天工國際有限公司*

**TIANGONG INTERNATIONAL COMPANY LIMITED**

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

Stock Code : 826

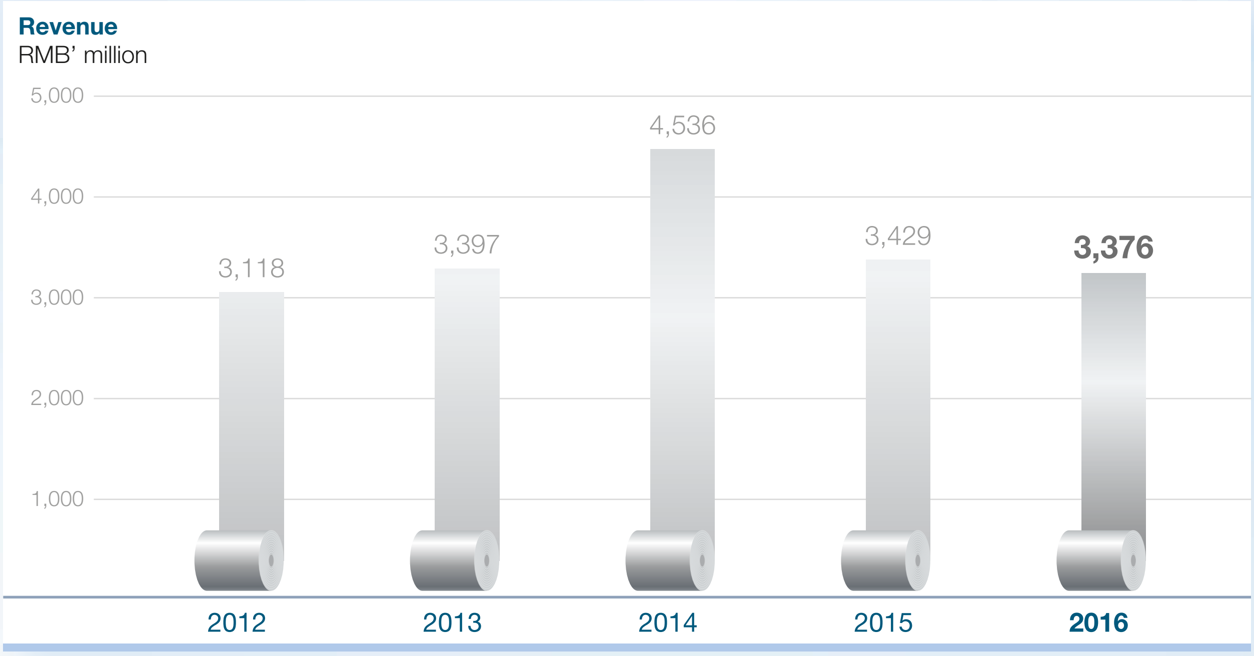
# Annual Report 2016

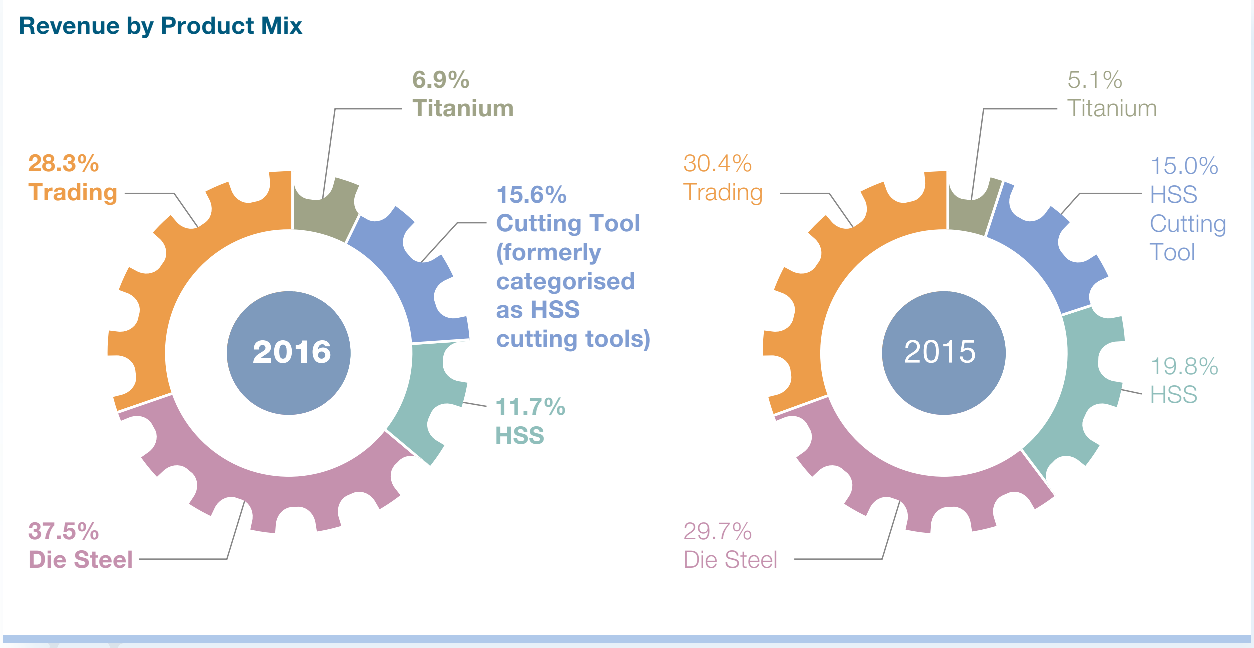
MIX
Paper from responsible sources
FSC™ C008061
FSC
www.fsc.org

# Contents

# Financial Highlights

| | 2016 | 2015 |
|---|---|---|
| Revenue (RMB'000) | **3,376,134** | 3,429,397 |
| Net profit for the year attributable to equity shareholders of the Company (RMB'000) | **110,571** | 72,623 |
| Basic Earnings per share (RMB) | **0.050** | 0.033 |
| Proposed final dividend per share (RMB) | **0.0100** | 0.0065 |



# Chairman's Statement

**Leveraging on our dominating position in the market and our advantage in costing and product range, we will strive to maintain growth and maximize returns to the shareholders of the Company.**

Zhu Xiaokun
*Chairman*

Dear Shareholders,

On behalf of the board of directors (the "Board") of Tiangong International Company Limited (the "Company", together with its subsidiaries, collectively the "Group"), I am pleased to present to you the annual results for the year ended 31 December 2016.

2016 is a year of breakthrough for the Group. From a financial point of view, the Group completed a turnaround from the extremely severe environment in 2015 to the slow recovery in 2016. Most of the core segments caught back the ascending trend. Although total revenue decreased by 1.6% to RMB3,376.1 million from RMB3,429.4 million in previous year, the revenue generated by the Group's core businesses other than trading of goods increased by 1.5%. Gross profit decreased by 4.9% year-on-year to RMB372.2 million (2015: RMB391.3 million) due to the delayed recovery in the high speed steel market. Net profit attributable to equity shareholders of the Company significantly increased by 52.3% year-on-year to RMB110.6 million (2015: RMB72.6 million). From an operating perspective, the Group improved its debt collecting efficiency and credit control over customers. It also significantly improved its gearing after a few years of capital investment.

Innovation is the key for the Group's breakthrough. The Group was glad to have a strong research and development team and eventually got rewarded during the year. We mastered the production of bimetallic saw blade steel, the supply of which was previously purely relying on imports. The advance was a promising step for the Group to capture the domestic market of this high-end product. The Group also improved capacity utilisation by refining the process and parameter in the smelting process. Without additional investment, we achieved a 25% improvement in capacity utilisation.

On the distribution network, we expanded our global footprint to Canada by setting up a new associate. On the domestic side, the Group invested in a die steel e-commerce platform which served the southern China area by providing one-stop online ordering, customisation and warehousing solution. The Group's distribution network was enriched in terms of geographic presence and means of distribution.

More importantly, the Group developed its global and domestic status through a few important events during the year. After nearly eight months of investigation by the European Commission, the Group obtained a favourable decision in the anti-dumping and anti-subsidy cases against the China industry of flat-rolled products of iron, non-alloy steel or other alloy steel. Under the decision, tool steel and high-speed steel produced by the Group's subsidiary would be excluded from the scope of investigation, and therefore, not subject to the protective measures imposed by the European Commission. For the domestic market, after experiencing China's national supply side reform, some competitors with obsolete production capacity were eliminated from the market. With the reduced number of competitors, the Group gained market share and pricing power in the domestic die steel market. Following which, the Group enhanced its status in the domestic special steel market.

Finally, on behalf of the Board, I would like to express my sincere gratitude to our management and staff for their outstanding performance over the year, as their contribution was the key to the Group's success. I would also like to take this opportunity to cordially thank all shareholders, customers and business partners for their support and assistance.

**Tiangong International Company Limited**
**Zhu Xiaokun**
*Chairman*
Hong Kong, 28 March 2017

# Management Discussion and Analysis

# Management Discussion and Analysis

## Business and Market Review

### Revenue

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2016** | | 2015 | | Change | |
| | **RMB'000** | **%** | RMB'000 | % | RMB'000 | % |
| Die Steel ("DS") | **1,262,376** | **37.5** | 1,017,875 | 29.7 | 244,501 | 24.0 |
| High speed steel ("HSS") | **395,239** | **11.7** | 678,679 | 19.8 | (283,440) | (41.8) |
| Cutting tools (formerly categorised as HSS cutting tools) | **527,821** | **15.6** | 514,857 | 15.0 | 12,964 | 2.5 |
| Titanium alloy | **234,295** | **6.9** | 173,361 | 5.1 | 60,934 | 35.1 |
| Trading of goods | **956,403** | **28.3** | 1,044,625 | 30.4 | (88,222) | (8.4) |
| | **3,376,134** | **100.0** | 3,429,397 | 100.0 | (53,263) | (1.6) |

### DS – accounted for 37.5% of the Group's revenue in FY 2016

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2016** | | 2015 | | Change | |
| | **RMB'000** | **%** | RMB'000 | % | RMB'000 | % |
| DS | | | | | | |
| Domestic | **638,862** | **50.6** | 333,637 | 32.8 | 305,225 | 91.5 |
| Export | **623,514** | **49.4** | 684,238 | 67.2 | (60,724) | (8.9) |
| | **1,262,376** | **100.0** | 1,017,875 | 100.0 | 244,501 | 24.0 |

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

During the year, revenue generated from DS segment increased by approximately 24.0% to RMB1,262,376,000 (2015: RMB1,017,875,000). The Group's domestic revenue in DS increased by 91.5% to RMB638,862,000 (2015: RMB333,637,000), contributing to 50.6% of the segment revenue for the year. The increase in domestic revenue was mainly because of the recovery in demand from domestic high-end equipment manufacturing industry, especially, for moulding materials, which drove up the sales volume of the Group's DS products.

The speed of recovery in overseas markets was relatively slow compared to the domestic market. The average selling price of DS products in overseas markets had not yet fully recovered to the same level as in 2015. However, with the Group's prior effort devoted to expanding the overseas markets, the negative impact on revenue due to the slower recovery was minimised. As a result, the Group's export revenue decreased by 8.9% to RMB623,514,000 (2015: RMB684,238,000).

**HSS – accounted for 11.7% of the Group's revenue in FY 2016**

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2016** | | 2015 | | Change | |
| | **RMB'000** | **%** | RMB'000 | % | RMB'000 | % |
| HSS | | | | | | |
| Domestic | **262,817** | **66.5** | 471,250 | 69.4 | (208,433) | (44.2) |
| Export | **132,422** | **33.5** | 207,429 | 30.6 | (75,007) | (36.2) |
| | **395,239** | **100.0** | 678,679 | 100.0 | (283,440) | (41.8) |

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

The global HSS market was in a recession period during the year. Demand of HSS in both domestic and overseas markets was weak and the Group experienced price pressure globally, especially in domestic markets. As a result, domestic revenue significantly decreased by 44.2% to RMB262,817,000 (2015: RMB471,250,000).

Compared to the domestic market, the more sustainable average selling price in the overseas markets moderated the reduction in export revenue, which still resulted in a net decrease by 36.2% to RMB132,422,000 (2015: RMB207,429,000).

**Cutting tools (formerly categorised as HSS cutting tools) – accounted for 15.6% of the Group's revenue in FY 2016**

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2016** | | 2015 | | Change | |
| | **RMB'000** | **%** | RMB'000 | % | RMB'000 | % |
| Cutting tools | | | | | | |
| Domestic | **201,970** | **38.3** | 186,496 | 36.2 | 15,474 | 8.3 |
| Export | **325,851** | **61.7** | 328,361 | 63.8 | (2,510) | (0.8) |
| | **527,821** | **100.0** | 514,857 | 100.0 | 12,964 | 2.5 |

Cutting tools segment included HSS and carbide cutting tools. HSS cutting tools products can be categorized into four major types – twist drill bits, screw taps, end mills and turning tools. All of these are used in industrial manufacturing. The two main types of HSS cutting tools manufactured by the Group are twist drill bits and screw taps. The Group's vertical integration extending from upstream HSS production to downstream HSS cutting tool production brought us a significant cost advantage over our peers. The Group has also started the production of high end carbide tools since 2016, which mainly comprised of customised tools.

To cope with competition in the domestic market of cutting tools, the Group modified the sales strategy in the cutting tools segment. By selling cutting tools products at a more competitive price, the Group achieved an increase in sales volume in the domestic market. The Group recorded a significant increase in domestic sales volume by around 20%. Compromised by the lower average selling price, overall domestic revenue increased by 8.3% to RMB201,970,000 (2015: RMB186,496,000).

The business environment in the overseas markets of cutting tools remained relatively stable. Accordingly, the Group's export revenue decreased slightly by 0.8% to RMB325,851,000 (2015: RMB328,361,000).

**Titanium alloy – accounted for 6.9% of the Group's revenue in FY 2016**

| | For the year ended 31 December | | | | | |
|---|---|---|---|---|---|---|
| | **2016** | | 2015 | | Change | |
| | **RMB'000** | **%** | RMB'000 | % | RMB'000 | % |
| Titanium alloy | | | | | | |
| Domestic | **233,830** | **99.8** | 173,361 | 100.0 | 60,469 | 34.9 |
| Export | **465** | **0.2** | – | – | 465 | – |
| | **234,295** | **100.0** | 173,361 | 100.0 | 60,934 | 35.1 |

Titanium alloy is lighter, stronger and has higher corrosion resistance compared to aluminum alloy. Thus, it finds applications in aviation, marine engineering and the medical industries. Its production involves sponge titanium as well as other various rare metals. The production of titanium and titanium alloy is both capital and technology intensive. Thus, it is an industry with a high entry barrier.

Revenue of the titanium alloy segment continued to grow at over 30% annually in the 4 years since its introduction by the Group in 2012. During the year, titanium alloy revenue recorded a significant increase of 35.1% to RMB234,295,000 (2015: RMB173,361,000). The average selling price of titanium products remained stable during the year. The increase in revenue was mainly attributable to an increase in sales volume. As more distribution channels were created during the past 4 years, the Group gradually built up a reliable sales force and a large distribution network for its titanium products.

Titanium alloy segment recorded the first export sales during the year. Although the export revenue was not significant, it was an achievement of the Group in developing overseas markets of titanium alloy segment.

### Trading of goods

This segment involves the purchase and sales of normal carbon steel products which were not within the Group's production capacity. Due to its slim profitability, the Group will place less focus on this segment in the future.

## Financial Review

Net profit attributable to equity shareholders of the Company increased by 52.3% from RMB72,623,000 in 2015 to RMB110,571,000 in 2016. The increase was mainly attributable to (i) contribution from the Group's DS and titanium alloy segments, which offset the recession in the HSS market; (ii) government grants received from the PRC government in rewarding the Group's contribution to the local economy and encouraging the Group's technology innovation; (iii) recovery of previously impaired trade receivables; and (iv) reduction in finance costs as a result of the Group's effort in reducing its gearing.

### Revenue

Revenue for the Group for 2016 totalled RMB3,376,134,000, representing a decrease of 1.6% as compared with RMB3,429,397,000 in 2015. However, the Group recorded an increase of 1.5% in revenue generated by its core businesses other than trading of goods. Among the Group's four core businesses, the DS and titanium segments benefited from a recovery in demand in the domestic high-end equipment manufacturing industry. Cutting tools segment's performance remained stable across 2015 and 2016. The positive influences on revenue from these three segments was partially offset by the recession in the HSS market, resulting in the net increase of 1.5% in revenue.

### Cost of sales

The Group's cost of sales was RMB3,003,942,000 in 2016, representing a decrease of 1.1% as compared with RMB3,038,061,000 in 2015 as a result of a reduction in sales. As a percentage of total revenue, the Group's cost of sales increased to 89.0% during the year (2015: 88.6%). The increase was mainly due to downward price adjustments in order to maintain the Group's competitiveness in the stagnant markets.

### Gross margin

For 2016, the overall gross margin was approximately 11.0% (2015: 11.4%). Set out below is the gross margin of our five product segments in 2016 and 2015:

| | **2016** | 2015 |
|---|---|---|
| DS | **15.7%** | 15.2% |
| HSS | **18.6%** | 19.4% |
| Cutting tools (formerly categorised as HSS cutting tools) | **12.2%** | 15.4% |
| Titanium alloy | **14.6%** | 13.6% |
| Trading of goods | **0.2%** | 0.2% |

#### *DS*

The gross margin of DS increased from 15.2% in 2015 to 15.7% in 2016. The increase was mainly due to a recovery in demand in the domestic markets.

