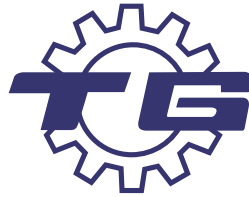


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## **Tiangong International Company Limited**

**天工國際有限公司\***

*(incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 826)**

### **ANNOUNCEMENT OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 JUNE 2011**

#### **FINANCIAL HIGHLIGHTS**

Revenue of the Group for the first half of 2011 totaled RMB1,553,550,000, representing an increase of 43.7% when compared with RMB1,081,293,000 for the same period in 2010.

All three main product segments of the Group grew in the first half of 2011. Revenue of High Speed Steel (“HSS”), HSS cutting tools and Die Steel (“DS”) increased by approximately 75.6%, 35.5% and 25.3%, respectively, when compared with those for the same period in 2010.

Profit attributable to equity holders of the Company was RMB150,473,000 (2010: RMB110,294,000), representing an increase of 36.4% when compared with that for the same period in 2010.

The Board of Directors (the “Board”) of Tiangong International Company Limited (the “Company”) is pleased to announce the unaudited consolidated statement of comprehensive income of the Company and its subsidiaries (the “Group”) for the six months ended 30 June 2011 and the consolidated statement of financial position of the Group as at 30 June 2011 which have been reviewed by the Company’s auditor, KPMG, and the Audit Committee of the Company, together with the comparative figures for the same period of 2010 as follows:

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the six months ended 30 June 2011 (unaudited)

		Six months ended 30 June	
		2011	2010
	Note	RMB'000	RMB'000
Revenue	5	1,553,550	1,081,293
Cost of sales		(1,248,576)	(864,910)
<b>Gross profit</b>		<b>304,974</b>	<b>216,383</b>
Other income	6	6,103	3,351
Distribution expenses		(17,867)	(19,372)
Administrative expenses		(30,696)	(33,080)
Other expenses		(13,858)	(4,871)
<b>Result from operations</b>		<b>248,656</b>	<b>162,411</b>
Finance income		7,488	1,347
Finance expenses		(75,904)	(29,681)
<b>Net finance costs</b>	7(a)	<b>(68,416)</b>	<b>(28,334)</b>
Share of profits of associates		270	14
Share of profit/(loss) of a jointly controlled entity		762	(859)
<b>Profit before income tax</b>	7	<b>181,272</b>	<b>133,232</b>
Income tax expense	8	(30,799)	(22,938)
<b>Profit and total comprehensive income for the period attributable to the equity shareholders of the Company</b>		<b>150,473</b>	<b>110,294</b>
<b>Earnings per share (RMB)</b>	9		
Basic		0.090	0.066
Diluted		0.087	0.066

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

at 30 June 2011 (unaudited)

	<i>Note</i>	At 30 June 2011 <i>RMB'000</i>	At 31 December 2010 <i>RMB'000</i>
<b>Non-current assets</b>			
Property, plant and equipment		1,602,263	1,572,108
Lease prepayments		60,649	61,312
Goodwill		21,959	21,959
Interest in associates		41,551	41,281
Interest in a jointly controlled entity		4,894	4,132
Other financial assets		10,000	10,000
Deferred tax assets		10,606	9,645
		<u>1,751,922</u>	<u>1,720,437</u>
<b>Current assets</b>			
Inventories		1,139,434	1,218,332
Trade and other receivables	10	1,392,655	940,625
Pledged deposits		309,401	136,635
Cash and cash equivalents		207,495	315,831
		<u>3,048,985</u>	<u>2,611,423</u>
<b>Current liabilities</b>			
Interest-bearing borrowings		1,450,185	1,222,250
Trade and other payables	11	1,091,125	650,290
Income tax payables		19,152	19,665
Deferred income		1,162	1,162
		<u>2,561,624</u>	<u>1,893,367</u>
<b>Net current assets</b>		<u>487,361</u>	<u>718,056</u>
<b>Total assets less current liabilities</b>		<u>2,239,283</u>	<u>2,438,493</u>
<b>Non-current liabilities</b>			
Interest-bearing borrowings		289,000	633,500
Deferred income		6,609	7,190
Deferred tax liabilities		19,028	16,561
		<u>314,637</u>	<u>657,251</u>
<b>Net assets</b>		<u>1,924,646</u>	<u>1,781,242</u>
<b>Capital and reserves</b>			
Share capital		31,806	31,806
Reserves		1,892,840	1,749,436
<b>Total equity</b>		<u>1,924,646</u>	<u>1,781,242</u>

Notes:

## 1. REPORTING ENTITY

The Company was incorporated in the Cayman Islands on 14 August 2006 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961 as consolidated and revised) of the Cayman Islands.

The interim financial report of the Company as at and for the six months ended 30 June 2011 comprises the Company and its subsidiaries.

## 2. BASIS OF PREPARATION

This interim financial report of Tiangong International Company Limited (the “Company”) and its subsidiaries (collectively referred to as the “Group”) has been prepared in accordance with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard (“IAS”) 34, *Interim financial reporting*, issued by the International Accounting Standards Board (“IASB”). It was authorised for issue on 26 August 2011.

The interim financial report has been prepared in accordance with the same accounting policies adopted in the 2010 annual financial statements, except for the accounting policy changes and adoptions that are expected to be reflected in the 2011 annual financial statements. Details of these changes and adoptions of accounting policies are set out in the following notes.

