowered the overheads including maintenance and repair costs incurred mostly on the aged production equipment.

3. Overstatement of DS Exports

The Report alleges *"In 2019, the company's claimed DS exports even exceeded national total!"*

The Company reiterates that it did not made such claim. The export figures set out in the annual reports of the Company were based on invoices and export filings of the Group. Declaration to Custom was required and verifiable for all these exports. We have reassured the 54k tonnes export volume in 2020 with Zhenjiang custom. As set out in the Announcement, the Company notes the Report's analysis on 2020 national export figure (and the deduced 2019 figure) was a summation of export figures of a selection of over 10 exporters followed by the author of an article published by Mysteel.com, not a national figure. The Company does not comment on the accuracy of such summation and the Report's inference on the Group's share of national export.

B. CLARIFICATION ON JURONG TG NEW MATERIALS

The Report also alleges that:

- *"Strangely, the NECIPS data show that TG New Materials revenue in 2020 was a staggering Rmb2,696m. Even more mysteriously, its revenue in 2018 collapsed 90% year-on-year, only to surge 10x the next year."*

- *"However, in 2020, TG Trading's revenue was exactly the same as the trading of goods revenue reported by Tiangong. This means TG New Materials did not do any trading business that year. So, how did it generate Rmb2,696m of revenue?"*

The Company would clarify as follows:

(i) Based on the alleged 2020 revenue figure of RMB2,696 million for the year 2020, the company concerned should be Jurong TG New Materials. The principal business of Jurong TG New Materials include (1) the processing of DS and HSS and (2) trading business.

(ii) The revenue of Jurong TG New Materials as filed with NECIPS was RMB2,232 million for the year 2018, and formed part of the audited revenue of the Group of 2018. There was no collapse of 90% year-on-year in 2018.

The Company confirms that it is not aware of any inside information relating to the negative statements/comments made in the Report that need to be disclosed under Part XIVA of the Securities and Future Ordinance (Chapter 571 of the laws of Hong Kong).

The Company welcome shareholders, investors and regulators to monitor the Group's business operations and financial performance. Nevertheless, the Company will not tolerate malicious defamation against the Company which damages the Company's reputation and business prospects, whether such defamation is for the benefit of the maker or not. If the Company and/or any of its shareholders suffer any material losses due to such defamation, the Company will have no hesitation to initiate legal proceedings or such other actions as the Board deems appropriate or necessary.

Investors and shareholders are reminded to exercise caution when reviewing and applying the information of the Report and when dealings in the shares of the Company.

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

Hong Kong, 25 February 2022

As at the date of this announcement, the directors of the Company are:

Executive Directors: ZHU Xiaokun, WU Suojun, YAN Ronghua and JIANG Guangqing
Independent non-executive Directors: GAO Xiang, LEE Cheuk Yin, Dannis and WANG Xuesong

* *For identification purpose*