#### *HSS*

The gross margin of HSS decreased from 19.4% in 2015 to 18.6% in 2016. The decrease was due to a downward adjustment of selling price under price pressure caused by the recession of global HSS market.

#### *Cutting tools (formerly categorised as HSS cutting tools)*

The gross margin of cutting tools decreased from 15.4% in 2015 to 12.2% in 2016. In view of severe competition in the cutting tools market, the Group modified its sales strategy by offering products at a more competitive price. Thus, the gross margin of cutting tools was affected. On the other hand, by adopting this strategy, the Group achieved increased sales volume.

#### *Titanium alloy*

The gross margin of titanium alloy increased from 13.6% in 2015 to 14.6% in 2016. The increase was attributable to higher utilisation of production capacity so that fixed costs were shared to more units of goods resulting in a decrease in the per-unit production costs.

#### *Trading of goods*

The gross margin of this segment remained stable at 0.2% (2015: 0.2%).

### Other income

Other income increased from RMB19,324,000 in 2015 to RMB76,299,000 in 2016. The increase was mainly due to (i) increased PRC local government grants for the Group's contribution to the local economy and technology innovation from RMB6,808,000 in 2015 to RMB36,013,000 in 2016; and (ii) reversal of impairment loss on trade receivables of RMB39,308,000 in 2016.

### Distribution expenses

Distribution expenses in 2016 were RMB66,264,000 (2015: RMB67,855,000), representing a decrease of approximately 2.3%. The decrease was mainly attributable to a decrease in export sales volume and implementation of a cost reduction policy in reducing marketing and advertising expenditure. For 2016, distribution expenses as a percentage of revenue was 2.0% (2015: 2.0%).

### Administrative expenses

Administrative expenses increased from RMB115,404,000 in 2015 to RMB142,918,000 in 2016. The increase was mainly due to an increase in labour related costs during the year. More staff incentives were provided to raise the morale of the work force to achieve a better performance of the Group. For 2016, administrative expenses as a percentage of revenue was 4.2% (2015: 3.4%).

### Other operating expenses

Other operating expenses decreased from RMB14,154,000 in 2015 to RMB12,294,000 in 2016. Other operating expenses in 2016 mainly resulted from foreign exchange losses as RMB weakened against USD and EUR throughout the year. Other operating expense in 2015 was mainly the result of recognition of impairment loss on receivables. No significant impairment loss was identified in 2016.

### Net finance costs

The Group's finance income was RMB9,398,000 in 2016, representing an increase of RMB877,000 primarily due to an increase in average bank deposit balance. The Group's finance expense was RMB112,697,000 in 2016, representing a decrease of 24.5% from RMB149,240,000 in 2015. The decrease resulted from a reduction in debts according to the Group's lower gearing ratio policy implemented during the year.

### Income tax

As set out in Note 8 of the consolidated statement of profit or loss, the Group's income tax increased by 14.1% from RMB13,074,000 in 2015 to RMB14,920,000 in 2016, mainly because of an increase in the Group's profit before taxation for the year.

### Profit for the year attributable to equity shareholders of the Company

As a result of the factors discussed above, the Group's profit increased by approximately 52.3% from RMB72,623,000 in 2015 to RMB110,571,000 in 2016. The net profit margin increased from 2.1% in 2015 to 3.3% in 2016.

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

For 2016, total comprehensive income for the year attributable to equity shareholders of the Company was RMB156,284,000 (2015: RMB44,836,000) after taking into account of foreign currency translation differences and the fair value adjustment on available-for-sale securities.

During the year, the Group recognised a foreign currency translation difference of RMB27,642,000 (2015: RMB27,787,000) related to translation of financial statements of Hong Kong subsidiaries and overseas equity accounted investees.

The Group also recognised a fair value gain of RMB73,355,000 (2015: Nil) on its available-for-sales securities investment.

### Other financial assets

The Group has invested in shares in Bank of Jiangsu. Previously, there was no quoted market price in an active market for shares in Bank of Jiangsu before it was listed on Shanghai Stock Exchange on 2 August 2016. After the listing of Bank of Jiangsu, the Group's other financial assets comprising 10,000,000 shares in Bank of Jiangsu was revalued at RMB96,300,000 according to its fair value of RMB9.63 per share as at 31 December 2016. The fair value gain, net of tax, of RMB73,355,000 was recorded in other comprehensive income during the year.

### Trade and bills receivables

Trade and bills receivables decreased from RMB1,670,158,000 in 2015 to RMB1,367,982,000 in 2016 which was mainly due to improved control over credit given to customers in 2016 as compared with 2015. Debts collection efficiency and effectiveness was also enhanced in 2016. Approximately 82% of the trade and bills receivables were neither past due nor impaired. During the year, the impairment losses was decreased by RMB39,308,000 as previously impaired debts were subsequently collected during the year.

The significant amount of previously impaired debts recovered was mainly related to a customer, whose sales and production condition deteriorated since 2014, and therefore, was unable to settle our invoices timely. To control the risks of bad debts against the customer, the Group applied a special credit control arrangement under which subsequent sales to this customer were not allowed until remittance was received. After receipt of remittance, sales were then allowed subject to a limitation up to a certain percentage of remittance received. During the year, the Group assisted the customer to resell the previously supplied goods by sourcing other customers. The collected proceeds of the resales were used to repay the previously impaired debts.

## Outlook

During the year, the business environment of the Group's four major segments changed. While DS and titanium alloy segments recorded a growth caused by the recovery in demand from domestic high-end equipment manufacturing industry, HSS encountered a recession during the year. For cutting tools (formerly categorised as HSS cutting tools), the result was driven by the Group's competitive pricing policy with the intention to increase the sales volume and remove inventory of outdated design.

From the Group perspective, 2016 was a year for breakthrough and internal refinement. The Group implemented various policies to enhance its operating and financial positions, including automation of production line, lowering of financial gearing, higher efficiency on debt collection, and improved control over credit to customers.

The Group achieved a few innovation breakthroughs, including mastering the production of bimetallic saw blade steel, the previous supply of which was purely relying on imports. The advance was a promising step to the Group for capturing the domestic market of this high-end product. We achieved a 25% improvement in the capacity utilisation by refining the process and parameter in the smelting process without additional investment.

On the distribution network development, the Group's global footprint has extended to Canada with a new associate setup during the year. For the domestic side, as announced by the Company on 20 December 2016, the Group enriched the means of distribution by investing in a DS e-commerce platform which served southern China area by providing one-stop online ordering, customisation and warehousing solution.

After nearly eight months of investigation by the European Commission, the Group obtained a favourable decision in the anti-dumping and anti-subsidy cases against the China industry of flat-rolled products of iron, non-alloy steel or other alloy steel. Under the decision, tool steel and high-speed steel produced by TG Tools would be excluded from the scope of investigation, and therefore, not subject to the protective measures imposed by the European Commission.

Looking forward to 2017, following the successful removal of excess capacity in the PRC steel industry in 2016, China's national supply side reform will be continued with a greater focus on removing low-end steel manufacturers by means of operational and environmental standardisation. The new focus of the reform is to protect the advanced production capacity by removing obsolete production capacity. To synchronise with the national policy, the Group established a new research centre focusing on research and development of high-end products. The new research centre will be put into full operation in 2017. In addition, the Group will cooperate with major special steel research institutions on new product and technology development.

The Group already acquired pricing power in domestic DS market through China's national supply side reform in 2016. We hope to improve our pricing power in the HSS market by positioning at high-end manufacturing.

For the overseas markets, the Group sought to improve the profit margin by increasing the direct exposure and connection with end customers. It was believed that both the Group and the end customers could benefit from a more streamlined distribution mechanism.

Revenue of the titanium alloy segment continued to grow at over 30% annually in the 4 years since its introduction by the Group. The prime focus of the segment would be the development of new products and their application. Effort would be put on steel-titanium composite plate development and its application in the ocean-related industry, with our strategic partner, Nanjing Iron & Steel Co., Ltd. ("Nanjing Steel").

During the year, Jiangsu Tiangong Technology Company Limited ("TG Tech"), a non-wholly owned subsidiary of the Group, entered into a subscription agreement with Nanjing Steel for a subscription of 40 million TG Tech placing shares at the placing price of RMB1.24 per share for a cash consideration of up to approximately RMB49.6 million (the "First Placing"). After the completion of the First Placing, the equity interests held by the Company in TG Tech was diluted by approximately 11.76% from 100% to approximately 88.24% of the enlarged share capital of TG Tech. The proceeds from the First Placing has been used for procurement of material and utility expenses and the replenishment of its working capital, which enabled TG Tech to (i) increase its production capacity; (ii) strengthen its current research and development level; and (iii) increase its financial strength. For further details, please refer to the announcements of the Company dated 7 March 2016, 24 March 2016, 27 April 2016 and 25 August 2016.

Further, on 6 June 2016, TG Tech entered into another subscription agreement with Nanjing Steel, certain directors and core management of TG Tech for a subscription of total of 65 million TG Tech placing shares at the placing price of RMB1.24 per share for a cash consideration of up to approximately RMB80.6 million (the "Second Placing"). Subsequently on 11 July 2016, the Second Placing and the subscription agreement were resolved and approved in the extraordinary general meeting of the Company. The Second Placing was completed on 7 November 2016 and the equity interests held by the Company in TG Tech was further diluted to approximately 74.07% of the enlarged share capital of TG Tech. TG Tech remains as a subsidiary of the Group after the completion of the Second Placing. For further details, please refer to the announcements of the Company dated 6 June 2016, 11 July 2016 and 25 August 2016 and the circular of the Company dated 23 June 2016.

The proceeds from the Second Placing has been used as intended:

| **Intended use of proceeds from the Second Placing** | **Actual use of proceeds (as at 31 December 2016)** | **Proposed use of the remaining unutilized proceeds (as at 31 December 2016)** |
|---|---|---|
| (i) Research and development for new materials of high-quality, high-end titanium alloy, including but not limited to titanium wire for 3D printing and a co-developing project with Nanjing Steel on the development of a new composite material by the combination of titanium and steel | (a) RMB15.0 million was used in research and development of titanium wire for 3D printing<br>(b) RMB9.6 million was used in research and development of production process of high quality titanium alloy round plate<br>(c) RMB4.8 million was used in research and development of a new composite material by the combination of titanium and steel | The Group plans to fully utilise the balance of RMB0.6 million for research and development projects |
| (ii) Integration with upstream and downstream products suppliers/contractors/customers by way of alliance or investment | RMB25.7 million was used for market development on upstream and downstream counterparties within the supply chain | The Group plans to fully utilise the balance of RMB14.3 million for upstream and downstream integration within the supply chain |
| (iii) Replenishment of TG Tech's working capital to procure raw materials and meet any cashflow requirements that may arise from the daily operations of TG Tech | RMB7.4 million was used as working capital and for daily operation, of TG Tech including payment of electricity, staff salaries and procurement of raw materials | The Group plans to fully utilise the balance of RMB3.2 million as the working capital of TG Tech to meet the needs arising from its daily operations |

On 8 December 2016, the Group sold 0.04% of its equity interests in TG Tech to an independent third party, at a consideration of RMB398,790. After the completion of the disposal, the Group holds 74.03% of the equity interests of TG Tech, and TG Tech remains as a subsidiary of the Group.

On 20 December 2016, Tiangong Aihe Company Limited ("TG Aihe"), a wholly owned subsidiary of the Company, entered into an investment agreement with three other partners for the formation of a corporation, Shenzhen 51 Mocai Technology Company Limited ("Shenzhen 51 Mocai"), with a registered capital of RMB50 million. According to the agreement, TG Aihe contributed RMB5 million, representing 10% of the total registered capital of Shenzhen 51 Mocai. Shenzhen 51 Mocai was established on 20 December 2016. The principal business of Shenzhen 51 Mocai are computer technology development and technical services; the e-commerce of moulding materials; development of moulding software; development, production and sales of smart device; research and development, production, sales and import and export of moulding materials, special function materials, energy-storage materials, fine alloy, corrosion-resistant alloys, high-temperature alloys and moulding accessories and mould peripheral equipment; supply chain management and related supporting services; warehousing services; leasing of self-owned properties, property management services and inventory loading and unloading services and transport services. Shenzhen Xinyuan Steel Material Company Limited subsequently transferred the die steel e-commerce platform (www.51mocai.com) to Shenzhen 51 Mocai on 13 February 2017.

The e-commerce platform was intended to provide online DS customisation, centralised warehousing and one-stop online ordering for DS and moulding by integrating the production information of upstream DS manufacturers, capacity of deep processing subcontractors, demand from end consumers and regional inventory level.

Further, the e-commerce platform would allow the Group to follow the state advocated "Internet +" macro policy, focusing on transformation of the traditional distribution channel of DS by using internet technology.

The Group intended to initiate its integration of downstream operation by investing in Shenzhen 51 Mocai. The Group expected to benefit from the industrial Big Data acquired from the e-commerce platform to facilitate the analysis of the demand from the end consumers. The Group would then be able to refine the production and product mix according to the result from the analysis. Further, the analysis could provide a new direction to the Group on the strategy and development of its new products.

In addition, the Group considered the investment in Shenzhen 51 Mocai to be an effective way to expand its distribution network to the South China region.

Finally, we re-affirm that maximization of shareholder value, whilst adhering to the highest standards of corporate governance is always our top priority.

## Forward Looking Statements

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

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

## Liquidity and Financial Resources

As at 31 December 2016, the Group's current assets mainly included cash and cash equivalents of approximately RMB259,546,000, inventories of approximately RMB1,901,775,000, trade and other receivables of RMB1,577,383,000, pledged deposits of RMB180,180,000 and time deposits of RMB640,000,000. As at 31 December 2016, the interest-bearing borrowings of the Group were RMB2,888,912,000 (2015: RMB3,066,874,000), RMB2,678,912,000 of which were repayable within one year and RMB210,000,000 of which were repayable after more than one year. The Group's adjusted net debt-to-equity ratio, which is calculated based on adjusted net debt (defined as total interest-bearing borrowings plus unaccrued proposed dividends, less cash and cash equivalents) divided by adjusted capital (comprising all components of equity, less unaccrued proposed dividends) as at 31 December 2016, was 64.1% (2015: 71.4%).

The decrease in borrowings was mainly attributable to the repayment of bank loans and the Group's policy to reduce its gearing. As at 31 December 2016, borrowings of RMB2,033,050,000 were in RMB, USD89,215,588 were in USD and EUR34,752,464 were in EUR. The borrowings of the Group were subject to interests payable at rates ranging from 0.70% to 5.75% per annum. There is no seasonality of borrowing requirements of the Group. The Group did not enter into any financial instruments to hedge itself against the risks associated with interest rates and foreign currency exchange fluctuations.

During the year, the net cash generated from operating activities was RMB494,768,000 (2015: RMB632,532,000).

## Cash Conversion Cycle

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

The Group's turnover days of inventory for 2016 was 230 days (2015: 231 days). The relatively long turnover days of inventory is common in the special steel industry due to its complex production process. The Group's turnover days of trade receivables for 2016 was 164 days (2015: 195 days). The improved turnover days of trade receivables was mainly due to the strengthened credit control and debts collection policy implemented by the Group during the year. The Group's turnover days of trade payables for 2016 was 131 days (2015: 143 days). The shortened turnover days of trade payables was due to more timely payment to the suppliers as a result of accelerated debts collection.

Accordingly, the Group's cash conversion cycle for 2016 was 263 days (2015: 283 days). The improved cash conversion cycle was mainly due to the more effective and efficient control over trade receivables. Please note that the calculation of the aforesaid indexes may not be consistent with those measurement indexes published by other issuers.

## Capital Expenditure and Capital Commitments

For 2016, the Group's net increase in fixed assets amounted to RMB200,622,000, which mainly related to the production plant for thin steel plate project and research centre for HSS, DS and titanium alloy and were financed by a combination of our internal cash resources, operating cash flows and bank borrowings. As at 31 December 2016, capital commitments were RMB209,198,000 (2015: RMB467,945,000), of which RMB56,921,000 were contracted and RMB152,277,000 were authorised but not contracted for. The majority of the capital commitments were related to investment in melting facility and production line of HSS and DS sheet and would be funded by internal resources and operating cash flows of the Group.

## Foreign Exchange Exposure

The Group's revenues were denominated in RMB, USD and EUR, with RMB accounting for the largest portion (approximately 67.9%). Approximately 32.1% of total sales and the Group's costs and operating profit were subject to exchange rate fluctuations. The Group has put in place measures such as monthly review of product pricing in the light of foreign exchange fluctuations and incentivising overseas customers to settle balances on a more timely basis to minimize the financial impact from exchange rate exposure.

## Pledge of Assets

As at 31 December 2016, the Group pledged certain bank deposits amounting to approximately RMB180,180,000 (2015: RMB445,389,000), certain trade receivables amounting to approximately RMB147,748,000 (2015: RMB91,509,000) and other financial assets amounting to approximately RMB96,300,000 (2015: Nil).

## Employees' Remuneration and Training

As at 31 December 2016, the Group employed around 3,423 employees (2015: around 3,270 employees). Total staff costs during the year amounted to RMB235,618,000 (2015: RMB189,240,000). 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 training for all of its staff on a regular basis.