The preparation of an interim financial report in conformity with IAS 34 requires management to make judgments, estimates and assumptions that affect the application of policies and report amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates.

This interim financial report contains condensed consolidated financial statements and selected explanatory notes. The notes include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Group since the 2010 annual financial statements. The condensed consolidated interim financial statements and notes thereon do not include all of the information required for full set of financial statements prepared in accordance with International Financial Reporting Standards (“IFRSs”).

The interim financial report is unaudited, but has been reviewed by KPMG in accordance with Hong Kong Standard on Review Engagements 2410, *Review of interim financial information performed by the independent auditor of the entity*, issued by the Hong Kong Institute of Certified Public Accountants. KPMG’s independent review report to the Board of Directors is included in the interim financial report.

The financial information relating to the financial year ended 31 December 2010 that is included in the interim financial report as being previously reported information does not constitute the Company’s annual financial statements for that financial year but is derived from those financial statements. Annual financial statements for the year ended 31 December 2010 are available from the Company’s registered office. The auditor has expressed an unqualified opinion on those financial statements in the report dated 30 March 2011.

## 3. CHANGES IN ACCOUNTING POLICIES

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

- IAS 24 (revised 2009), *Related party disclosures*
- Improvements to IFRSs (2010)
- IFRIC 19, *Extinguishing financial liabilities with equity instruments*

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

IFRIC 19 has not yet had a material impact on the Group's financial statements as these changes will first be effective as and when the group enters a relevant transaction (for example, a debt for equity swap).

The remaining developments related primarily to clarification of certain disclosure requirements applicable to the Group's financial statements. These developments have had no material impact on the contents of this interim financial report.

#### 4. ACCOUNTING POLICIES FOR NEW TRANSACTIONS AND EVENTS

##### (a) Derivative financial instruments

Derivative financial instruments are recognised initially at fair value. At the end of each reporting period the fair value is remeasured. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. The Group derecognises the derivative financial instruments when the liabilities arising from their contractual obligations are discharged, cancelled or expired.

##### (b) Share-based payments

The fair value of share options granted to employees is recognised as an employee cost with a corresponding increase in a capital reserve within equity. The fair value is measured at grant date using the binomial lattice model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to the options, the total estimated fair value of the options is spread over the vesting period, taking into account the probability that the options will vest.

During the vesting period, the number of share options that is expected to vest is reviewed. Any resulting adjustment to the cumulative fair value recognised in prior years is charged/credited to the profit or loss for the year of the review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of options that vest (with a corresponding adjustment to the capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the company's shares. The equity amount is recognised in the capital reserve until either the option is exercised (when it is transferred to the share premium account) or the option expires (when it is released directly to retained profits).

#### 5. SEGMENT REPORTING

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

- *High speed steel ("HSS")*      The HSS segment manufactures and sells high speed steel for the steel industry.
- *HSS cutting tools*              The HSS cutting tools segment manufactures and sells HSS cutting tools for the tool industry.
- *Die steel ("DS")*                The DS segment manufactures and sells die steel for the steel industry.
- *Chemical goods*                The chemical goods segment sells purified terephthalic acid and other chemicals.

(a) Segment results, assets and liabilities

	Six months ended and as at 30 June 2011				
	HSS RMB'000	HSS cutting tools RMB'000	DS RMB'000	Chemical goods RMB'000	Total RMB'000
Revenue from external customers	573,672	293,215	489,990	196,673	1,553,550
Inter-segment revenue	121,992	—	—	—	121,992
<b>Reportable segment revenue</b>	<b>695,664</b>	<b>293,215</b>	<b>489,990</b>	<b>196,673</b>	<b>1,675,542</b>
<b>Reportable segment profit (adjusted EBIT)</b>	<b>117,335</b>	<b>43,493</b>	<b>122,706</b>	<b>3,573</b>	<b>287,107</b>
<b>Reportable segment assets</b>	<b>1,195,114</b>	<b>916,869</b>	<b>2,077,159</b>	<b>119</b>	<b>4,189,261</b>
<b>Reportable segment liabilities</b>	<b>285,595</b>	<b>150,671</b>	<b>600,676</b>	<b>6</b>	<b>1,036,948</b>
	Six months ended 30 June 2010				
	HSS RMB'000	HSS cutting tools RMB'000	DS RMB'000	Chemical goods RMB'000	Total RMB'000
Revenue from external customers	326,657	216,464	390,981	147,191	1,081,293
Inter-segment revenue	119,051	—	—	—	119,051
<b>Reportable segment revenue</b>	<b>445,708</b>	<b>216,464</b>	<b>390,981</b>	<b>147,191</b>	<b>1,200,344</b>
<b>Reportable segment profit (adjusted EBIT)</b>	<b>62,775</b>	<b>32,573</b>	<b>100,114</b>	<b>1,549</b>	<b>197,011</b>
	At 31 December 2010				
	HSS RMB'000	HSS cutting tools RMB'000	DS RMB'000	Chemical goods RMB'000	Total RMB'000
<b>Reportable segment assets</b>	<b>953,025</b>	<b>879,940</b>	<b>1,939,191</b>	<b>21,052</b>	<b>3,793,208</b>
<b>Reportable segment liabilities</b>	<b>208,383</b>	<b>115,836</b>	<b>293,358</b>	<b>20,954</b>	<b>638,531</b>