## Contingent Liabilities

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

## Principal Risks and Uncertainties

The main activities of the Group include production and sales of DS, HSS, cutting tools (formerly categorised as HSS cutting tools) and titanium alloy. The Group is exposed to a variety of financial risks including credit risk, liquidity risk, currency risk and interest rate risk. Details of the above main risks and measures for risk reduction are set out in the note 31 to the financial statements.

Apart from the financial risks mentioned above, the Group is exposed to certain operating risks and uncertainties including rare metal price volatility and market demand.

### *Risks and uncertainties arising from rare metal price volatility*

Rare metal represented a significant portion in the cost of materials of the Group's products. Price of rare metal significantly affected the per unit production costs of the Group's products. In view of the risk on rare metal price volatility, the Group has already engaged with rare metal suppliers to obtain discounted price for purchasing rare metal over a fixed period of time. Moreover, since the price of rare metal is publicly available market information, the Group was capable to partially transmit the effect of rare metal price volatility to the downstream customers. However, because of the transparency of the rare metal price, in extreme situation where the rare metal price stayed low, the Group could be under pressure to make downward pricing adjustments on our products.

### *Risks and uncertainties arising from market demand of the Group's products*

The Group's business and profitability growth were affected by the uncertainties of global macroeconomic situations, which could materially affect the manufacturing and infrastructure industry. These uncertainties eventually affect the demand of the Group's products. To minimise the effect of the global macroeconomic uncertainties, the Group continued to developed new markets all over the world. The Group believed that the best way to manage such risks and uncertainties was to avoid the reliance on demand from a particular Economy.

## In Compliance with Laws and Regulations

As a company listed in Hong Kong, the Company is subject to the regulations of the Securities and Futures Commission of Hong Kong and The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). Moreover, various PRC government authorities, particularly the State Environmental Protection Administration, have the authority to issue and implement regulations governing various aspects of special steel production. The Group will constantly update and ensure compliance with new rules and regulations issued by these regulators.

As at 31 December 2016 and up to the date of this report, the Board was unaware of any non-compliance with the relevant laws and regulations that had a significant impact on the Group.

## Relationships with Key Stakeholders

(i) Employees

The Group recognises human resources as assets important to the Group's development and growth. Most of the Group's employees were working at the manufacturing plant in Zhenjiang City, the PRC. The Group provided employees with remuneration packages comparable to the market rates and employees were 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 provided compulsory continuous training for all of its staff on a regular basis.

(ii) Suppliers

The Group's suppliers mainly supplied us with raw materials and utilities in the PRC. The Group developed long-standing and good relationships with the suppliers. Our procurement department conducted regular meetings with the suppliers of raw material and utilities to ensure that raw materials supplied were in stable and good quality.

(iii) Customers

The Group established long-term cooperation relationships with major customers. The sales team in domestic and overseas sales offices visited and discussed with customers regularly so as to keep us well-informed of the market information and changes.

# Environmental, Social and Governance Report

## 1. About this report

The Company published the first Environmental, Social and Governance Report ("ESG Report") in 2016. The purpose of this ESG Report is to convey the Group's management principles and sustainable development strategies to both internal and external stakeholders. The Group is committed to providing customers with DS, HSS, cutting tools and titanium materials manufactured in processes with consideration to the environmental and social well-being as a whole. The Group is committed to reduce environmental footprint, enhancing the safety of the work environment while providing quality products.

The Group has invited Allied Environmental Consultants Limited to carry out an materiality assessment, various internal stakeholder communications and engagements, and investigation of matters that may have a significant impact on the Group's sustainable development, the relevant results of which has been stated in this ESG Report.

The Company's senior management team has approved this ESG Report and confirmed that the environmental, social and governance risk management and internal control systems of the Group are effective. The Group is grateful to all those who have assisted in the preparation of this ESG Report and contributed to our positive environmental, social and governance performance.

### 1.1 Guidelines

This ESG Report contains information in accordance with reporting principles of Materiality, Quantitative, Balance and Consistency, which is defined in Appendix 27 "*Environmental, Social and Governance Reporting Guide*" of the Listing Rules.

The Company's corporate governance report is prepared in accordance with all applicable provisions as set out in Appendix 14 of the Listing Rules, which has been reported in "Corporate Governance Report" of the annual report.

### 1.2 Scope

The ESG Report contains the environmental and social operational data for the fiscal year 2016 (1 January 2016 to 31 December 2016).

Unless otherwise specified, this ESG Report covers the main operations of the Group, including the data and activities of the production base in Jiangsu, China.

For subsidiaries and affiliates of the Group located in mainland China, Hong Kong, Taiwan and overseas which are not directly engaged in production and therefore have little impact on the overall environmental and social aspects of the Group, they are not included in the reporting area for 2016. If the Company's business scope changes in the future, resulting in an increase in the impact and importance on the Group's environmental and social aspects, it would be incorporated into the scope of future reports.

### 1.3 The Group's Vision on Sustainability

The Group is committed in the pursuit of excellence by providing top of the line products in the steel industry. While the "Tiangong" brand has been established for well over 35 years, the Group understands that long-term sustainable growth goes beyond running a profitable business and requires social and environmental contributions.

In addition to the reporting of business and economic activities, the Group has begun to structure the reporting of environmental and social performance in order to better communicate to stakeholders the Group's sustainable development.

The following actions were undertaken in the reporting year of 2016:

- Compiling the Group's first Environment, Social and Governance Report (ESG Report)
- Establishing a data collection mechanism for monitoring both environmental and social aspects
- Designating responsible personnel from different departments for the preparation of the ESG Report
- Establishing goals for the Group's sustainable development for the year of 2017

The Group endeavours to communicate with its internal and external stakeholders to develop the Group's sustainability. Effective communication with stakeholders will further enhance a safe working environment for the Group's employees, promote an environmentally-friendly production line and produce quality products for customers.

### 1.4 Contact

If you have any comments or suggestions regarding this ESG Report, please contact the Investor Relations Department at the address below:

Room 1303, 13/F
Jubilee Centre
18 Fenwick Street
Wanchai, Hong Kong

Phone No.:
(852) 3102-2386

Fax No.:
(852) 3102-2331

## 2. Our Staff

### Talent selection (B1,B3,B4)

The Company's staff management objectives are: nurturing rich and powerful enterprise staff. It is believed that excellent talented staff will contribute to a flourishing enterprise and the achievements of which can be enjoyed by all employees. Therefore, the Company has developed an employment and staff management system to effectively promote the development of the Group as a whole.

It is our commitments to:

- comply with all applicable laws, regulations and other requirements, including the "Labour Law", "Employment Contract Law" and "Trade Union Law";
- prohibit the use of child labor and forced labor, not accept any supplier who uses child labor, prisoners or forced labor;
- equally treat all the employees and stand against discrimination;
- provide all employees with reasonable working hours and holidays;
- when it comes to employment, remuneration, training opportunities, promotion, dismissal or retirement, any discrimination based on race, ethnic or social origin, social class, descent, religion, physical disability, gender, sexual orientation, family responsibilities, marital status, union membership, political opinion, age or other, will not be allowed;
- respect the basic human rights of employees and prohibit any form of personality insult;
- provide safe and hygienic working and living conditions to ensure the health and safety of employees;
- provide reasonable and improving wages, benefits and working conditions.

#### *Recruitment management system*

The Group adheres to the principal of open recruitment, internal promotion before external recruitment, equal competition, and matching people's talent to the post. In accordance with the careful recruitment system and procedures, our Human Resources Department will first examine the applicants' qualifications and experience to identify potential staff meeting the Group's need, and interviews will then be arranged to select the appropriate personnel. The recruitment process is consistently just, fair, open and equal.

During this recruitment process, the Human Resources Department will be able to verify the applicant's background with the support of their identity documents, academic and qualification certificates, so as to ensure that the candidates meet the age requirements of the Group and to ascertain the accuracy of their identity before considering the employment. There has been no non-compliance in relation to the employment of child labor or forced labor by the Group in this year.

### Prevention of forced labor

The Group strictly prohibits forced labour. If any employee suspects a case of forced labour, he or she must contact the Security Department, which will carry out investigation and verification.

### Promotion

The promotion management system of the Group aims to standardize the selection process and actively excavate and cultivate the excellent management personnel of the Company, to provide a platform for the promotion and competition of the employees, and to form a positive staff atmosphere and reduce the human factors in the process of personnel management, so that talents selection for each post would be based on a just, fair, and open process, which effectively promotes the Company's management. The Group has clear guidelines on the promotion management system, which set out the conditions and procedures for promotion, so that all the employees have a fair promotion opportunity.

### Training


*Tiangong Mentoring Scheme- signing of Master/Apprentice agreement*

Employee training at the Group operates with four goals in mind: to accelerate employees' career progression; fully utilize our company's internal human resources; cultivate the Company's own talents; increase human capital to strengthen our company's momentum. With respect to these goals, a master-apprentice program known as the "Pass the Baton" has been incorporated in training. Under the "Pass the Baton" program, new employees are paired with experienced employees through a one-on-one apprenticeship agreement in which the experienced employees are obligated to help transition the new employees. The mentoring program has been introduced and updated in the Company's newsletter, forming a strong atmosphere of bonding among staffs.

This year, the Group's second echelon talent training program was launched, which has benefitted 39 trainees. The program offers various classic courses such as "the development of team leadership", "Internet-based business model innovation", "leadership and managers EQ training", "enterprise information in the business application" and "shaping corporate culture and core values". The training of second echelon of personnel will be an important source of supply of capable staff for managing and implementing the Group's projects. According to the plan, the Company will annually provide training in different phases to staff with good performance and high loyalty, in order to continue to build an outstanding team and provide multi-level echelon talents for the future development of the Company.


*Tiangong training*

### *Payment and benefits*

The Company has established a system to provide reasonable wages and benefits and working conditions to its staff to improve the Company's core competitiveness. The Group aims to establish a remuneration system suitable for the development of the Company, standardize the management of remuneration and benefits, and build a value distribution mechanism and internal incentive mechanism so as to attract and retain the talents and thus reach the principle of sustainable development.

The Group firmly believes that our competitive remuneration and benefits program will invigorate human resources, contribute to the increase of our company's core competitiveness and for talents retention.

The Group will organize an awards ceremony for employees each year, to acknowledge their contribution. There will be a staff show at the same time to improve the team's cohesion.


***2016 annual awards ceremony of Tiangong***

### *Employee resignation or dismissal management*

The Group manages the procedures for the resignation or dismissal of employees, ensures a relatively stable workforce, maintain the order of normal personnel flow, and handle staff movements in a confidential manner and keep the work coherent and smooth.

### Corruption prevention and internal audit system (B7)

During the reporting period, the Company implemented a strict anti-corruption policy to prohibit all acts related to bribery, blackmail, fraud and money laundering, and convey the message to all employees and business partners so as to adhere to the relevant codes.

The Group believes that employee integrity is one of the core values of the Group's operations. The Group pays attention to the individual behavior and the personal quality, prohibits bribery, extortion, and fraud etc. In order to maintain a normal working order, the Group motivates staff to fulfill their duties fairly, to further implement the Company's rules and regulations, and ensure that the Group complies with the relevant laws and regulations.

During the reporting period, the Company did not experience any corruption incident.

### Employee's health and safety (B2)

As a special steel manufacturer, the production process has some potential safety risks. The Group values the safety of employees, develops safety regulations and provides labor protection outfits (such as safety shoes, safety clothes, safety helmets, protective glasses, protective shoes, etc.). There are different electrical appliances and machinery on the production site, which are restricted to operation by qualified personnel. All qualified personnel should also be trained on a regular basis to enhance their risk awareness.

The Group arranges the Human Resources Department to provide medical examinations for the frontline employees twice a year to ensure employees health.

## 3. Our products

The Company's production principles are: production is subject to safety, production is subject to environmental protection, and production is subject to quality. Strict quality testings are implemented from the supply chain to the export of products, and relevant environmental impacts throughout the processes are considered.

### Supply Chain Management (B5)

The Company believes that a complete supply chain is very important for the Group's sustainable operations. So supply chain management systems and management regulations have been set up to assess the quality of selected suppliers while balancing environmental and social risks. In the case of equipment or raw materials, a regulatory system has been implemented to regularly review the number and performance of suppliers to ensure compliance with material specifications and to maintain smooth day-to-day operations. The Group will also consider the supply site, and try to use local suppliers to reduce the emissions of pollutants arising from the transportation, which also contributes to environmental protection at the same time.

The Group is strictly against any form of corruption or bribery with a purpose to influence the relevant decision-making of the Group. The Group believes that the preservation of confidentiality is the basis for the establishment of mutual trust between the Group and its business partners, and the effective protection of the interests of the Company. Internally, the Group also requires that the procurement staff shall not have any economic interests with the supplier, be honest and maintain confidentiality of business information so as to uphold the interests of the Company under any circumstances.

The Group will regularly arrange on-site visits to its business partners' establishments to assess their degree of social responsibility. If any supplier has been found to have hired child, forced labor or committed other serious violation of labor laws, the Group will immediately cease the business relationship.

The Group will work closely with suppliers to further improve the social responsibility of the upstream supply chain.

**Product responsibility (B6)**

The Company values product quality, believes that quality comes first, and constantly enhances the "Tiangong" corporate image. In order to win the confidence of customers, consistent quality must be ensured. The Group strictly regulates the product manufacturing process. There have been multiple quality testings on raw materials and final products before they are sold to the market, to make sure that the products are environmental friendly, healthy and safe. The Company believes that the use of appropriate management system will greatly enhance efficiency. As a result, quality control management will be carried out in accordance with the management system GB/T 19001-2008/ISO 9001: 2008, and the measurement management will be carried out in accordance with ISO 10012:2003. The Company is listed as Enterprise with Grade 1 Management and Measurement Systems in the Jiangsu province.

The Company also deeply believes that "products reflect the character, character determines the products". So by assigning the resources to the personnel training and team building, we aim at providing products of high quality, injected with the enthusiasm and extraordinary professionalism of our colleagues.

In the financial year, the Group has complied with all relevant laws and regulations regarding health and safety, advertising, labelling and privacy matters.

***Quality testing procedure***

## 4. Environmental protection (A1-A3)

The Group's operations strictly follow the principal of "production must be subject to safety, production must be subject to the environmental protection, and adherence to the green development". In accordance with the relevant provisions, taking into consideration of the actual situation of the Company, the Group will comprehensively promote the Company's environmental protection work to a new level. The Group is aware of the potential environmental impact of its business and manufacturing processes, including air pollution, water pollution, hazardous waste and greenhouse gas emissions from combustion of natural gas in production. The Group has taken all possible measures to comprehensively strengthen environmental management, environmental protection technology development and environmental protection education to prevent the occurrence of pollution incidents. The Group complied with the laws, regulations, policies, regulations and standards on environmental protection in accordance with "the Environmental Protection Law of the People's Republic of China", "the Law of the People's Republic of China on the Prevention and Control of Water Pollution", and "the Cleaner Production Law of the People's Republic of China", to protect the environment, promote cleaner production, and achieve sustainable development.

The Group's environmental policy is committed to the following principles to minimize the environmental impact of the Group's operations:

- complying with all relevant environmental laws, regulations and standards;
- setting up a management team to supervise the implementation of environmental protection policies and measures;
- conducting monthly inspection on environmental protection work to ensure that all aspects comply with the standards, and provide inspection records;
- inspecting and evaluating all aspects of the Company's environmental protection at the end of each year, and provide an annual comprehensive environmental assessment report, to enhance the level of environmental management;
- quantifying and monitoring the major impact of the Group's activities, products and services on the environment, and develop and review the annual specific improvement indicators;
- requiring all employees to carry out environmental responsibility and internal management procedures in daily operation procedures;
- promoting employees' awareness of environmental protection and resource benefits through different projects and programs.

### Emissions management

The Group is constantly striving to improve the efficiency of the production facilities and management of the emissions. Through a close monitor of potential emission in the operation and effective control of risk factors, environmental pollution has been reduced.

### Air Pollution Management

The Company replaced all of the coal-fired furnace heating facilities with natural gas heating facilities in 2011, which greatly reduced air pollution. Dust collection devices and fume collection devices have been constructed on-site to reduce dust and oil mist spread, whose removal efficiency is greater than 95%. Regular maintenance work on equipment has been done by the maintenance department of each production workshop to ensure that parameters stay in the normal range, so as to prevent the equipment from emitting exhaust abnormally.

### Sewage Disposal Management

The Group increased the sewage treatment station's daily processing capacity to 2250 tons in 2011, to ensure that the integrated wastewater can be treated timely to meet discharge standards. All the effluent from the production process will be concentrated in the sewage treatment station to ensure proper disposal, recycling and compliant emissions. Wastewater is divided into mixed wastewater and pickling wastewater, which are to be treated separately: mixed wastewater will be used as cooling water after biochemical treatment; and pickling wastewater will be added to untreated mixed wastewater after neutral processing and pressure filtration.

***Wastewater treatment system***

### Waste

The waste generated in the production process is mainly smelted slag and general household waste. After magnetic separation, the metal part of slag will be put back into the production line, while the remains will be transferred to the tile factory and cement plant for brick and cement production. General household waste will be collected by the government for centralized disposal. Hazardous waste is mainly composed of waste mineral oil, waste emulsion and pickling sludge, which was handed over to hazardous waste disposal center in accordance with the provisions of hazardous waste management.