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

	Six months ended 30 June	
	2011	2010
	RMB'000	RMB'000
<b>Revenue</b>		
Reportable segment revenue	1,675,542	1,200,344
Elimination of inter-segment revenue	(121,992)	(119,051)
Consolidated revenue	<u>1,553,550</u>	<u>1,081,293</u>
	Six months ended 30 June	
	2011	2010
	RMB'000	RMB'000
<b>Profit</b>		
Reportable segment profit	287,107	197,011
Net finance costs	(68,416)	(28,334)
Share of profits of associates	270	14
Share of profit/(loss) of a jointly controlled entity	762	(859)
Other unallocated head office and corporate expenses	(38,451)	(34,600)
Consolidated profit before income tax	<u>181,272</u>	<u>133,232</u>
	At 30 June	At 31 December
	2011	2010
	RMB'000	RMB'000
<b>Assets</b>		
Reportable segment assets	4,189,261	3,793,208
Interest in associates	41,551	41,281
Interest in a jointly controlled entity	4,894	4,132
Other financial assets	10,000	10,000
Deferred tax assets	10,606	9,645
Pledged deposits	309,401	136,635
Cash and cash equivalents	207,495	315,831
Other unallocated head office and corporate assets	27,699	21,128
Consolidated total assets	<u>4,800,907</u>	<u>4,331,860</u>
	At 30 June	At 31 December
	2011	2010
	RMB'000	RMB'000
<b>Liabilities</b>		
Reportable segment liabilities	1,036,948	638,531
Interest-bearing borrowings	1,739,185	1,855,750
Income tax payables	19,152	19,665
Deferred tax liabilities	19,028	16,561
Other unallocated head office and corporate liabilities	61,948	20,111
Consolidated total liabilities	<u>2,876,261</u>	<u>2,550,618</u>

## 6. OTHER INCOME

		Six months ended 30 June	
		2011	2010
		<i>RMB'000</i>	<i>RMB'000</i>
Government grants	(i)	5,968	1,725
Dividend income from unlisted securities		—	1,600
Others		135	26
		<u>6,103</u>	<u>3,351</u>

- (i) Jiangsu Tiangong Tools Company Limited (“TG Tools”), a wholly-owned subsidiary of the Company located in People’s Republic of China (the “PRC”), received unconditional grants amounting to RMB5,387,000 (six months ended 30 June 2010: RMB1,144,000) from the local government in Danyang mainly to reward its contribution to local economy and encourage its innovation of technology and recognised amortisation of government grants related to assets of RMB581,000 (six months ended 30 June 2010: RMB581,000) during the six months ended 30 June 2011.

## 7. PROFIT BEFORE INCOME TAX

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

		Six months ended 30 June	
		2011	2010
		<i>RMB'000</i>	<i>RMB'000</i>
<b>(a) Net finance costs</b>			
Interest income		(1,523)	(1,347)
Net foreign exchange gain		(5,965)	—
Finance income		<u>(7,488)</u>	(1,347)
Interest on bank loans		49,575	45,716
Fair value recognised upon issuance		42,754	—
Change in fair value		(5,566)	—
Less: interest expense capitalised into property, plant and equipment under construction		(10,859)	(25,492)
Net foreign exchange loss		—	9,457
Finance expenses		<u>75,904</u>	29,681
Net finance costs		<u>68,416</u>	28,334
<b>(b) Other items</b>			
Cost of inventories*		1,248,576	864,910
Depreciation		55,927	38,402
Amortisation of lease prepayments		663	663
Impairment loss for doubtful debts		12,972	3,088
Write (back)/down for inventories		(5,052)	10,870
Equity settled share-based transactions		<u>2,937</u>	—

- \* Cost of inventories includes RMB39,952,000 (six months ended 30 June 2010: RMB41,637,000) relating to depreciation expenses and write (back)/down for inventories which amounts are also included in the respective total amounts disclosed separately above for each of these types of expenses.



## 8. INCOME TAX EXPENSE

	Six months ended 30 June	
	2011	2010
	RMB'000	RMB'000
<b>Current tax</b>		
Provision for PRC income tax	29,293	16,827
<b>Deferred tax</b>		
Origination and reversal of temporary differences	1,506	6,111
	<u>30,799</u>	<u>22,938</u>

- (a) Pursuant to the rules and regulations of the Cayman Islands and British Virgin Islands, the Group is not subject to any income tax in the Cayman Islands or British Virgin Islands.
- (b) The Group does not carry on business in Hong Kong and therefore does not incur Hong Kong Profits Tax.
- (c) The provision for PRC income tax is based on the respective corporate income tax rates applicable to the subsidiaries located in the PRC as determined in accordance with the relevant income tax rules and regulations of the PRC.

The statutory corporate income tax rate of the Group's operating subsidiaries in the PRC is 25% (2010: 25%).

Pursuant to the income tax rules and regulations of the PRC, foreign-invested enterprises located in the PRC are entitled to a tax holiday of a tax-free period for two years from their first profit-making year of operations and thereafter, they are subject to PRC corporate income tax at 50% of the applicable income tax rate for the following three years. For the enterprises that do not benefit from such tax holiday due to their non-profit making status, the period of time for which such tax holiday apply shall be calculated commencing from the year of 2008.

Due to the above-mentioned tax holiday, TG Tools is subject to the PRC corporate income tax rate at 50% of its applicable tax rate for 3 years from 2009. Tiangong Aihe Special Steel Company Limited ("TG Aihe") is subject to the PRC corporate income tax rate at 50% of its applicable tax rate for 3 years from 2010.

Danyang Tianfa Forging Company Limited ("Tianfa Forging") and Jiangsu Tiangong Titanium Technology Company Limited ("TG Titan") are both subject to the statutory income tax rate 25%.

Danyang Tianji Tools Packaging Company Limited ("Tianji Packaging") is subject to the income tax rate 20% as it meets the criteria for a small low-profit enterprise.

## 9. EARNINGS PER SHARE

### (a) Basic earnings per share

The calculation of basic earnings per share is based on the profit attributable to equity shareholders of the Company of RMB150,473,000 during the period presented (six months ended 30 June 2010: RMB110,294,000) and the weighted average number of ordinary shares outstanding of 1,678,000,000 (six months ended 30 June 2010: 1,678,000,000).

### (b) Diluted earnings per share

The calculation of diluted earnings per share is based on the profit attributable to equity shareholders of the Company of RMB150,473,000 during the period presented and the weighted average number of potential ordinary shares outstanding of 1,721,317,781 for the six months ended 30 June 2011 after taking into account the potential dilutive effect of the warrants and equity settled share-based transactions described in note 12 and note 13 respectively. No dilutive potential ordinary shares were in issue as at 30 June 2010.

On 23 May 2011, the annual general meeting approved the share subdivision of issued and unissued shares with par value of USD0.01 each into shares with par value of USD0.0025 each in the share capital of the Company (the “Share Subdivision”). The comparative figures for the six months ended 30 June 2010 have also been restated to reflect the Share Subdivision.

#### 10. TRADE AND OTHER RECEIVABLES

	At 30 June 2011 <i>RMB'000</i>	At 31 December 2010 <i>RMB'000</i>
Trade receivables	973,201	540,549
Bills receivable	233,320	316,294
Less: impairment provision for doubtful debts	<u>(53,085)</u>	<u>(40,113)</u>
Net trade and bills receivable	1,153,436	816,730
Prepayments	211,364	75,700
Non-trade receivables	<u>27,855</u>	<u>48,195</u>
	<u><b>1,392,655</b></u>	<u><b>940,625</b></u>

Included in trade and other receivables are debtors and bills receivable (net of allowance for doubtful debts) with the following ageing analysis:

	At 30 June 2011 <i>RMB'000</i>	At 31 December 2010 <i>RMB'000</i>
Current	695,190	623,308
Less than 3 months past due	319,981	160,276
More than 3 months but less than 6 months past due	36,395	10,182
More than 6 months but less than 12 months past due	91,945	15,597
More than 12 months but less than 24 months past due	<u>9,925</u>	<u>7,367</u>
Trade debtors and bills receivable, net of allowance for doubtful debts	<u><b>1,153,436</b></u>	<u><b>816,730</b></u>

In respect of trade and other receivables, individual credit evaluations are performed on all customers requiring credit over a certain amount. These evaluations focus on the customer’s past history of making payments when due and current ability to pay, and taking into account information specific to the customer as well as pertaining to the economic environment in which the customer operates. The Group’s customers are normally granted credit terms of 0 to 150 days depending on the creditworthiness of individual customers. Normally, the Group does not obtain collateral from customers.

## 11. TRADE AND OTHER PAYABLES

Included in trade and other payables are trade creditors and bills payable with the following ageing analysis as at the date of the consolidated statement of financial position.

	At 30 June 2011 <i>RMB'000</i>	At 31 December 2010 <i>RMB'000</i>
Due within 3 months	824,950	502,529
Due after 3 months but within 6 months	92,515	36,092
Due after 6 months but within 12 months	5,006	4,867
Due over 1 year but within 2 years	4,582	6,954
Due over 2 years	2,165	1,314
	<hr/>	<hr/>
Total trade creditors and bills payable	929,218	551,756
Non-trade payables and accrued expenses	114,713	98,534
Dividends payable	47,194	—
	<hr/>	<hr/>
	<b>1,091,125</b>	<b>650,290</b>

## 12. FINANCIAL INSTRUMENT — WARRANTS

On 26 January 2011, an aggregate of 32,000,000 warrants were fully placed and issued to six places in accordance with the terms of a warrant placing agreement entered by the Company and a placing agent at a placing price of HKD0.02 per warrant. The holders of the warrants shall have the right to subscribe for 32,000,000 ordinary shares with par value of USD0.01 each at an initial subscription price of HKD4.00 per share (subject to adjustment pursuant to the terms of the warrants) within 2 years from their date of issue. Each warrant has been valued at approximately HKD1.58 by an external appraiser. The warrants were recognised as derivative financial liabilities in the consolidated financial statements.

The implementation of the Share Subdivision on 23 May 2011 led to pro rata adjustment to the subscription prices and number of subdivided shares which may be subscribed upon exercise of the subscription rights attached to the unlisted warrants of the Company. As a result, the warrants entitled the holders to subscribe for up to 128,000,000 subdivided shares with par value of USD0.0025 each at an adjusted initial subscription price of HKD1.00 each.