### Strengthen the employees' awareness of environmental protection

The Group protects the environment in different ways during the daily operation. Apart from the improvement of management system, the Group has equipped all the staff with knowledge of environmental protection through the training program. The Group believes that employees can consciously take care of the environment and ensure that the environment is not polluted during operation through education.

### Resources management

The Group's main resources used are water and natural gas. The Group has recycling measures to reduce water consumption. In terms of energy saving, production workshop has been designed and built to allow the penetration of natural light as much as possible so as to reduce the power consumption of lamps.

***The production workshop greatly uses natural light***

***Trees are planted as much as possible on-site to counteract the carbon dioxide produced.***

In order to improve energy efficiency, the Group implemented the "production-remuneration-energy-saving reward" wage accounting system, which linked staff wage income with the economic benefits of enterprises generated by energy saving to improve the overall enthusiasm for energy management, so as to build up a mechanism of "what I save benefits myself". The detailed implementation measures of energy management has been elaborated in this ESG Report above. Besides, with the improvement of production technology and condition, energy-saving targets will be adjusted regularly. The Group hopes to improve employees' awareness of environmental protection and efficient natural resources application through this mechanism.

## 5. Contribution to the society

The Company's value is "to contribute to the community, and to benefit people". In addition to the pursuit of excellence and commitment to product innovation, the Group's mission is more about fulfilling the commitment to the society. As a result, the Group actively takes up social responsibility and contributes to the society, by organizing various activities and focusing on caring for the community and providing assistance to the communities in need. The Group brings together the strength of every colleagues to actively participate in and put resources in the community. We hope to learn more about community needs through charitable activities and share our success with the community.

***Tiangong Kindergarten***

## 6. Index of HKEX ESG Reporting Guide

The ESG Report is prepared in accordance with HKEX ESG Reporting Guide. General policy disclosures and key indicators are set out in the table below, with related chapter links or direct explanations.

| Field | Index | Chapter/Statement | Page |
|---|---|---|---|
| **A. Environment** | | | |
| Emissions | A1 | Emissions management | 25-26 |
| Use of Resources | A2 | Resource management | 25, 27 |
| The Environment and Natural Resources | A3 | Environmental protection | 25, 27 |
| **B. Social** | | | |
| **Employment and Labour Practices** | | | |
| Employment | B1 | Talent selection | 20-22 |
| Health and Safety | B2 | Employee's health and safety | 23 |
| Development and Training | B3 | Talent selection | 21 |
| Labour Standards | B4 | Talent selection | 20-21 |
| **Operating Practices** | | | |
| Supply Chain Management | B5 | Supply Chain Management | 23-24 |
| Product Responsibility | B6 | Product responsibility | 24 |
| Anti-corruption | B7 | Corruption prevention and internal audit system | 22 |
| **Community** | | | |
| Community Investment | B8 | Contribution to the society | 28 |

# Directors & Senior Management

## Executive Directors

**Mr. ZHU Xiaokun**, aged 60, is an Executive Director and the Chairman of the Company. He is responsible for the overall business development strategy of the Group and has over 25 years of experience in HSS and cutting tools industry. Mr. Zhu graduated from the Economic and Management Department of Jiangsu Open University (formerly known as the Jiangsu Radio and TV University). In 1984, he joined Danyang Houxiang Television Antenna Factory (the predecessor of Jiangsu Tiangong Group Company Limited ("TG Group")) as the general manager. He led the factory to transform from a television antenna factory to an enterprise of HSS cutting tools in 1987 and also subsequently to expand to include the production of HSS in 1992, the production of DS in 2005 and the production of titanium products in 2012. He has been acting as the Chairman of the Group since July 1997. In 1998, he was awarded as a National Township Factory Manager, named as a National Township Entrepreneur in 2004 by Ministry of Agriculture, awarded as Model of Work Force in the Jiangsu Province in 2006, Model of the National Steel Industry Work Force in 2008, Top Ten Annual Jiangsu Businessman in 2010, "Most Benevolent Model" on Charitable Donations in Jiangsu Province in 2011, awarded National Labor Medal in 2012, continuously awarded of "Most Honored Business Leader of the Twelfth Five-year Plan in Jiangsu" in 2013 to 2015 and awarded of "National Model Worker" in 2015. Mr. Zhu is the father of the chief investment officer of the Group, Mr. Zhu Zefeng.

**Mr. WU Suojun**, aged 44, is an Executive Director of the Company and a deputy general manager of Jiangsu Tiangong Tools Company Limited ("TG Tools"), and a deputy general manager of Danyang Tianfa Forging Company Limited ("Tianfa Forging"). Mr. Wu joined the Group in 1993 as a workshop officer. He is in charge of the sales, production, operation management and purchase of HSS and DS. He is also responsible for the security and environmental works.

**Mr. YAN Ronghua**, aged 48, is an Executive Director of the Company. He graduated from the Economic and Management Department of the Jiangsu Open University (formerly known as the Jiangsu Radio and TV University). He joined the Group in 1994. He was appointed as the head of office administration and subsequently the assistant general manager, deputy general manager of the Group. Mr. Yan is currently in charge of external investment management, and monitoring and evaluation of the Group's accounting and warehousing function.

**Mr. JIANG Guangqing**, aged 52, is an Executive Director of the Company. He graduated from Aerospace Industry 061 Base Technical School (航天工業零六一基地技工學校), joined the Group in 1993 and currently is the special assistant of the general manager. He is in charge of the production, operation and management of HSS cutting tools.

## Independent Non-Executive Directors

**Mr. GAO Xiang**, aged 73, joined the Company in 2007 as an Independent Non-Executive Director. In July 1966, he graduated from Wuhan Institute of Mechanics, majoring in production craftsmanship of machines and equipment. He is a senior engineer. Under his leadership, the study of twist drill extrusion technology by Chengdu Tools Research Institute was honoured with Third Class Award of Technical Findings of the Ministry of Mechanics. His achievements are widely recognized in the industry, and he has been granted special government subsidy by the State Council since 1999 as a result of such achievements.

**Mr. LEE Cheuk Yin, Dannis**, aged 46, joined the Company as an Independent Non-executive Director in 2010. He obtained the Bachelor of Business Administration from Texas A & M University, the USA. He is an associate member of the Hong Kong Institute of Certified Public Accountants and a member of the American Institute of Certified Public Accountants. He possesses over 20 years of experience in accounting and auditing field. Mr. Lee is an independent non-executive director of Geely Automobile Holdings Limited (HK Stock Code: 175). He was an executive director of AMCO United Holding Limited (formerly known as Guojin Resources Holdings Limited) (HK Stock Code: 630) (resigned in 2011), a non-executive director of Kam Hing International Holdings Limited (HK Stock Code: 2307) (resigned in 2011) and an independent non-executive director of U-Home Group Holdings Limited (HK Stock Code: 2327) (resigned in 2015).

**Mr. WANG Xuesong**, aged 45, joined the Company as an Independent Non-executive Director in 2016. He is a holder of a Bachelor's Degree in Electronic Engineering from the Tsinghua University and a Master's Degree of Business Administration from the Columbia University. Mr. Wang has been the project manager of Sun Microsystems, Inc., responsible for the development of the world's leading fourth and fifth generations of UltraSPARC CPU chips. He has been awarded the second class National Science Progress Award of the People's Republic of China with his development in 32-bit slot in CPU technology. He has over 10 years of management and engineering experience in various industries in Silicon Valley in the United States and in China. Further, Mr. Wang has nearly 20 years of operating and investment experience in the United States and China. He has been a principal of China Renaissance Capital Investment, where he was responsible for private equity investments. He has also been an executive director and a senior investment member of China Everbright Investment and Assets Management Co., Ltd. Mr. Wang was a co-founding partner of Everbright ReinFore in 2013 and is currently a member of the firm's Investment Committee.

## Senior Management

**Mr. WANG Gang**, aged 33, is the chief financial officer of the Group. He graduated with a master's degree from the Royal Institute of Technology, Sweden. He is a member of The Chinese Institute of Certified Public Accountants. Prior to joining the Group in August 2015, he worked in KPMG Hong Kong and KPMG China and was promoted to the position of audit manager of KPMG China. Mr. Wang then joined TG Group as chief accountant in 2014. He was appointed as a director and the financial controller of TG Tech from August 2015 and subsequently resigned from the position of financial controller in TG Tech in January 2017, in preparation for the appointment as the chief financial officer of the Company. Mr. Wang has over 8 years of experience in the fields of finance, auditing, accounting and administration and is familiar with the business and operation of the Group.

**Mr. LIAO Jun**, aged 51, is the chief technology officer of the Group. He graduated from the College of Materials Science and Engineering of Chongqing University and acquired an Executive MBA Shanghai Jian Tong University in 2008. Prior to joining the Company in July 2014 as head of innovation and technology department, he worked as Deputy Chief of technical section of Equipment Engineering of Shanghai No. 5 Steel Co., Ltd. He then served as deputy head of technical center of China Bao Steel Group and director of its branch steel plant. He has over 30 years of experience in special steel production and technology innovation. Mr. Liao is taking the responsibility of the Company's technology advance and development in order to enhance the product grading, technical specification and quality control.

**Mr. ZHU Zefeng**, aged 34, is the chief investment officer of the Group. He graduated with Advanced Diploma in Business Operation Management from the Durham College. He joined the Company as management trainee in January 2016 to acquire the relevant experience and knowledge of the manufacturing process of the Group's products. He also involved in investigation and investment project on downstream subcontractor. Prior to his joining, he worked for TopTech Tools Manufacturing Inc. as an operation manager, with over 7 years of experience in overlooking and integration of upstream and downstream operation of its special steel business. His prime focus is to execute the Group's future investment strategy, in particular, in the integration of upstream and downstream component of the supply chain of the Group's existing business, as approved by the Board from time to time. Mr. Zhu is the son of the Executive Director and Chairman of the Company, Mr. Zhu Xiaokun.

**Mr. ZHU Wanglong**, aged 58, is an executive director and a deputy general manager of TG Aihe. Prior to joining the Group, Mr. Zhu worked for Qianxiang Village and Danyang Machining Tools Factory. He joined the Group in July 1997 and has been in charge of product innovation, technology improvement, investment development and quality inspection. He has over 20 years of experience in the production management of tools, HSS and DS.

**Mr. JIANG Rongjun**, aged 48, is an executive director and the general manager of TG Tech. He joined the Group in 1985 as a workshop officer. Mr. Jiang is currently in charge of the production, sales and management of titanium alloy plant.

**Mr. LEE Johnly**, aged 37, is the financial controller and company secretary of the Company. Mr. Lee joined the Group in July 2015 and has over 14 years of experience in the field of finance, auditing, accounting and administration, including working in the assurance and advisory business services department of Ernst & Young Certified Public Accountants. Mr. Lee graduated with a Bachelor's Degree in Accountancy from the Hong Kong Polytechnic University. He is a member of The Hong Kong Institute of Certified Public Accountants.

The Group strives to attain and maintain high standards of corporate governance and to apply the principles set out in the Corporate Governance Code (the "Code") set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") as it believes that good corporate governance practices are fundamental to the Group's development and essential for safeguarding shareholders' interests. To achieve this objective, the Group strengthens its internal policies and procedures, provides continuous training to its staff and increases the transparency of its operation and accountability to all shareholders. The Group is committed to improving this practice and maintaining an ethical corporate culture. Save as disclosed below, during the year ended 31 December 2016, the Group has complied with the applicable principles and code provisions set out in the Code.

## The Board

The Board's primary role is to secure and enhance long-term shareholder value. It focuses on the Group's overall strategic policy and provides proper supervision to ensure effective management and to achieve sound returns for its shareholders. The Board has delegated the authority and responsibility for implementing business strategies and management of the daily operations of the Group's business to the management. The Board is mainly responsible for developing long term objectives and strategy of the Group, monitoring operation performance and results, monitoring performance of the management, establishing dividend policy and reviewing significant investment plans and decisions. The Board meets at least four times a year and additional meetings are held when required to discuss significant events and issues.

The Board is responsible for determining the policy for corporate governance of the Company and performing the corporate governance duties including:

(a) to develop and review the Company's policies and practices on corporate governance;

(b) to review and monitor the training and continuous professional development of Directors and senior management;

(c) to review and monitor the Company's policies and practices in compliance with legal and regulatory requirements;

(d) to develop, review and monitor the code of conduct and compliance manual (if any) applicable to employees and Directors; and

(e) to review the Company's compliance with the Code.

Corporate governance duties performed by the Board during the year were covered in the below sections of the corporate governance report.

The company secretary of the Company (the "Company Secretary") assists the Chairman in preparing the agenda for Board meetings and all Directors shall have access to the advice and services of the Company Secretary with a view to ensuring that Board procedures, and all applicable rules and regulations are followed. All Directors can give notice to the Chairman of the Board or the Company Secretary if they intend to include matters in the agenda for Board meetings. Regular board meetings are held with at least 14 days' advance notice, and all Directors would be served with an agenda with supporting papers at least 3 days before the intended date of a Board meeting, so as to ensure that there is timely access to relevant information. The Group ensures that all the Board members are informed of the Group's latest development and thereby assists them in the discharge of their duties. Procedures have been agreed by the Board to enable the Directors to seek independent professional advice, at the Company's expense.

### Number of Meetings and Directors' Attendance

| | Attendance/Number of Board Meetings | | | |
|---|---|---|---|---|
| Name of Director | Board Meeting | Audit Committee | Remuneration Committee | Nomination Committee |
| Mr. Zhu Xiaokun *(Chairman)* | 5/5 | N/A | 2/2 | 3/3 |
| Mr. Wu Suojun *(Chief executive officer)* | 4/5 | N/A | N/A | N/A |
| Mr. Jiang Guangqing | 5/5 | N/A | N/A | N/A |
| Mr. Yan Ronghua | 5/5 | N/A | N/A | N/A |
| Mr. Gao Xiang | 5/5 | 2/2 | 2/2 | 3/3 |
| Mr. Lee Cheuk Yin Dannis | 5/5 | 2/2 | 2/2 | 3/3 |
| Mr. Yin Shuming (resigned on 3 September 2016) | 4/5 | 1/2 | 1/2 | 2/3 |
| Mr. Wang Xuesong | 0/0 | 0/0 | 0/0 | 0/0 |

### General Meetings With Shareholders

The Company's annual general meeting provides a useful platform for direct communication between the Board and its shareholders. Separate resolutions are proposed on each substantially separate issue at the general meetings.

The annual general meeting ("AGM") was held on 18 May 2016. Mr. Zhu Xiaokun acted as the chairman of the AGM.

The attendance records of the Directors at the shareholders' meetings held in the year 2016 are set out below:

| | AGM |
|---|---|
| **Executive Directors** | |
| Mr. Zhu Xiaokun *(Chairman)* | ✓ |
| Mr. Wu Suojun *(Chief executive officer)* | – |
| Mr. Jiang Guangqing | – |
| Mr. Yan Ronghau | – |
| **Independent non-executive Directors** | |
| Mr. Gao Xiang | ✓ |
| Mr. Lee Cheuk Yin Dannis | ✓ |
| Mr. Yin Shuming (resigned on 3 September 2016) | – |

In respect of the code provision A.6.7 of the Code which requires that independent non-executive directors and other non-executive directors should attend general meetings, Mr. Yin Shuming, the Independent Non-executive Director, was unable to attend the AGM due to health reasons.

Minutes of the Board and Board Committees which record in sufficient detail the matters considered by the Board and the Board Committees and their decisions reached, including any concerns raised by Directors or dissenting views expressed are taken by the Company Secretary. Such minutes of the Board and Board Committees, together with supporting papers, are open for inspection following reasonable notice by any Director. Draft and final versions of minutes were sent to all Directors for their comment and records within a reasonable time after the relevant meeting was held. The Company has arranged appropriate insurance cover on Directors' liabilities in respect of legal actions against them arising from corporate activities.

## Composition of the Board

The Board comprises four Executive Directors (Mr. Zhu Xiaokun, Mr. Wu Suojun, Mr. Yan Ronghua and Mr. Jiang Guangqing), and three Independent Non-Executive Directors (Mr. Gao Xiang, Mr. Lee Cheuk Yin, Dannis and Mr. Wang Xuesong). Biographical details of the Directors as at the date of this report are set out on pages 30 to 31 of this annual report.

Independent Non-Executive Directors account for more than one-third of the members of the Board. The Independent Non-Executive Directors come either from the steel industry or have related professional background, bringing valuable expertise and experience that promotes the best interests of the Company and its shareholders. The role of the Independent Non-Executive Directors is to provide independent and objective opinions to the Board for its consideration, take the lead where potential conflicts of interests arise, serve on the audit, remuneration and nomination committees and scrutinise the Company's performance in achieving agreed corporate goals and objectives, and monitor the reporting of performance. The Company has received an annual confirmation of independence from each of the Independent Non-Executive Directors. The Company is of the view that all the Independent Non-Executive Directors meet the guidelines for assessing independence as set out in Rule 3.13 of the Listing Rules and considers each of them to be independent.

The Company had adopted a Board diversity policy aiming to set out the approach to achieve the diversity of the Board. The Company recognises and embraces the benefits of having a diverse Board to enhance the quality of its performance. It endeavours to ensure that the Board has a balance of skills, experience and diversity of perspectives appropriate to the requirements of the Company's business. All Board appointments will continue to be made on a merit basis with due regard for the benefits of diversity of the Board members.

The Nomination Committee will follow a range of diversified perspectives, including but not limited to gender, age, cultural and educational background, professional experience, skills, knowledge and length of service. The ultimate decision will be made upon the possible contribution that the selected candidates will bring to the Board.

The Nomination Committee considered that the current composition of the Board is balanced in terms of diversity and is able to meet the objectives of the Board. The Board's diversity provides the Company with experienced individuals and professionals with proven and extensive industry experience whose opinions and expertise are useful for the decision-making of the Board and the implementation of its business directives.

## Directors and Company Secretary's Continuous Training and Development

Directors also participate in continuous professional development to develop and refresh their knowledge and skills. The Company has from time to time provided information and updates to the Directors on the latest developments regarding the Listing Rules and other applicable regulatory requirements so as to ensure the Directors are in compliance with good corporate governance practices.

During the year ended 31 December 2016, all Directors have been provided with and read seminar materials covering topics including the Code, the disclosure of inside information and updates relating to the latest development of the Listing Rules and other applicable regulatory requirements to refresh their knowledge and to facilitate the discharge of their responsibilities. Each of the Directors has provided to the Company his records of training received during the financial year ended 31 December 2016 to the Company.

For the financial year ended 31 December 2016, the Company Secretary has taken no less than 15 hours of relevant professional training.

## Chairman and Chief Executive Officer

The Chairman of the Board is Mr. Zhu Xiaokun, and the chief executive officer is Mr. Wu Suojun. The Chairman's and the chief executive officer's roles and responsibilities are clearly defined to ensure their independence and a balance of power and authority. The Chairman of the Board provides leadership for the Board and he is responsible for the overall management of the Board and monitoring the Group's business strategies, while the chief executive officer is responsible for the Group's day-to-day management in accordance with the instructions issued by the Board and operating the business of the Group and implementing policies and strategies adopted by the Board. Save as disclosed in the directors & senior management section of this report, there is no relationship (including financial, business, family or other material/relevant relationship(s) among the Directors and in particular, between the chairman and the chief executive officer.

In 2016, the Chairman has held a meeting with the Independent Non-Executive Directors without the Executive Directors being present.

## Appointment, Re-election and Removal of Directors

Mr. Wang Xuesong was appointed as an Independent Non-executive Director following the resignation of Mr. Yin Shuming on 3 September 2016. A person may be appointed as a member of the Board at any time either by shareholders' resolutions in general meetings or by resolutions of the Board upon recommendation by the Nominations Committee of the Company. New Directors appointed by the Board during the year are required to retire and submit themselves for re-election at the first general meeting immediately following their appointments.

Each newly appointed Director is provided with induction material on the first occasion of his/her appointment, so as to ensure that he/she has appropriate understanding of the business and operations of the Group and that he/she is sufficiently aware of his/her responsibilities and obligations under the Listing Rules, code of conduct and other relevant regulatory compliance requirements.

All Directors are required to retire by rotation at least once every three years at the annual general meeting, subject to re-election by the shareholders. All Non-Executive Directors (including Independent Non-Executive Directors) are appointed for a term of not more than three years.

## Board Committees

The Board has established three Board Committees to oversee different aspects of the Company's affairs. These Board Committees include the Audit Committee, the Remuneration Committee and the Nomination Committee. The Board Committees have been structured to include a majority of Independent Non-Executive Directors as members in order to ensure that all relevant issues are reviewed independently and objectively. These Board Committees will report back to the Board on their decisions or recommendations. The terms of reference of the respective Board Committees have complied with the Code provisions and are available on the Company's website www.tggj.cn and the website of the Stock Exchange www.hkexnews.hk.

## Audit Committee

The Audit Committee comprises three Independent Non-Executive Directors, namely, Mr. Lee Cheuk Yin, Dannis, Mr. Gao Xiang and Mr. Wang Xuesong. The Chairman of the Audit Committee, Mr. Lee Cheuk Yin, Dannis, possesses expertise in accounting, auditing and finance.

Under its terms of reference, the Audit Committee is mainly responsible for overseeing the Company's financial reporting system and internal procedures, reviewing the financial information of the Company and overseeing the relationship with external auditors. These include reviewing and recommending for the Board's approval the interim and the annual financial statements; reviewing the external auditors' independence, objectivity and the effectiveness of the audit process; and reviewing and recommending to the Board for approval of the external auditor's remuneration; reviewing and obtaining explanation from management and the external auditor on the results for the year, including causes of changes from the previous period, effects on the application of new accounting policies, compliance with the Listing Rules and relevant legislation, and any audit issues, before recommending their adoption by the Board; considering and proposing to the Board the re-appointment of the Company's external auditors; considering and approving the procedures and guidelines in employing the external auditor to perform non-audit assignments for the Company; receiving and reviewing the internal audit reports from the internal auditor; holding meetings with the external auditors in the absence of management to discuss any audit issues; holding meetings with the internal auditor in private to discuss internal audit issues; approving the internal audit program for the year; carrying out a review of the internal control and risk management systems of the Company during the year including the adequacy of resources, qualifications and experience of staff of the Company's accounting and financial reporting function, and their training programs and budget and review of the effectiveness of the internal control and risk management systems of the Group. The Audit Committee has been provided with sufficient resources to discharge its duties.

The Audit Committee had a meeting on 27 March 2017 to consider and review the 2016 annual report and annual financial statements of the Group and to give their opinion and recommendation to the Board. The Audit Committee considered that the 2016 annual report and annual financial statements of the Company have complied with the Listing Rules and the applicable accounting standards and the Company has made appropriate disclosure thereof.

The Audit Committee held two meetings in 2016 and one meeting to date in 2017.

The meetings were held together with the external auditors of the Company, the Chief Financial Officer, and the Financial Controller of the Company, to discuss auditing, risk management, internal control, internal audit functions and financial reporting matters which include the review of the interim and annual financial statements. Full minutes of the Audit Committee meetings were kept by the Company Secretary. Draft and final versions of such minutes were sent to all members of the Audit Committee for their comment and records respectively, in both cases within a reasonable time after the meeting. The Audit Committee has made recommendations to the Board on the reappointment of the external auditors and their remuneration and terms of engagement and reviewed their independence. No former partner of KPMG, the existing auditing firm of the Company, was acting as a member of the Audit Committee for a period of 1 year from the date of his ceasing to be a partner of the firm; or to have any financial interest in the firm.

## Remuneration Committee

The Remuneration Committee comprises one Executive Director, namely, Mr. Zhu Xiaokun, and three Independent Non-Executive Directors, namely, Mr. Gao Xiang, Mr. Lee Cheuk Yin, Dannis and Mr. Wang Xuesong. Mr. Wang Xuesong is the Chairman of the Remuneration Committee.

The primary role of the Remuneration Committee is to make recommendation to the Board on the Company's policy and structure for remuneration of Directors and senior management and to ensure that their compensation arrangements are determined in accordance with relevant contractual terms. No Director and any of his associates has taken part in any discussion on his own remuneration. Details of the fees of the Directors are set out in note 10 to the financial statements. The Company's remuneration policy is to maintain fair and competitive remuneration packages based on business needs and market practice. Factors such as market rate, an individual's qualification, experience, performance and expected workload are taken into account during the remuneration package determination process. The Remuneration Committee has consulted the Chairman of the Board, Mr. Zhu Xiaokun or the chief executive officer, Mr. Wu Suojun, about their proposals relating to the remuneration of other Executive Directors and have access to professional advice if considered necessary. The Remuneration Committee was provided with sufficient resources to discharge its duties.

The Remuneration Committee held two meetings in 2016 and one meeting to date in 2017.

The meetings were held to assess the performance of the Directors and senior management, approve the terms of executive Director's service contracts, discuss and review the overall remuneration policy and structure. Recommendations have been made to the Board on the remuneration packages of individual executive Directors and senior management.

For the year ended 31 December 2016, the remuneration of the senior management is listed as below by band:

| Band of remuneration | No. of persons |
|---|---|
| RMB7,000,000 to RMB8,000,000 | 1 |
| RMB0 to RMB1,000,000 | 10 |

* Mr. Wang Gang , Mr. Liao Jun and Mr. Zhu Zefeng were senior management appointed after the year ended 31 December 2016. Their remuneration was not included in the above list.

Further details of the remuneration of Directors and the 5 highest paid employees have been set out in notes 10 and 11 to the financial statement.

## Nomination Committee

The Nomination Committee comprises one Executive Director, namely, Mr. Zhu Xiaokun, and three Independent Non-Executive Directors, namely, Mr. Gao Xiang, Mr. Lee Cheuk Yin, Dannis and Mr. Wang Xuesong. Mr. Gao Xiang is the Chairman of the Nomination Committee.

The primary responsibility of the Nomination Committee is to make recommendations to the Board on matters relating to the appointment or re-appointment of Directors and succession planning for Directors, and assessing the independence of the Independent Non-Executive Directors. The Nomination Committee has been provided with sufficient resources to discharge its duties.

The Nomination Committee has adopted the terms of reference as outlined under the Code provisions regarding the selection, recommendation and nomination of candidates for directorship during the year. The current terms of reference of the Nomination Committee are available on the websites of the Company and the Stock Exchange.

The Nomination Committee held three meetings in 2016 and one meeting to date in 2017. The meetings were held to discuss and review the composition and structure of the Board and senior management and the re-appointment arrangement of the Directors in the Company's forthcoming annual general meeting. The Executive Directors were appointed based on their qualification and experience in relation to the Group's business. The Independent Non-Executive Directors were appointed based on their professional qualifications and experience in their respective areas.

## Directors' Responsibility for the Financial Statements

The Directors are responsible for overseeing the preparation of financial statements on a going concern basis, with supporting assumptions or conditions as necessary, for each financial period with a view to ensuring that such financial statements give a true and fair view of the state of affairs of the Group and of the results and cash flow for that financial year. Management of the Company has provided such explanation and information to the Board to enable the Board to make an informed assessment of the financial and other information put before the Board for approval. The Company's accounts are prepared in accordance with the Listing Rules, the Companies Ordinance, all relevant statutory requirements and applicable accounting standards. The Company has selected appropriate accounting policies and has applied them consistently based on prudent and reasonable judgments and estimates.

The Directors endeavor to ensure a balanced, clear and understandable assessment of the Company's position and prospects in annual reports, interim reports, price-sensitive announcements and other disclosures required under the Listing Rules and other statutory requirements.

## Internal Control and Risk Management

Sound internal control and risk management systems enhance the effectiveness and efficiency of operations, ensures compliance with laws and regulations and mitigates the Group's business risk. The Company has an internal audit function. The Board is responsible for the internal control and risk management systems of the Group and reviewing their effectiveness and adequacy. Such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board and the Group's management hold meetings on a regular basis to review and evaluate the Group's business operations, production processes and financial reporting processes, adequacy of resources, qualifications and experience of staff of the Company's accounting and financial reporting function, their training programmes and budget in order to achieve reasonable assurance of the following:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

To maintain effective internal control and risk management systems that helps The Group to achieve its business objectives and safeguard its assets, the Group has implemented measures including: (i) establishing written policies and work flow for major operations and production cycles; (ii) having in place appropriate segregation of duties; and (iii) setting proper authorisation levels.

The Group has established an internal control and monitoring department to perform the internal control review on every workshop and department and furnish opinions to the Board in respect of material matters or bring to the attention of the management the existence of any relevant risks to prevent internal control defects. This department is responsible for performing independent review of the adequacy and effectiveness of the risk management and internal control systems.

The Board also ensures timely publication of the Group's financial statements and aims to present a clear, balanced and understandable assessment of the Group's performance and position through all its publications and communications to the public and complies with the requirements under the applicable rules and regulations about timely disclosure of inside information.

The Board, through the Audit Committee, have conducted a review covering all material controls, including financial, operational and compliance controls and risk management functions of the Group for the year ended 31 December 2016. The Audit Committee and the Board were not aware of any areas of concern that would have a material impact on the Group's financial position or results of operations and, having taken into account of the adequacy of resources, staff qualifications and experience, training programs, internal audit and financial reporting functions, considered that effective and adequate internal control and risk management systems of the Group had been in place and had been functioning effectively.

## External Auditors

KPMG was re-appointed as the external auditors of the Company by the shareholders at the AGM until the next annual general meeting. In order to maintain their independence, objectivity and effectiveness in performing the audit services, the Audit Committee pre-approved all audit services and discussed with KPMG the nature and scope of the audit services. KPMG is primarily responsible for providing audit services in connection with the annual consolidated financial statements.

During the year ended 31 December 2016, the total remuneration paid or payable to KPMG in respect of audit services was RMB2,500,000.

## The Model Code for Securities Transactions by Directors of Listed Issuers

The Group has adopted a code of conduct governing securities transactions by Directors in compliance with and 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 (the "Model Code"). All of the Directors have confirmed, following specific enquiry by the Company, that they have complied with the required standard set out in the Model Code and the Group's code of conduct governing securities transactions by Directors and employees who may possess or have access to price sensitive information or inside information during the year ended 31 December 2016.

## Shareholders' Rights

Set out below is a summary of certain rights of the shareholders of the Company as required to be disclosed pursuant to the Code:

### Convening of extraordinary general meeting on requisition or putting forward proposals at general meetings by shareholders

In accordance with the section 79 of the Company's articles of association, general meetings may be convened on the written requisition of any two or more members of the Company deposited at the registered office of the Company in Hong Kong specifying the objects of the meeting and signed by the requisitionists, provided that such requisitionists held as at the date of deposit of the requisition not less than one tenth of the paid up capital of the Company which carries the right of voting at general meetings of the Company. General meetings may also be convened on the written requisition of any one member of the Company which is a recognised clearing house (or its nominee(s)) deposited at the registered office of the Company in Hong Kong specifying the objects of the meeting and signed by the requisitionist, provided that such requisitionist held as at the date of deposit of the requisition not less than one-tenth of the paid up capital of the Company which carries the right of voting at general meetings of the Company.

If the Board does not within 21 days from the date of deposit of the requisition proceed duly to convene the meeting to be held within a further 21 days, the requisitionists themselves or any of them representing more than one-half of the total voting rights of all of them, may convene the general meeting in the same manner, as nearly as possible, as that in which meetings may be convened by the Board provided that any meeting so convened shall not be held after the expiration of three months from the date of deposit of the requisition, and all reasonable expenses incurred by the requisitionists as a result of the failure of the Board shall be reimbursed to them by the Company.

Shareholders may also make use of the above mechanism in putting forward proposals at general meeting. In order to allow shareholders to make an informed decision at the relevant general meeting, requisitionists are requested to provide contact details to the Board at the time of deposition of the requisition in case further information is required to be included in the notice of meeting.

Shareholders should note that the Company is required to give notice of extraordinary meeting of not less than 10 clear business days (pursuant to Listing Rules requirements) and not less than 14 days (pursuant to the articles of association of the Company).

### Procedures for directing shareholders' enquiries to the Board

Shareholders may at any time send their enquiries and concerns to the Board of the Company in writing through the Company Secretary whose contact details are as follows:

The Company Secretary
Tiangong International Company Limited
Unit 1303, 13/F Jubilee Center
18 Fenwick Street, Wanchai, Hong Kong
Email: tiangong@biznetvigator.com
Tel No.: (852) 3102-2386
Fax No.: (852) 3102-2331

The Company Secretary shall forward the shareholders' enquiries and concerns to the Board and/or relevant Board Committees of the Company, where appropriate, to answer the shareholders' questions.

## Investor Relationship and Communication

The Board and senior management recognize the importance of communication with shareholders and accountability to shareholders. Annual and interim reports offer comprehensive operational and financial performance information to shareholders and the annual general meetings provide a forum for shareholders to make comments and raise concerns to the Board directly. The Group's senior management also maintains close communication with investors, analysts and the media by other channels including roadshows, briefings and individual meetings. The Group has set up its own website www.tggj.cn, which is updated on a regular basis, as a means to provide updated information on the Company to investors. Shareholders are encouraged to attend the forthcoming annual general meeting of the Company for which at least 20 clear business days' notice (pursuant to Listing Rules requirements) and not less than 21 days' notice (pursuant to the articles of association of the Company) is given. At the meeting, the Chairman of the Board, the chairman of the Board Committees (or their respective committee members) and the Directors are available to answer questions on the Group's business. There is no change in the Company constitutional documents during the year.

# Report of the Directors

The Directors are pleased to submit the annual report together with the audited financial statements for the year ended 31 December 2016.

## Principal Place of Business

The Company is a company incorporated and domiciled in Cayman Islands and has its principal place of business at Danbei Town, Danyang City, Jiangsu Province, the PRC.

## Principal Activities

The principal activities of the Company are the production and sales of DS, HSS, cutting tools (formerly categorised as HSS cutting tools) and titanium alloy. The principal activities and other particulars of the subsidiaries are set out in note 16 to the financial statements.

## Financial Statements

The results of the Group for the year ended 31 December 2016 are set out in the consolidated statement of profit or loss and the consolidated statement of profit or loss and other comprehensive income on page 63 and 64.

The financial position of the Group as at 31 December 2016 is set out in the consolidated statement of financial position of the Group on pages 65 to 66. The financial position of the Company as at 31 December 2016 is set out in note 34 to the financial statement on page 125.