Subsequently, the Company reached agreements with its warrants holders to revise the initial subscription price of the warrants to be denominated in RMB (the functional currency of the accounts of the Group). The revised subscription price of the warrant was RMB0.845 per share with par value of USD0.0025 each (at the fixed exchange rate of RMB1:HKD1.18282, which was equivalent to the adjusted initial subscription price of HKD1.00 per share with par value of USD0.0025 each (as adjusted by the Share Subdivision)). Each warrant has been revalued at approximately HKD1.40 by an external appraiser. Upon this revision of the denomination of the subscription price, the derivative financial liabilities were extinguished and therefore the warrants have been recognised in equity since then.

### 13. EQUITY SETTLED SHARE-BASED TRANSACTIONS

On 28 January 2011, the Company granted an aggregate of 4,970,000 share options to employees of the Company to subscribe for ordinary shares of par value USD0.01 each in the capital of the Company under its share option scheme adopted on 7 July 2007. The holders of the share options shall have the right to subscribe for ordinary shares during the period from 1 July 2012 to 30 June 2016 at an exercise price of HKD5.10 per share, which was equal to the market price of the ordinary shares on the date of grant. The amount payable on acceptance per grant is HKD1.00. Each share option has been valued at approximately HKD2.47 by an external appraiser.

Due to the implementation of Share Subdivision on 23 May 2011, the maximum aggregate number of shares which may be issued under the share option scheme was adjusted to 19,880,000 shares of par value USD0.0025 at an exercise price of HKD1.275 per share.

### 14. DIVIDENDS

Dividends payable to equity shareholders attributable to the previous financial year, approved but not paid during the interim period:

	<b>Six months ended 30 June</b>	
	<b>2011</b>	2010
	<b><i>RMB'000</i></b>	<i>RMB'000</i>
Dividend in respect of the previous financial year, approved but not paid during the interim period, of RMB0.1125 per share with par value of USD0.01 each (six months ended 30 June 2010: RMB0.0534 per share with par value of USD0.01 each)	<b><u>47,194</u></b>	<u>22,401</u>

Note: For information only, assuming the Share Subdivision became effective prior to the record dates for the dividends, dividend in respect of the previous financial year, approved but not paid during the interim period, would be RMB0.028125 per share with par value of USD0.0025 each (six months ended 30 June 2010: RMB0.01335 per share with par value of USD0.0025 each).

## MANAGEMENT DISCUSSION AND ANALYSIS

### Business Highlights

In the six months ended 30 June 2011 (the “Period”), Tiangong International Company Limited (“Tiangong International” or the “Company”, together with its subsidiaries, collectively the “Group”) continued to excel in the industry by achieving record high revenue of RMB1,553,550,000. All our core product segments, including HSS, HSS cutting tools and die steel recorded strong growth.

Our operations are classified into the following product segments:

#### HSS

High Speed Steel (HSS) accounted for approximately 37% of the Group’s revenue in the Period (1H2010: 30%). Its production involves various rare metals, such as tungsten, molybdenum, chromium, vanadium, and several raw materials. Approximately 17% of HSS output was consumed internally by the Group’s HSS cutting tools production; and 83% was sold to external customers. Because of its high wear resistant, high temperature and pressure tolerances, HSS is produced for more specific industrial applications such as automotive, machinery manufacture, aviation, chemical processing and electronics. The Group commenced its HSS production in 1992.

#### HSS Cutting Tools

HSS cutting tools accounted for approximately 19% of the Group’s revenue in the Period (1H2010: 20%). This segment involves the production and sales of HSS cutting tools to both domestic and international customers. About 63% of its sales were from the export to over 30 regions and countries throughout Europe, North America, Africa and the Middle East in the Period. This segment has been in operation since 1987. Being the longest-established segment of the Group, our HSS cutting tool products can be categorized into four major types – twist drill bits, screw taps, end mills, and turning tools.

#### Die Steel

Die steel accounted for approximately 32% of the Group’s revenue in the Period (1H2010: 36%). This segment involves the purchase of various rare metals and other raw materials, production and sale of die steel to customers. It is suitable for application in dies and moulds for die casting and machining processes, being applied in various sectors such as automotive industry, high-speed railway construction, aviation and plastic materials. The Group commenced its production of die steel in 2005.

#### Chemical Goods

Chemical goods accounted for approximately 13% of the Group’s revenue in the Period (1H2010: 14%). This segment involves the trading of chemicals which mainly comprises purified terephthalic acid. Purified terephthalic acid is mainly used for production of household building materials such as blinds and covers.

#### Market Review

2011 is the beginning of China’s “Twelfth Five-Year Plan”, which brings, amongst others, the nationwide urbanization and livelihood improvement projects to another platform higher, with speed. According to the National Bureau of Statistic of China, investment on fixed assets, such as infrastructure, both on national and municipal levels, and railway network rose some 26% year-on-

year to RMB12.5 trillion in the Period. Boosted by the rapid urbanization and heavy fixed asset investments, construction equipment and machinery experienced strong surge in demand. This in turns led to correspondingly strong sales growth in HSS, HSS cutting tools and die steel. At the other end, the consistent improvement in national disposable income led to the rapid rise in demand for consumables, primarily automotive and electronics. This further drove the demand growth for die steel.