The cash flows of the Group for the year ended 31 December 2016 are set out in the consolidated cash flow statement on page 68.

## Results and Appropriations

The Board proposed a final dividend payment of RMB0.0100 per share for the financial year ended 31 December 2016 (2015: RMB0.0065).

## Charitable Donations

Charitable donations made by the Group during the year amounted to RMB600,000 (2015: RMB100,000).

## Property, Plant and Equipment

Details of the movements in the property, plant and equipment of the Group during the year are set out in note 13 to the financial statements.

## Reserves

Details of movements in the reserves of the Company and of the Group during the year are set out in note 30 to the financial statements and in the consolidated statements of changes in equity, respectively.

## Distributable Reserves

Distributable reserves of the Company as at 31 December 2016, calculated in accordance with the Companies Law (Cap. 22) (Law 3 of 1961, as consolidated and revised) of the Cayman Islands, amounted to RMB1,272,771,000 (2015: RMB1,331,935,000).

## Pre-emptive Rights

There is no provision for pre-emptive rights under the Company's articles of association and there is no restriction against such rights under the laws of the Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

## Share Capital

Details of the movements in share capital of the Company during the year are set out in note 30 to the financial statements.

## Business Review

A review of the business of the Group during the year and a discussion on the Group's future business development are provided in the management discussion and analysis and the Chairman's statement of this annual report. Descriptions of possible risks and uncertainties that the Group may be facing and an analysis of the Group's performance during the year using financial key performance indicators is provided on page 5 to 17 of this annual report. Particulars of important events affecting the Group that have occurred since the end of the financial year are provided on note 37 to the financial statements.

In addition, further information of the Company's environmental protection policies and compliance with relevant laws and regulations which have a significant impact on the Group are provided in the ESG Report and in the management discussion and analysis of this annual report. An account of the Company's relationships with its key stakeholders are disclosed in the section heading "Relationships with key stakeholders" on page 17 of the management discussion and analysis of this annual report.

## Directors

The Directors during the financial year were:

## Executive Directors

Mr. Zhu Xiaokun
Mr. Wu Suojun
Mr. Yan Ronghua
Mr. Jiang Guangqing

## Independent Non-Executive Directors

Mr. Gao Xiang
Mr. Lee Cheuk Yin, Dannis
Mr. Wang Xuesong
Mr. Yin Shuming (resigned on 3 September 2016)

Directors will retire by rotation in accordance with the requirement of the Listing Rules and the articles of association of the Company in the annual general meetings.

The Independent Non-Executive Directors are appointed for periods of one year. The Company considers that Mr. Gao Xiang, Mr. Lee Cheuk Yin, Dannis and Mr. Wang Xuesong are independent pursuant to the criteria set out in the Listing Rules and that a confirmation of independence has been received from each of them.

## Directors' Interests and Short Positions in Shares, Underlying Shares and Debentures

As at 31 December 2016, the interests, long positions or short positions of the Directors and chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) which were recorded in the register required to be kept under Section 352 of the SFO, or which were notified to the Company and the Stock Exchange pursuant to the Model Code (set out in Appendix 10 of the Listing Rules) were as follows:

### (a) Interests in the Company

| Director's name | Interests | Ordinary shares held | Approximate attributable interests (%) |
|---|---|---|---|
| Zhu Xiaokun [1 and 2] | Interests of controlled corporations | 787,390,000(L) | 35.47 |
| | Interests of controlled corporations | 50,000,000(S) | 2.25 |
| | Beneficial owner | 1,600,000(L) | 0.07 |
| | Beneficial owner[3] | 500,000(L) | 0.02 |
| | | | 37.81 |
| Wu Suojun | Beneficial owner[3] | 867,000(L) | 0.04 |
| Yan Ronghua | Beneficial owner[3] | 300,000(L) | 0.01 |
| Jiang Guangqing | Beneficial owner[3] | 300,000(L) | 0.01 |

Notes:

As at 31 December 2016,

(1) Tiangong Holdings Company Limited ("THCL") held 793,458,000 ordinary shares. THCL was held as to 89.02% and 10.98% by Zhu Xiaokun and Yu Yumei, the spouse of Zhu Xiaokun, respectively. Zhu Xiaokun is deemed to be interested in the 793,458,000 shares held by THCL.

(2) Silver Power (HK) Limited, which was wholly-owned by Zhu Xiaokun, held 43,932,000 ordinary shares.

(3) Options granted under Share Option Scheme of the Company.

(L) Represents long position.

(S) Represents short position.

### (b) Interests in the shares of associated corporation

| Name of Director | Name of associated corporation | Nature of interests and capacity | Total number of shares | Approximate percentage of interests (%) |
|---|---|---|---|---|
| Mr. Zhu Xiaokun | THCL | Beneficial owner | 44,511 (L) | 89.02 |
| | | Spousal interest (1) | 5,489 (L) | 10.98 |
| Mr. Zhu Xiaokun | TG Tech | Beneficial owner | 10,000,000 (L)(2) | 2.47 |

Notes:

(1) Ms. Yu Yumei, the spouse of Mr. Zhu Xiaokun held 5,489 shares in THCL. Mr. Zhu Xiaokun is deemed to be interested in such 5,489 shares in THCL.

(2) Mr. Zhu Xiaokun has acquired the shares in TG Tech in the Second Placing.

(L) Represents long position.

Save as disclosed above, as at the end of the reporting period, as far as the Directors are aware, none of the Directors and chief executive had any other interests, long positions or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations.

## Substantial Shareholders' Interests

As at 31 December 2016, save for the Directors or chief executives as disclosed above, the following persons have an interest or short position in the shares or the underlying shares or debentures of the Company and its associated corporations which are required to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or, which were recorded in the register required to be kept under Section 336 of the SFO:

### (a) Interests in the Company

| Substantial shareholders' name | Nature of interest and capacity | Ordinary shares | Approximate attributable interest (%) |
|---|---|---|---|
| Yu Yumei (1) | Spousal interest (2) | 789,490,000(L) | 35.56 |
| | Spousal interest (2) | 50,000,000(S) | 2.25 |
| THCL (1) | Beneficial owner | 743,458,000(L) | 33.49 |
| | Beneficial owner | 50,000,000(S) | 2.25 |
| Guo Guangchang | Interests of controlled corporations (3) | 136,290,000(L) | 6.14 |
| 南京鋼鐵集團有限公司工會委員會 (Labour Union Committee of Nanjing Iron & Steel Group Co., Ltd.*) | Interests of controlled corporations (4) | 136,290,000(L) | 6.14 |
| 南京新工投資集團有限責任公司 (Nanjing Xingong Investment Group Co., Ltd.*) | Interests of controlled corporations (5) | 136,290,000(L) | 6.14 |

(L) Represents long position.

(S) Reports short position.

Notes:

(1) THCL is owned as to 89.02% by Mr. Zhu Xiaokun and 10.98% by his spouse, Madam Yu Yumei.

(2) Ms. Yu Yumei is the spouse of Mr. Zhu Xiaokun and is deemed to be interested in the shares of the Company held by Mr. Zhu Xiaokun. For information in relation to shares of the Company held by Mr. Zhu Xiaokun, please refer to the paragraph headed "Directors' Interests and Short Positions in Shares, Underlying Shares and Debentures — (a) Interests in the Company".

(3) Guo Guangchang was deemed to hold a total of 136,290,000 ordinary shares (long position) of the Company by virtue of his control over numerous corporations:

(a) Guo Guangchang controlled 64.45% of Fosun International Holdings Ltd.

(b) Fosun International Holdings Ltd. controlled 100% of 復星控股有限公司 (Fosun Holdings Limited).

(c) 復星控股有限公司 (Fosun Holdings Limited) controlled 71.55% of 復星國際有限公司 (Fosun International Ltd.).

(d) 復星國際有限公司 (Fosun International Ltd.) controlled 100% of 上海復星高科技（集團）有限公司 (Shanghai Fosun High Mainland China Technology (Group) Co., Ltd.).

(e) 上海復星高科技（集團）有限公司 (Shanghai Fosun High Mainland China Technology (Group) Co., Ltd.) controlled 100% of 上海復星產業投資有限公司 (Shanghai Fosun Industrial Investment Co., Ltd.) and 30% of 南京南鋼鋼鐵聯合有限公司 (Nanjing Nangang Iron & Steel United Co., Ltd.).

(f) 上海復星產業投資有限公司 (Shanghai Fosun Industrial Investment Co., Ltd.) controlled 100% of 上海復星工業技術發展有限公司 (Shanghai Fosun Industrial Technology Development Co., Ltd.) and 20% of 南京南鋼鋼鐵聯合有限公司 (Nanjing Nangang Iron & Steel United Co., Ltd.).

(g) 上海復星工業技術發展有限公司 (Shanghai Fosun Industrial Technology Development Co., Ltd.) controlled 10% of 南京南鋼鋼鐵聯合有限公司 (Nanjing Nangang Iron & Steel United Co., Ltd.).

(h) 南京南鋼鋼鐵聯合有限公司 (Nanjing Nangang Iron & Steel United Co., Ltd.) controlled 100% of 南京鋼鐵聯合有限公司 (Nanjing Iron & Steel United Co., Ltd.) and 45.31% of 南京鋼鐵股份有限公司 (Nanjing Iron & Steel Co., Ltd.).

(i) 南京鋼鐵聯合有限公司 (Nanjing Iron & Steel United Co., Ltd.) controlled 2.88% of 南京鋼鐵股份有限公司 (Nanjing Iron & Steel Co., Ltd.).

(j) 南京鋼鐵股份有限公司 (Nanjing Iron & Steel Co., Ltd.) controlled 100% of 南京南鋼產業發展有限公司 (Nanjing Nangang Industry Development Co., Ltd.*).

(k) 南京南鋼產業發展有限公司 (Nanjing Nangang Industry Development Co., Ltd.*) controlled 100% of 香港金騰國際有限公司 (Hong Kong Jinteng International Company Limited).

(l) 香港金騰國際有限公司 (Hong Kong Jinteng International Company Limited) controlled 100% of Jin Tou Capital Limited which directly held 136,290,000 ordinary shares in the Company.

(4) 南京鋼鐵集團有限公司工會委員會 (Labour Union Committee of Nanjing Iron & Steel Group Co., Ltd.*) was deemed to hold a total of 136,290,000 ordinary shares (long position) of the Company by virtue of its control over numerous corporations:

(a) 南京鋼鐵集團有限公司工會委員會 (Labour Union Committee of Nanjing Iron & Steel Group Co., Ltd.*) controlled 34.87% of 南京鋼鐵創業投資有限公司 (Nanjing Iron & Steel Business Investment Co., Ltd.*).

(b) 南京鋼鐵創業投資有限公司 (Nanjing Iron & Steel Business Investment Co., Ltd.*) controlled 51% of 南京鋼鐵集團有限公司 (Nanjing Iron & Steel Group Co., Ltd.*).

(c) 南京鋼鐵集團有限公司 (Nanjing Iron & Steel Group Co., Ltd.*) controlled 40% of 南京南鋼鋼鐵聯合有限公司 (Nanjing Nangang Iron & Steel United Co., Ltd.).

(d) 南京南鋼鋼鐵聯合有限公司 (Nanjing Nangang Iron & Steel United Co., Ltd.) in turn controlled various corporations set out in note 3(h) to (l) above.

(5) 南京新工投資集團有限責任公司 (Nanjing Xingong Investment Group Co., Ltd.*) was deemed to hold a total of 136,290,000 ordinary shares (long position) of the Company by virtue of its control over numerous corporations:

(a) 南京新工投資集團有限責任公司 (Nanjing Xingong Investment Group Co., Ltd.*) controlled 49% of 南京鋼鐵集團有限公司 (Nanjing Iron & Steel Group Co., Ltd.*).

(b) 南京鋼鐵集團有限公司 (Nanjing Iron & Steel Group Co., Ltd.*) controlled 40% of 南京南鋼鋼鐵聯合有限公司 (Nanjing Nangang Iron & Steel United Co., Ltd.).

(c) 南京南鋼鋼鐵聯合有限公司 (Nanjing Nangang Iron & Steel United Co., Ltd.) in turn controlled various corporations set out in note 3(h) to (l) above.

* For identification purpose only

## (b) Interests in the shares of associated corporation

| Substantial shareholder's name | Name of associated corporation | Nature of interests and capacity | Total number of shares | Approximate percentage of interests (%) |
|---|---|---|---|---|
| Ms. Yu Yumei | THCL | Beneficial owner<br>Spousal interest (1) | 5,489(L)<br>44,511(L) | 10.98<br>89.02 |
| Ms. Yu Yumei | TG Tech | Spousal interest (1) | 10,000,000 (L) | 2.47 |
| Guo Guangchang | TG Tech | Interests of controlled corporations (2) | 72,697,000 (L) | 17.95 |
| 南京鋼鐵集團有限公司工會委員會 (Labour Union Committee of Nanjing Iron & Steel Group Co., Ltd.*) | TG Tech | Interests of controlled corporations (3) | 72,697,000 (L) | 17.95 |
| 南京新工投資集團有限責任公司 (Nanjing Xingong Investment Group Co., Ltd.*) | TG Tech | Interests of controlled corporations (4) | 72,697,000 (L) | 17.95 |

Notes:

(1) Ms. Yu Yumei is the spouse of Mr. Zhu Xiaokun and is deemed to be interested in the shares of the associated corporations of the Company held by Mr. Zhu Xiaokun. For information in relation to shares of associated corporations of the Company held by Mr. Zhu Xiaokun, please refer to the paragraph headed "Directors' Interests and Short Positions in Shares, Underlying Shares and Debentures — (b) Interests in the shares of associated corporation".

(2) Guo Guangchang was deemed to hold a total of 72,697,000 shares (long position) in TG Tech directly held by 南京鋼鐵股份有限公司 (Nanjing Iron & Steel Co., Ltd.) by virtue of his control over numerous corporations. For information in relation to the controlled corporations, please refer to note 3 of the paragraph headed "Substantial Shareholders' Interests – (a) Interests in the Company".

(3) 南京鋼鐵集團有限公司工會委員會 (Labour Union Committee of Nanjing Iron & Steel Group Co., Ltd.*) was deemed to hold a total of 72,697,000 shares (long position) in TG Tech directly held by南京鋼鐵股份有限公司 (Nanjing Iron & Steel Co., Ltd.) by virtue of its control over numerous corporations. For information in relation to the controlled corporations, please refer to note 4 of the paragraph headed "Substantial Shareholders' Interests – (a) Interests in the Company".

(4) 南京新工投資集團有限責任公司 (Nanjing Xingong Investment Group Co., Ltd.*) was deemed to hold a total of 72,697,000 shares (long position) in TG Tech directly held by南京鋼鐵股份有限公司 (Nanjing Iron & Steel Co., Ltd.) by virtue of its control over numerous corporations. For information in relation to the controlled corporations, please refer to note 5 of the paragraph headed "Substantial Shareholders' Interests – (a) Interests in the Company".

* For identification purpose only

## Arrangements to Acquire Shares or Debentures

Save as disclosed in this report (note Share Option Scheme below), at no time during the year was the Company or any of its subsidiaries, holding companies or fellow subsidiaries a party to any arrangements to enable a Director to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

## Biographical Details of Directors and Senior Management

Brief biographical details of the Directors and the senior management are set out on pages 30 to 32.

## Final Dividend and Closure of Register of Members

The register of members of the Company will be closed from 23 May 2017 to 26 May 2017 (both days inclusive), for the purpose of determining shareholders' entitlement to attend and vote at the forthcoming annual general meeting of the Company (the "Annual General Meeting") on 26 May 2017, during which period no transfer of shares of the Company will be registered. In order to qualify for attending and voting at the Annual General Meeting, shareholders should ensure that all transfer documents, accompanied by the relevant share certificates, are lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, No. 183 Queen's Road East, Wan Chai, Hong Kong, for registration by no later than 4:30 p.m. on 22 May 2017.

The Board has resolved to recommend the payment of a final dividend of RMB0.0100 per share for the year ended 31 December 2016 (2015: RMB0.0065) to shareholders of the Company whose names appear on the register of members of the Company on 7 June 2017. The register of members will be closed from 2 June 2017 to 7 June 2017, both days inclusive, and the proposed final dividend is expected to be paid on or before 21 July 2017. The payment of dividends shall be subject to the approval of the shareholders of the Company at the Annual General Meeting expected to be held on 26 May 2017. In order to qualify for the proposed dividend, shareholders of the Company should ensure that all transfer documents, accompanied by the relevant share certificates, are lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong, for registration by no later than 4:30 p.m. on 1 June 2017.

## Share Option Scheme

The Company has a share option scheme (the "Scheme") which was adopted on 7 July 2007. The purpose of the Scheme is to provide participants with the opportunity to acquire proprietary interests in the Company and to encourage participants to work towards enhancing the value of the Company and its Shares for the benefit of the Company and its Shareholders as a whole. The Scheme will provide the Company with a flexible means of either retaining, incentivising, rewarding, remunerating, compensating and/or providing benefits to participants. The major terms of the Scheme are as follows:

1. The Directors may, at their discretion, invite any directors (including executive directors, non-executive directors and independent non-executive directors) and employees of any member of the Group and any advisers, consultants, distributors, contractors, contract manufacturers, suppliers, agents, customers, business partners, joint venture business partners, service providers of any member of the Group who the Board considers, in its sole discretion, have contributed or will contribute to the Group (the "Participants") to participate in the Scheme.

2. The maximum number of shares over which options may be granted under the Scheme must not exceed 80,000,000 shares of nominal value USD0.0025 each in the capital of the Company. As at the date of this report, options in respect of 79,999,000 shares may be granted, representing approximately 3.6% of the issued share capital of the Company as at the date of this report.

3. The total number of shares of the Company issued and to be issued upon exercise of the options granted to each Participant (including both exercised, cancelled and outstanding options) under the Scheme in any 12 month period must not exceed 1% of the shares in issue. Any further grant of options which would result in the number of shares issued as aforesaid exceeding the said 1% limit must be subject to prior shareholders' approval with the relevant Participant and his associates abstaining from voting.

4. The period within which the options must be exercised will be specified by the Company at the time of grant.

   This period must expire no later than 10 years from the relevant date of grant (being the date on which the Board resolves to make an offer of option to the relevant grantee).

5. At the time of grant of the options, the Company may specify any minimum period(s) for which an option must be held before it can be exercised. The Scheme does not contain any such minimum period.

6. The amount payable on acceptance of an option is HKD1.00.

7. The subscription price for the shares, the subject of the options, shall be no less than the higher of (i) the closing price of the shares as stated in the daily quotations sheet issued by the Stock Exchange on the date of grant; (ii) the average closing price of the shares as stated in the daily quotations sheets issued by the Stock Exchange for the five Stock Exchange business days immediately preceding the date of grant; and (iii) the nominal value of a share on the date of grant. The subscription price will be established by the Board at the time the option is offered to the Participants.

8. The Scheme shall be valid and effective till 6 July 2017.

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. These share options had vested 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 closing 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 Scheme was adjusted to 19,880,000 shares of USD0.0025 each at an exercise price of HKD1.275 per share. All the remaining share options for 3,080,000 shares lapsed on 1 July 2016.

On 17 January 2014, options entitled holders to subscribe for a total of 9,057,000 shares of USD0.0025 each were granted to and accepted by employees of the Company in respect of their services to the Group. Among the total 9,057,000 shares options, 55,000 shares options were not vested and the remaining share options were vested on 1 June 2014 and have an initial exercise price of HKD2.50 per share of USD0.0025 each and an exercise period ranging from 1 June 2014 to 31 May 2016. The closing price of the Company's shares at the date of grant was HKD2.48 per share of USD0.0025 each. All the remaining share options for 9,002,000 shares lapsed on 1 June 2016.

On 18 August 2014, options entitled holders to subscribe for a total of 22,147,000 shares of USD0.0025 each were granted to and accepted by certain Directors and employees of the Company in respect of their services to the Group. These share options were vested on 19 August 2014 and have an initial exercise price of HKD1.78 per share of USD0.0025 each and an exercise period ranging from 19 August 2014 to 18 August 2019. The closing price of the Company's shares at the date of grant was HKD1.78 per share of USD0.0025 each.

On 22 July 2016, options entitled holders to subscribe for a total of 18,970,000 shares of USD0.0025 each were granted to and accepted by certain Directors and employees of the Company in respect of their services to the Group. These share options were vested on 1 January 2017 and have an initial exercise price of HKD0.60 per share of USD0.0025 each and an exercise period ranging from 1 January 2017 to 31 December 2017. The closing prices of the Company's shares at the date of grant and at the date immediately before the grant were, respectively, HKD0.56 and HKD0.55 per share of USD0.0025 each.

At 31 December 2016, the Directors and employees of the Company had the following interests in options to subscribe for shares of the Company (market value per share at 31 December 2016 was HKD0.99) under the Scheme of the Company. The options are unlisted. Each option gives the holder the right to subscribe for one ordinary share of USD0.0025 each of the Company.

| | No. of options outstanding at the beginning of the year | No. of options granted during the year | No. of shares acquired on exercise of options during the year | No. of shares cancelled/ lapsed/ forfeited during the year | No. of options outstanding at the end of the year | Date granted | Period during which options are exercisable | Exercise price per share | Market value per share at date of grant of options* | Market value per share on exercise of options* |
|---|---|---|---|---|---|---|---|---|---|---|
| **Directors** | | | | | | | | | | |
| Mr. Zhu Xiaokun | 400,000 | – | – | 400,000 | – | 28 January 2011 | 01 July 2012 to 30 June 2016 | HKD1.275 | HKD1.275 | – |
| | 500,000 | – | – | – | 500,000 | 18 August 2014 | 19 August 2014 to 18 August 2019 | HKD1.78 | HKD1.78 | – |
| | – | 2,200,000 | – | – | 2,200,000 | 22 July 2016 | 01 January 2017 to 31 December 2017 | HKD0.60 | HKD0.138 | – |
| Mr. Wu Suojun | 400,000 | – | – | 400,000 | – | 28 January 2011 | 01 July 2012 to 30 June 2016 | HKD1.275 | HKD1.275 | – |
| | 867,000 | – | – | – | 867,000 | 18 August 2014 | 19 August 2014 to 18 August 2019 | HKD1.78 | HKD1.78 | – |
| | – | 800,000 | – | – | 800,000 | 22 July 2016 | 01 January 2017 to 31 December 2017 | HKD0.60 | HKD0.138 | – |
| Mr. Yan Ronghua | 320,000 | – | – | 320,000 | – | 28 January 2011 | 01 July 2012 to 30 June 2016 | HKD1.275 | HKD1.275 | – |
| | 300,000 | – | – | – | 300,000 | 18 August 2014 | 19 August 2014 to 18 August 2019 | HKD1.78 | HKD1.78 | – |
| | – | 500,000 | – | – | 500,000 | 22 July 2016 | 01 January 2017 to 31 December 2017 | HKD0.60 | HKD0.138 | – |
| Mr. Jiang Guangqing | 400,000 | – | – | 400,000 | – | 28 January 2011 | 01 July 2012 to 30 June 2016 | HKD1.275 | HKD1.275 | – |
| | 300,000 | – | – | – | 300,000 | 18 August 2014 | 19 August 2014 to 18 August 2019 | HKD1.78 | HKD1.78 | – |
| | – | 300,000 | – | – | 300,000 | 22 July 2016 | 01 January 2017 to 31 December 2017 | HKD0.60 | HKD0.138 | – |
| Employees | 1,560,000 | – | – | 1,560,000 | – | 28 January 2011 | 01 July 2012 to 30 June 2016 | HKD1.275 | HKD1.275 | – |
| Employees | 9,002,000 | – | – | 9,002,000 | – | 17 January 2014 | 01 June 2014 to 31 May 2016 | HKD2.50 | HKD2.48 | – |
| Employees | 20,180,000 | – | – | – | 20,180,000 | 18 August 2014 | 19 August 2014 to 18 August 2019 | HKD1.78 | HKD1.78 | – |
| Employees | – | 15,170,000 | – | – | 15,170,000 | 22 July 2016 | 01 January 2017 to 31 December 2017 | HKD0.60 | HKD0.138 | – |
| | 34,229,000 | 18,970,000 | – | 12,082,000 | 41,117,000 | | | | | |

The options granted to the Directors are registered under the names of the Directors who are also the beneficial owners.

* being the weighted average closing price of the Company's ordinary shares immediately before the dates on which the options were granted or exercised, as applicable.

Information on the accounting policy for share options granted and the weighted average value per option is provided in note 3 (m)(ii) and note 28 to the financial statements respectively.

Apart from the foregoing, at no time during the year was the Company, or any of its holding company or subsidiaries a party to any arrangement to enable the Directors to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

## Directors' and Controlling Shareholders' Interests in Contracts

Save as disclosed under the heading "Continuing connected transactions" below and "Material related party transactions" in note 33 to the financial statements, there is no contract of significance to the business of the Group between the Company, or any of its subsidiary companies, or a controlling shareholder or any of its subsidiaries during the year. During the year, no contract of significance for the provision of services to the Group by a controlling shareholder or any of its subsidiaries was made. There is no transaction, arrangement or contract of significance to the Group subsisting during or at the end of the year in which any Director or any entity connected with a Director is or was materially interested, either directly or indirectly.

## Directors' Service Contracts

No Director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries, which is not determinable by the employing company within one year without payment of compensation (other than statutory compensation).

## Permitted indemnity provision

During the year ended 31 December 2016, there was no permitted indemnity provision in force for the benefit of one or more (existing or former) directors of the Company or of its associated companies or such directors' associated companies.

## Purchase, Sales or Redemption of Shares

During the year ended 31 December 2016, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's shares or any of its subsidiaries' shares.

## Issue of Shares or Debentures

Save as disclosed in this annual report, during the year ended 31 December 2016, neither the Company nor any of its subsidiaries has issued any shares or debentures.

## Corporate Governance

The Company has, so far where applicable, adopted and complied with the principles and code provisions set out in the Corporate Governance Code (the "CG Code") in Appendix 14 of the Listing Rules during the year ended 31 December 2016, except for the following deviation:

### Code Provision A.6.7

Code provision A.6.7 of the CG Code stipulates that independent non-executive directors ("INEDs") and other non-executive directors should also attend general meetings. One of the INEDs, Mr. Yin Shuming was unable to attend the annual general meeting of the Company held on 18 May 2016 due to health reasons. Mr. Yin Shuming subsequently resigned on 3 September 2016 due to his old age of 71 and intention to spend more time with his family.

## Audit Committee

The Audit Committee comprises three INEDs. The Audit Committee held a meeting on 27 March 2017 to consider and review the 2016 annual report and annual financial statements of the Group and to give their opinion and recommendation to the Board. The Audit Committee considered that the 2016 annual report and annual financial statements of the Company have complied with the applicable accounting standards and the Company has made appropriate disclosure thereof.

## Defined contribution pension funds

The Group participates in defined contribution pension funds managed by the PRC local government authorities as disclosed in note 8(b) to the financial statements.

The PRC subsidiaries of the Group participate in defined contribution retirement benefit schemes (the "Schemes") organised by the PRC municipal and provincial government authorities whereby the PRC subsidiaries are required to make contributions at the rate of 19% starting from 1 July 2016 (before 1 July 2016: 20%) of the eligible employees' salary rate to the Schemes. The Group has accrued for the required contributions which are remitted to the respective local government authorities when the contributions become due. The local government authorities are responsible for the pension obligations payable to the retired employees covered under the Schemes.

Forfeited contributions could not be used by the Group to reduce the existing level of contributions.

## Major Customers and Suppliers

The information in respect of the Group's sales and purchases attributable to the major customers and suppliers during the financial year ended 31 December 2016 is as follows:

| | **Percentage of the Group's total** | |
|---|---|---|
| | **Sales** | **Purchases** |
| The largest customer/supplier | 26% | 12% |
| Five largest customers/suppliers in aggregate | 38% | 21% |

At no time during the year had the Directors, their close associates or any shareholder of the Company (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had any interest in these major customers and suppliers.

A majority of the domestic customers were granted credit for a term of 90 days, depending on the sales order volumes and the creditworthiness of individual customers. Beyond the normal credit term, a 90-day extension was also granted to key and credit-worthy customers subject to specific approval from management.

Overseas customers were generally granted Letter of Credit ("L/C") of 90 days, and a longer term-up L/C up to 120 days was allowed to customers with steady and high sales volumes.

The Group accepted bills from customers as settlement of trade receivables. The maturity period of bills ranges from three to twelve months.

## Continuing Connected Transactions

The related party transactions on leases as disclosed in note 33 to the financial statements also constituted continuing connected transactions under the Listing Rules.

The continuing connected transactions of the Group on leases from controlling shareholders fall under the de minimis provision set forth in Rule 14A.76 (1) of the Listing Rules and are therefore exempt from reporting, announcement and independent shareholders' approval.

The independent non-executive Directors have reviewed the continuing connected transactions and confirmed that they have been entered into in the ordinary and usual course of business of the Group on normal commercial terms and according to the agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

## Pledge of Assets

As at 31 December 2016, the Group pledged certain bank deposits amounting to approximately RMB180,180,000 (31 December 2015: RMB445,389,000). The Group also pledged certain trade receivables amounting to approximately RMB147,748,000 (31 December 2015: RMB91,509,000) and other financial assets amounting to approximately RMB96,300,000 (31 December 2015: Nil).

## Financial Information Summary

A summary of the published results and assets, liabilities and non-controlling interests of the Group for the last five financial years, as extracted from the audited financial statements, is set out on page 129. This summary does not form part of the audited financial statements.

## Directors' Interests in Competing Business

During the year and up to the date of this annual report, none of the Directors are considered to have interests in any business which competes or is likely to compete, either directly or indirectly, with the businesses of the Group, pursuant to the Listing Rules.

## Management Contracts

No contracts concerning the management and/or administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

## Sufficiency of Public Float

Based on the information that is publicly available to the Company and within the knowledge of the Directors of the Company, as at the date of this annual report, the Company has maintained sufficient public float as required under the Listing Rules.

## Auditors

KPMG will retire and, being eligible, will offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Company is to be proposed at the forthcoming Annual General Meeting. There has been no change in the Company's auditors in any of the preceding three years.

By order of the Board

**Tiangong International Company Limited**
**Zhu Xiaokun**
*Chairman*
Hong Kong, 28 March 2017

**Independent auditor's report to the shareholders of**
**Tiangong International Company Limited**
*(Incorporated in the Cayman Islands with limited liability)*

## Opinion

We have audited the consolidated financial statements of Tiangong International Company Limited ("the Company") and its subsidiaries ("the Group") set out on pages 63 to 128, which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statement of profit or loss, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and have been properly prepared in compliance with the disclosure requirements of the Hong Kong Companies Ordinance.

## Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report. We are independent of the Group in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code") together with any ethical requirements that are relevant to our audit of the consolidated financial statements in the Cayman Islands, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

## Revenue recognition

*Refer to note 5 to the consolidated financial statements and the accounting policies on page 80.*

| The Key Audit Matter | How the matter was addressed in our audit |
|---|---|
| The Group's revenue principally comprises sales of high speed steel, die steel, high speed steel cutting tools and titanium-related products to distributors and manufacturers and the trading of billet steel.<br><br>Contracts for different products with different types of customers have a variety of different terms relating to goods acceptance and the right of return. Such terms may affect the timing of the recognition of sales to these customers. Management evaluates the terms of each contract in order to determine the appropriate timing for revenue recognition.<br><br>We identified the recognition of revenue as a key audit matter because revenue is a key performance indicator of the Group which increases the risk that revenue could be manipulated to meet financial expectations or targets and because the Group has a large number of customers with which it has different terms of trade which increases the risk of error in the timing of recognition of revenue. | Our audit procedures to assess the recognition of revenue included the following:<br><br>• obtaining an understanding of and assessing the design, implementation and operating effectiveness of management's key internal controls in relation to revenue recognition;<br><br>• inspecting key customer contracts to identify terms and conditions relating to goods acceptance and the right of return and assessing the Group's timing of recognition of revenue with reference to the requirements of the prevailing accounting standards;<br><br>• comparing, on a sample basis, specific revenue transactions recorded before and after the financial year end date with underlying documentation, which included goods delivery notes and goods acceptance notes, to assess whether the revenue had been recognised in accordance with the terms of the sales contracts and in the appropriate financial period;<br><br>• inspecting underlying documentation for manual journal entries relating to revenue which were recorded during the year and which were considered to be material or met other specific risk-based criteria;<br><br>• confirming, on a sample basis, the value of sales transactions for the year ended 31 December 2016 directly with customers and inspecting underlying documentation relating to reconciling differences between the transactions confirmed and the Group's accounting records to assess whether the related revenue had been recognised in the appropriate financial period; and<br><br>• inquiring of management as to the reasons for sales credits issued subsequent to the year end and inspecting relevant underlying documentation in order to assess whether the sales credits were properly accounted for in the appropriate financial period. |

**Recoverability of trade receivables**

*Refer to note 21 to the consolidated financial statements and the accounting policies on page 74.*

| The Key Audit Matter | How the matter was addressed in our audit |
|---|---|
| At 31 December 2016, the Group's gross trade receivables totalled RMB989 million, against which a provision for doubtful debts of RMB37 million was recorded.<br><br>The Group's provision for doubtful debts is based on management's estimate of the expected losses to be incurred, which is estimated by taking into account the credit history of the Group's customers and current market and customer-specific conditions all of which involve a significant degree of management judgement.<br><br>The Group's provision for doubtful debts includes a specific element based on individual debtors and a collective element based on historical experience adjusted for certain current factors.<br><br>We identified the recoverability of trade receivables as a key audit matter because the Group has significant trade receivables and because due to the challenging market conditions in the steel industry in Mainland China there is an increased risk of downstream customers experiencing liquidity issues and a consequential risk in respect of the recoverability of the Group's trade receivables. | Our audit procedures to assess the recoverability of trade receivables included the following:<br><br>• obtaining an understanding of and assessing the design, implementation and operating effectiveness of management's key internal controls relating to credit control, debt collection and making provisions for doubtful debts;<br><br>• assessing the classification of trade receivables in the trade receivables ageing report by comparison with sales invoices and other relevant underlying documentation on a sample basis;<br><br>• obtaining an understanding of the basis of management's judgement about the recoverability of individual material trade receivables balances and evaluating the provision for doubtful debts made by management for these individual trade receivables balances with reference to correspondence with the debtors, agreed settlement plans, the debtors' financial condition, the industry in which the debtors are operating, the ageing of overdue balances and historical and post year-end payment records;<br><br>• assessing the assumptions and estimates made by the management for the provision for doubtful debts calculated based on a collective assessment by performing a retrospective review of the historical accuracy of these estimates and recalculating the Group's provision with reference to the Group's policy for collective assessment; and<br><br>• comparing cash receipts from customers subsequent to the financial year end relating to trade receivable balances at 31 December 2016 with bank statements and other relevant underlying documentation. |