Despite all uncertainties in global economy during the Period, the Group's export business still performed well with demand continued to come from the ongoing investment plans implemented by local governments since early 2010. All of our product categories recorded significant growth in export sales. Emerging markets such as India continued their economic growth, and that has translated into strong demand for machineries and consumables. The enormous potentials from these markets, fueled the growth of the global special steel industry thus providing the Group with opportunities to further diversify our footprint globally.

## Business Review

In the first half of 2011, the Group achieved a significant revenue growth to RMB1,553,550,000, representing a surge of 44% year-on-year. Our core product segments, including HSS, HSS cutting tools and die steel recorded an encouraging year-on-year growth of 76%, 36% and 25%, respectively.

The breakdown of revenue by product is listed as follows:

	For the period ended 30 June					
	2011		2010		Change	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
HSS	<b>573,672</b>	<b>36.9%</b>	326,657	30.2%	247,015	75.6%
HSS cutting tools	<b>293,215</b>	<b>18.9%</b>	216,464	20.0%	76,751	35.5%
Die steel	<b>489,990</b>	<b>31.5%</b>	390,981	36.2%	99,009	25.3%
Chemical goods	<b>196,673</b>	<b>12.7%</b>	147,191	13.6%	49,482	33.6%
	<b><u>1,553,550</u></b>	<b><u>100.0%</u></b>	<u>1,081,293</u>	<u>100.0%</u>	<u>472,257</u>	<u>43.7%</u>

Tiangong International has been the largest manufacturer of HSS and HSS cutting tools by volume in China. In 2010, for the first time, the Group ranked as the third largest die steel producer in the world, elevated five places from the eighth in just two years, according to the Steel & Metal Market Research. In 2011, the Group's die steel annual capacity has exceeded 60,000 tons.

According to China's "Twelfth Five-year Plan", the new material sector is encouraged to produce more high-value products, meeting demands arising from the nation's rapid urbanization and infrastructure development. To capture these opportunities, the Group struck alliances with top research institutes across China on technical enhancement as well as research projects aiming to improve product quality and production efficiency. This strategic and important move served to diversify our product mix, moving it into higher-value items whilst developing alternatives to substitute imported industrial materials.

In spite of the continuously rising material and labor costs, the Group's cost-plus strategy on pricing has successfully minimized the pressure on our margins. In addition, with vertically integrated HSS and HSS cutting tool production give the Group further cost advantages over our competitors. This sustains our competitiveness, as well as profitability.

*HSS — accounting for 37% of the Group's revenue in 1H2011*

HSS has become the greatest revenue contributor during the Period with a rapid growth of 76% to RMB573,672,000 (1H2010: RMB326,657,000). With our vigorous effort to capture the opportunities arisen from China's rapid urbanization, domestic sales rose by 70% year-on-year, accounting for 91% of HSS sales. Although export only accounted for 9% of HSS sales, the impressive 184% growth reflected well of the Group's effort in expanding our client base in oversea markets.

	For the period ended 30 June					
	2011		2010		Change	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
HSS						
Domestic	<b>524,512</b>	<b>91.4%</b>	309,368	94.7%	215,144	69.5%
Export	<b>49,160</b>	<b>8.6%</b>	17,289	5.3%	31,871	184.3%
	<b><u>573,672</u></b>	<b><u>100.0%</u></b>	<u>326,657</u>	<u>100.0%</u>	<u>247,015</u>	<u>75.6%</u>

*HSS cutting tools — accounting for 19% of the Group's revenue in 1H2011*

During the Period, revenue generated from HSS cutting tools increased to RMB293,215,000 (1H2010: RMB216,464,000), representing a 36% year-on-year growth. Exports accounted for 63% of segment sales, is a major revenue contribution to HSS cutting tools traditionally. However, China's vigorous economic activities have been driving domestic demand that grew even stronger at 56% versus that of export's 26%.

	For the period ended 30 June					
	2011		2010		Change	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
HSS cutting tools						
Domestic	<b>108,617</b>	<b>37.0%</b>	69,866	32.3%	38,751	55.5%
Export	<b>184,598</b>	<b>63.0%</b>	146,598	67.7%	38,000	25.9%
	<b><u>293,215</u></b>	<b><u>100.0%</u></b>	<u>216,464</u>	<u>100.0%</u>	<u>76,751</u>	<u>35.5%</u>

*Die steel — accounting for 32% of the Group's revenue in 1H2011*

In the first half of 2011, revenue generated from die steel increased by 25% from the corresponding period in 2010 to RMB489,990,000 (1H2010: RMB390,981,000). The distribution of domestic sales and exports was relatively even, accounting for 53% and 47% of die steel sales respectively. In particular, export sales recorded a strong growth of 56%, which was mainly attributable to our ability to consistently deliver quality products with competitive selling prices in the export market.

	For the period ended 30 June					
	2011		2010		Change	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
Die steel						
Domestic	<b>257,415</b>	<b>52.5%</b>	241,875	61.9%	15,540	6.4%
Export	<b>232,575</b>	<b>47.5%</b>	149,106	38.1%	83,469	56.0%
	<b>489,990</b>	<b>100.0%</b>	<b>390,981</b>	<b>100.0%</b>	<b>99,009</b>	<b>25.3%</b>

*Chemical goods — accounting for 13% of the Group's revenue in 1H2011*

Chemical goods were included in our product segment in the second half of 2009. Sales of chemical goods increased significantly by 33.6% compare to the same period in 2010, amounting to RMB196,673,000.

## FINANCIAL REVIEW

As a result of the rise in market demand of the Group's products, revenue of the Group's all main businesses increased significantly and the net profit attributable to equity holders of the Company increased by approximately 36.4% to RMB150,473,000 in the first half of 2011 from RMB110,294,000 for the first half of 2010.

### Revenue

Revenue of the Group for the first half of 2011 totalled RMB1,553,550,000, representing an increase of approximately 43.7% when compared with RMB1,081,293,000 in first half of 2010.

The increase was mainly attributable to the increase in sales volume and selling prices of the products of the Group.

### Cost of sales

The Group's cost of sales increased by RMB383,666,000 from RMB864,910,000 for the first half of 2010 to RMB1,248,576,000 for the first half of 2011, representing an increase of approximately 44.4%. The increase was in line with the 43.7% increase in revenue during the period. As a percentage of total revenue, the Group's cost of sales increased from approximately 80.0% in the first half of 2010 to approximately 80.4% in the first half of 2011.



## Gross margin

For the first half of 2011, the gross margin was approximately 19.6% (2010 : 20.0%). There is no significant fluctuation on the overall gross margin. Set out below is the gross margin for our four products for the first half of 2010 and 2011 :

	For the period ended	
	30 June	
	2011	2010
HSS	21.3%	20.5%
HSS cutting tools	16.2%	17.3%
Die steel	26.8%	28.2%
Chemical goods	1.8%	1.1%

## HSS

The HSS gross margin increased slightly from 20.5% in the first half of 2010 to 21.3% in the same period in 2011 was mainly due to the increase in the export sales which had a higher gross profit margin.

## HSS cutting tools

In the first half of 2011, the gross margin of HSS cutting tools decreased slightly to 16.2% (2010 : 17.3%) as a result of the increase in cost of sales in the first half of 2011.

## Die steel

The gross margin of die steel decreased slightly from 28.2% in the first half of 2010 to 26.8% in the first half of 2011. The decrease was mainly due to the increase in the sales of hot die steel which had a lower gross profit margin as compared with cold die steel.

## Other income

The Group's other income totalled RMB6,103,000 in the first half of 2011, representing an increase of RMB2,752,000 from RMB3,351,000 in the first half of 2010. The increase was mainly attributable to increase of RMB4,243,000 in grants received from local government.

## Distribution expenses

The Group's distribution expenses was RMB17,867,000 (2010 : RMB19,372,000), representing a decrease of approximately 7.8%. The decrease was mainly attributable to the decrease in transportation expenses as a result of a decrease in shipping charges. For the first half of 2011, the distribution expenses as a percentage of revenue was 1.2% (2010 : 1.8%).

## Administrative expenses

For the first half of 2011, the Group's administrative expenses decreased by RMB2,384,000 to RMB30,696,000 (2010 : RMB33,080,000) primarily due to the decrease in professional fees and travelling expenses for the first half of 2011, the administrative expenses as a percentage of revenue was 2.0% (2010 : 3.1%).

## **Net finance cost**

The Group's finance income was RMB7,488,000 for the first half of 2011, representing an increase of RMB6,141,000 when compared with the RMB1,347,000 for the first half of 2010. The increase was mainly due to the higher bank deposit rate as well as foreign exchange gain generated in the first half of 2011. The Group's finance expenses were RMB75,904,000 for the first half of 2011, representing an increase of 155.7% when compared with the RMB29,681,000 for the first half of 2010. The increase was attributable to the fair value of warrants of RMB37,188,000 during the period and the increase in loan interest rate.

## **Income tax expense**

The Group's income tax expense increased by RMB7,861,000 from RMB22,938,000 in the first half of 2010 to RMB30,799,000 in the first half of 2011. Such increase was mainly due to the increase in sales and net profits.

## **Profit for the period**

As a result of the factors discussed above, the Group's profit increased by approximately 36.4% to RMB150,473,000 for the first half of 2011 from RMB110,294,000 for the first half of 2010. The Group's net profit margin decreased slightly from 10.2% in the first half of 2010 to 9.7% in the same period of 2011.

## **Profit attributable to equity holders of the Company**

For the first half of 2011, profit attributable to equity holders of the Company was RMB150,473,000 (2010 : RMB110,294,000), representing an increase of 36.4%.

## **Outlook**

During the Period, the Group sustained the growth momentum despite the unstable global economic environment. Going forward into the second half of 2011, the Group will strive to capture opportunities in emerging markets such as India diversifying our customer portfolio, and that in turns expands our revenue base.

According to the "Twelfth Five-Year Plan", China is estimated to invest as much as RMB7 trillion on urban and rural infrastructure development between 2011 and 2015. With the investment already underway, industries such as construction machinery as well as transportation are expected to grow rapidly in the foreseeable future. This provides enormous opportunities for the Group to achieve higher revenue and to expand market share further.

In the second half of 2011, our titanium and titanium alloy production lines will commence production in the Nanjing plant, signaling the Group's further expansion into the high-value metal market. As compared to special steel and aluminum alloy, titanium is lighter, non-magnetic and harder with higher corrosion resistance. Therefore, titanium is widely applied in the aviation, marine engineering and medical industry and it's expected to be the key new material in the future. We believed that these new products, along with our diversified product mix will further improve our profitability and creating long-term value for our shareholders.

## **LIQUIDITY AND FINANCIAL RESOURCES**

As at 30 June 2011, the Group's current assets mainly included cash and cash equivalents of approximately RMB207,495,000, inventories of approximately RMB1,139,434,000, trade and other receivables of RMB1,392,655,000 and pledged deposits of RMB309,401,000. As at 30 June 2011, the interest bearing borrowings of the Group was RMB1,739,185,000, RMB1,450,185,000 of which was repayable within one year and RMB289,000,000 of which was repayable over one year. The Group's gearing ratio (calculated based on the total outstanding interest-bearing debt divided by the total assets) was 36.2%, lower than 42.8% as at 31 December 2010. The decrease was mainly attributable to the repayment of interest-bearing debt during the period. As at 30 June 2011, borrowings of RMB1,669,200,000 were in RMB and USD10,650,000 were in USD. The majority of the borrowings of the Group were subject to interests payable at rates ranging from 0.03% to 6.94% rates. The Group did not enter into any interest rate swap to hedge itself against the risks associated with interest rates.

## **CAPITAL EXPENDITURES AND CAPITAL COMMITMENTS**

For the first half of 2011, the Group's net increase in fixed assets amounted to RMB30,155,000, which were mainly for the production plant and facilities for titanium plant. As at 30 June 2011, capital commitments was RMB444,647,000, of which RMB99,614,000 was contracted and RMB345,033,000 was authorised but not contracted for. The majority of the capital commitment was related to acquisition of production equipment.

## **FOREIGN EXCHANGE EXPOSURE**

The Group's revenues were denominated in RMB, US dollars and Euros, with RMB accounting for the largest portion (approximately 57.3%). Approximately 42.7% of total sales and the Group's costs and operating profit were subject to exchange rate fluctuations. The Group did not enter into any financial instrument to hedge against foreign exchange risk. The Group has put in place measures such as monthly review of product pricing in light of foreign exchange fluctuation and incentivising overseas customers to settle balances on a more timely basis to minimize the financial impact from exchange rate exposure.

## **PLEDGE OF ASSETS**

As at 30 June 2011, the Group pledged certain bank deposits amounting to approximately RMB309,401,000 (31 December 2010: RMB136,635,000). Details are set out in the notes to the financial statements.

## **EMPLOYEE'S REMUNERATION AND TRAINING**

As at 30 June 2011, the Group employed around 3,848 employees (31 December 2010: around 3,826). The Group provided employees with remuneration packages comparable to the market rates and employees are further rewarded based on their performance according to the framework of the Group's salary, incentives and bonus scheme. In order to enhance the Group's productivity, and further improve the quality of the Group's human resources, the Group provides compulsory continuous education and training for all of its staff on a regular basis.

## **CONTINGENT LIABILITIES**

The Company had no material contingent liabilities as at 30 June 2011.

## **INTERIM DIVIDEND**

The Directors do not recommend the payment of an interim dividend for the period (no interim dividend for the six months period ended 30 June 2010).

## **SHARE OPTIONS SCHEME**

The Company adopted a share options scheme (the “Scheme”) in July 2007. On 28 January 2011, options entitled holders to subscribe for a total of 4,970,000 shares of USD0.01 each were granted to certain of the directors and employees of the Company in respect of their services to the Group in the forthcoming year. These share options vest on 1 July 2012 and have an initial exercise price of HKD5.10 per share of USD0.01 each and an exercise period ranging from 1 July 2012 to 30 June 2016. The price of the Company’s shares at the date of grant was HKD5.10 per share of USD0.01 each. Due to the implementation of Share Subdivision on 23 May 2011, the maximum aggregate number of shares which may be issued under the share option scheme was adjusted to 19,880,000 shares of USD0.0025 each at an exercise price of HKD1.275.

## **PURCHASE, SALES OR REDEMPTION OF SHARES**

During the six months ended 30 June 2011, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of its securities.

## **CORPORATE GOVERNANCE**

During the six months ended 30 June 2011, the Company has, so far where applicable, complied with the code provisions set out in the Code on Corporate Governance Practices contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (“Listing Rules”).

## **AUDIT COMMITTEE**

The Audit Committee comprises three independent non-executive directors. The Audit Committee held a meeting on 25 August 2011 to consider and review the interim report and interim financial statements of the Group and to give their opinion and recommendation to the Board. The Audit Committee considers that the 2011 interim report and interim financial statements of the Company have complied with the applicable accounting standards and the Company has made appropriate disclosure thereof.

## **THE MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS OF LISTED ISSUERS**

The Company has adopted a code of conduct regarding directors’ securities transactions on terms no less exacting than the required standard set out in the “Model Code for Securities Transactions by Directors of Listed Issuers” as set out in Appendix 10 of the Listing Rules. Having made specific enquiry of all directors, all directors have complied with the required standard set out in the Model Code and the Company’s code of conduct regarding directors’ securities transactions.

## APPRECIATION

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

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

Hong Kong, 26 August 2011

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

*Executive Directors: ZHU Xiaokun, ZHU Zhihe, YAN Ronghua and WU Suojun*

*Independent non-executive Directors: LI Zhengbang, GAO Xiang and LEE Cheuk Yin, Dannis*

\* *For identification purpose*