**Assessing potential impairment of property, plant and equipment**

*Refer to note 13 to the consolidated financial statements and the accounting policies on page 76.*

| The Key Audit Matter | How the matter was addressed in our audit |
|---|---|
| At 31 December 2016 the Group's market capitalisation was significantly lower than the Group's net asset value as reflected in the consolidated financial statements.<br><br>Management considered, on the basis of the above, that an indicator of potential impairment of the Group's property, plant and equipment existed and consequently management performed impairment assessments of the Group's property, plant and equipment.<br><br>Management assessed the recoverable amounts of the relevant cash-generating units ("CGUs") to which the property, plant and equipment had been allocated at the higher of value in use and fair value less costs of disposal of the relevant assets. Having determined that the fair value of the Group's property, plant and equipment was not readily available, management performed impairment assessments based on discounted cash flow forecasts and concluded that no provision for impairment was necessary as at 31 December 2016.<br><br>The preparation of discounted cash flow forecasts involves a significant degree of management judgement, in particular in forecasting future revenue, future gross profit margins and cost growth rates, determining the discount rates applied and estimating the recoverable amounts of the relevant CGUs.<br><br>We identified assessing potential impairment of property, plant and equipment as a key audit matter because determining the level of impairment, if any, involves a significant degree of management judgment, which can be inherently uncertain and may be subject to management bias. | Our audit procedures to assess potential impairment of property, plant and equipment included the following:<br><br>• engaging our internal valuation specialists to assist us in evaluating the methodology adopted by management in its preparation of the discounted cash flow forecasts with reference to the requirements of the prevailing accounting standards;<br><br>• evaluating management's identification of CGUs and the allocation of property, plant and equipment and other assets to each CGU with reference to the requirements of the prevailing accounting standards;<br><br>• comparing the most significant inputs used in the discounted cash flow forecasts, including future revenue and future gross profit margins, with the historical performance of each CGU, management's forecasts, details in the financial budgets approved by management and available industry reports;<br><br>• evaluating the discount rates adopted by management in the discounted cashflow forecasts by benchmarking against other comparable companies in the same industry;<br><br>• comparing the forecast revenue and forecast operating costs included in discounted cashflow forecasts prepared in the prior year with the current year's performance of each CGU to assess how accurate the prior year's discounted cashflow forecasts were and making enquiries of management as to the reasons for any significant variations identified; and<br><br>• performing sensitivity analyses of the key assumptions, including the discount rates and revenue growth rates, and evaluating the resulting impact on the conclusion of the impairment assessments and considering whether there was any indication of management bias in the selection of the assumptions. |

**Valuation of inventories**

*Refer to note 20 to the consolidated financial statements and the accounting policies on page 77.*

| The Key Audit Matter | How the matter was addressed in our audit |
|---|---|
| At 31 December 2016, the Group's gross inventories totalled RMB1.9 billion, against which provisions for inventories of RMB31 million were recorded.<br><br>The Group's inventories are valued at the lower of cost and net realisable value. The Group's provisions for inventories to write down the cost of inventories to their net realisable value is determined by management on an individual item basis by taking into account the estimated selling prices of the Group's steel products, the estimated costs of completion of work-in-progress at the reporting date and the estimated costs necessary to make the sale.<br><br>The selling prices of the Group's special steel products are subject to the market price volatility of the main raw materials, which include steel and alloys. Certain steel products are produced to meet the specific needs of downstream customers, the demand for which may change significantly from time to time.<br><br>We identified the valuation of inventories as a key audit matter because of the significant management judgment involved in assessing the level of provisions for inventories, particularly in respect of slow moving inventories and inventories where the net realisable value may be less than the recorded cost. | Our audit procedures to assess the valuation of inventories included the following:<br><br>• obtaining an understanding of and assessing the design, implementation and operating effectiveness of management's key internal controls over making provisions for inventories;<br><br>• assessing the assumptions and estimates made by management in making provisions for inventories by performing a retrospective review of the historical accuracy of these estimates, discussing any significant variances with management and considering the impact of these variances on the current year's assumptions and estimates;<br><br>• evaluating whether items were correctly categorised in the finished goods inventory ageing report by comparison with production records, on a sample basis;<br><br>• recalculating the Group's inventory provision with reference to the sales prices achieved after the year end date, where available, and the latest market prices for the Group's products;<br><br>• comparing year end inventory levels of individual products, on a sample basis, with procurement plans agreed with customers in order to assess the residual risk of the inventories' realisability;<br><br>• inspecting the inventory ageing report to identify any slow moving and obsolete inventory items and critically assessing whether appropriate provisions had been established for slow moving and obsolete items, for which there was a lack of recent sales transactions. |

## Information other than the consolidated financial statements and auditor's report thereon

The directors are responsible for the other information. The other information comprises all the information included in the annual report, other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## Responsibilities of the directors for the consolidated financial statements

The directors are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRS issued by the IASB and the disclosure requirements of the Hong Kong Companies Ordinance and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The directors are assisted by the Audit Committee in discharging their responsibilities for overseeing the Group's financial reporting process.

## Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and, where applicable, related safeguards.

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Ko Chee Wai David.

*Certified Public Accountants*
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

28 March 2017

# Consolidated Statement of Profit or Loss

For the year ended 31 December 2016
*(Expressed in Renminbi)*

| | note | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|---|
| Revenue | 5 | **3,376,134** | 3,429,397 |
| Cost of sales | | **(3,003,942)** | (3,038,061) |
| **Gross profit** | | **372,192** | 391,336 |
| Other income | 6 | **76,299** | 19,324 |
| Distribution expenses | | **(66,264)** | (67,855) |
| Administrative expenses | | **(142,918)** | (115,404) |
| Other operating expenses | 7 | **(12,294)** | (14,154) |
| **Profit from operations** | | **227,015** | 213,247 |
| Finance income | | **9,398** | 8,521 |
| Finance expenses | | **(112,697)** | (149,240) |
| **Net finance costs** | 8(a) | **(103,299)** | (140,719) |
| Share of profits of associates | 17 | **7,751** | 5,857 |
| Share of (losses)/profits of joint ventures | 18 | **(551)** | 6,820 |
| **Profit before taxation** | 8 | **130,916** | 85,205 |
| Income tax | 9 | **(14,920)** | (13,074) |
| **Profit for the year** | | **115,996** | 72,131 |
| **Attributable to:** | | | |
| Equity shareholders of the Company | | **110,571** | 72,623 |
| Non-controlling interests | | **5,425** | (492) |
| **Profit for the year** | | **115,996** | 72,131 |
| **Earnings per share** *(RMB)* | 12 | | |
| Basic | | **0.050** | 0.033 |
| Diluted | | **0.050** | 0.033 |

The notes on pages 69 to 128 form part of these financial statements. Details of dividends payable to equity shareholders of the Company attributable to the profit for the year are set out in note 30(b).

# Consolidated Statement of Profit or Loss and Other Comprehensive Income

For the year ended 31 December 2016
*(Expressed in Renminbi)*

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| **Profit for the year** | **115,996** | 72,131 |
| **Other comprehensive income for the year (after tax and reclassification adjustment)** | | |
| Items that may be reclassified subsequently to profit or loss: | | |
| Exchange differences on translation of: | | |
| – financial statements of Hong Kong subsidiaries and overseas equity-accounted investees (net of nil tax) | **(27,642)** | (27,787) |
| Available-for-sale securities | | |
| net movement in the fair value reserve (net of tax of RMB12,945,000) | **73,355** | – |
| **Other comprehensive income for the year** | **45,713** | (27,787) |
| **Total comprehensive income for the year** | **161,709** | 44,344 |
| **Attributable to:** | | |
| Equity shareholders of the Company | **156,284** | 44,836 |
| Non-controlling interests | **5,425** | (492) |
| **Total comprehensive income for the year** | **161,709** | 44,344 |

The notes on pages 69 to 128 form part of these financial statements.

# Consolidated Statement of Financial Position

As at 31 December 2016
*(Expressed in Renminbi)*

| | note | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 13 | **3,444,164** | 3,243,542 |
| Lease prepayments | 14 | **72,624** | 74,372 |
| Goodwill | 15 | **21,959** | 21,959 |
| Interest in associates | 17 | **46,484** | 38,503 |
| Interest in joint ventures | 18 | **25,343** | 24,509 |
| Other financial assets | 19 | **96,300** | 10,000 |
| Deferred tax assets | 29(b) | **30,146** | 20,089 |
| | | **3,737,020** | 3,432,974 |
| **Current assets** | | | |
| Inventories | 20 | **1,901,775** | 1,886,643 |
| Trade and other receivables | 21 | **1,577,383** | 1,895,480 |
| Pledged deposits | 22 | **180,180** | 445,389 |
| Time deposits | 23 | **640,000** | 400,000 |
| Cash and cash equivalents | 24 | **259,546** | 323,486 |
| | | **4,558,884** | 4,950,998 |
| **Current liabilities** | | | |
| Interest-bearing borrowings | 25 | **2,678,912** | 2,580,896 |
| Trade and other payables | 26 | **1,145,129** | 1,347,335 |
| Current taxation | 29(a) | **1,560** | – |
| Deferred income | 27 | **5,840** | 1,162 |
| | | **3,831,441** | 3,929,393 |
| **Net current assets** | | **727,443** | 1,021,605 |
| **Total assets less current liabilities** | | **4,464,463** | 4,454,579 |
| **Non-current liabilities** | | | |
| Interest-bearing borrowings | 25 | **210,000** | 485,978 |
| Deferred income | 27 | **43,876** | 48,168 |
| Deferred tax liabilities | 29(c) | **55,153** | 44,146 |
| | | **309,029** | 578,292 |
| **Net assets** | | **4,155,434** | 3,876,287 |

The notes on pages 69 to 128 form part of these financial statements.

# Consolidated Statement of Financial Position

As at 31 December 2016
*(Expressed in Renminbi)*

| | note | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|---|
| **Capital and reserves** | | | |
| Share capital | 30(a)/(c) | **40,167** | 40,167 |
| Reserves | 30(d) | **3,977,548** | 3,836,120 |
| **Total equity attributable to equity shareholder of the Company** | | **4,017,715** | 3,876,287 |
| **Non-controlling interests** | | **137,719** | – |
| **Total equity** | | **4,155,434** | 3,876,287 |

Approved and authorised for issue by the board of directors on 28 March 2017.

**Zhu Xiaokun**
*Directors*

**Yan Ronghua**
*Directors*

The notes on pages 69 to 128 form part of these financial statements.

# Consolidated Statement of Changes in Equity

For the year ended 31 December 2016
*(Expressed in Renminbi)*

| | note | Attributable to equity shareholders of the Company | | | | | | | | | Non-controlling interests RMB'000 | Total equity RMB'000 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Share Capital RMB'000 (note 30 (c)(i)) | Share premium RMB'000 (note 30 (d)(i)) | Capital redemption reserve RMB'000 (note 30 (d)(i)) | Capital reserve RMB'000 (note 30 (d)(ii)) | Merger reserve RMB'000 (note 30 (d)(iii)) | Exchange reserve RMB'000 (note 30 (d)(iv)) | Fair value reserve RMB'000 (note 30 (d)(v)) | PRC Statutory reserve RMB'000 (note 30 (d)(vi)) | Retained earnings RMB'000 | | |
| **Balance at 1 January 2016** | | **40,167** | **1,590,760** | **492** | **74,367** | **91,925** | **(34,259)** | **-** | **530,335** | **1,582,500** | **-** | **3,876,287** |
| **Changes in equity for 2016** | | | | | | | | | | | | |
| Profit for the year | | - | - | - | - | - | - | - | - | 110,571 | 5,425 | 115,996 |
| Other comprehensive income | | - | - | - | - | - | (27,642) | 73,355 | - | - | - | 45,713 |
| Total comprehensive income | | - | - | - | - | - | (27,642) | 73,355 | - | 110,571 | 5,425 | 161,709 |
| Dividends approved in respect of the previous year | 30 (b)(ii) | - | - | - | - | - | - | - | - | (14,912) | - | (14,912) |
| Transfer to reserve | | - | - | - | - | - | - | - | 14,203 | (14,203) | - | - |
| Issuance of share options | | - | - | - | 2,253 | - | - | - | - | - | - | 2,253 |
| Partial disposal to non-controlling interest | 16 (iii) | - | - | - | - | - | - | - | - | (2,197) | 132,294 | 130,097 |
| Forfeiture of share options | | - | - | - | (3,772) | - | - | - | - | 3,772 | - | - |
| **Balance at 31 December 2016** | | **40,167** | **1,590,760** | **492** | **72,848** | **91,925** | **(61,901)** | **73,355** | **544,538** | **1,665,531** | **137,719** | **4,155,434** |

| | note | Attributable to equity shareholders of the Company | | | | | | | | | Non-controlling interests RMB'000 | Total equity RMB00 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Share Capital RMB'000 (note 30 (c)(i)) | Share premium RMB'000 (note 30 (d)(i)) | Capital redemption reserve RMB'000 (note30 (d)(i)) | Capital reserve RMB'000 (note 30 (d)(ii)) | Merger reserve RMB'000 (note 30 (d)(iii)) | Exchange reserve RMB'000 (note 30 (d)(iv)) | PRC Statutory reserve RMB'000 (note 30 (d)(vi)) | Retained earnings RMB'000 | Total RMB'000 | | |
| **Balance at 1 January 2015** | | 40,167 | 1,590,760 | 492 | 74,367 | 91,925 | (6,472) | 519,106 | 1,617,580 | 3,927,925 | 1,896 | 3,929,821 |
| **Changes in equity for 2015** | | | | | | | | | | | | |
| Profit for the year | | – | – | – | – | – | – | – | 72,623 | 72,623 | (492) | 72,131 |
| Other comprehensive income | | – | – | – | – | – | (27,787) | – | – | (27,787) | – | (27,787) |
| Total comprehensive income | | – | – | – | – | – | (27,787) | – | 72,623 | 44,836 | (492) | 44,344 |
| Dividends approved in respect of the previous year | 30(b)(ii) | – | – | – | – | – | – | – | (96,402) | (96,402) | – | (96,402) |
| Transfer to reserve | | – | – | – | – | – | – | 11,301 | (11,301) | – | – | – |
| Disposal of a subsidiary | | – | – | – | – | – | – | (72) | – | (72) | (1,404) | (1,476) |
| **Balance at 31 December 2015** | | 40,167 | 1,590,760 | 492 | 74,367 | 91,925 | (34,259) | 530,335 | 1,582,500 | 3,876,287 | – | 3,876,287 |

The notes on pages 69 to 128 form part of these financial statements.

# Consolidated Cash Flow Statement

For the year ended 31 December 2016
*(Expressed in Renminbi)*

| | note | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|---|
| **Operating activities** | | | |
| Cash generated from operations | 24(b) | 516,931 | 710,820 |
| Income tax paid | | (22,163) | (78,288) |
| **Net cash generated from operating activities** | | 494,768 | 632,532 |
| **Investing activities** | | | |
| Payment for the purchase of property, plant and equipment | | (392,961) | (443,014) |
| Payment for lease prepayment | | – | (515) |
| Proceeds from disposal of property, plant and equipment | | 10,604 | 3,335 |
| Net (payment to purchase)/proceeds from maturity of time deposits | | (240,000) | 143,100 |
| Net proceeds from maturity/(payment for purchase) of pledged deposits | | 265,209 | (40,989) |
| Interest received | 8(a) | 9,398 | 8,521 |
| Proceeds from disposal of a subsidiary | | – | (2,084) |
| Dividends received from unlisted securities | | – | 800 |
| Dividends received from an associate | | 1,738 | – |
| Proceeds from disposal of a joint venture | | 656 | – |
| Payment for establishment of associate | | (4,587) | – |
| Payment for capital injection in joint ventures | | (2,670) | (5,314) |
| **Net cash used in investing activities** | | (352,613) | (336,160) |
| **Financing activities** | | | |
| Proceeds from interest-bearing borrowings | | 4,902,796 | 4,485,757 |
| Repayment of interest-bearing borrowings | | (5,080,758) | (4,394,935) |
| Interest paid | | (118,925) | (151,654) |
| Dividends paid to equity shareholders of the Company | 30(b)(ii) | (14,912) | (96,402) |
| Proceeds from partial disposal to non-controlling interests | | 130,097 | – |
| **Net cash used in financing activities** | | (181,702) | (157,234) |
| **Net (decrease)/increase in cash and cash equivalents** | | (39,547) | 139,138 |
| **Cash and cash equivalents at 1 January** | | 323,486 | 181,373 |
| **Effect of foreign exchange rate changes** | | (24,393) | 2,975 |
| **Cash and cash equivalents at 31 December** | | 259,546 | 323,486 |

The notes on pages 69 to 128 form part of these financial statements.

## 1 Reporting entity

Tiangong International Company Limited (the "Company") was incorporated in the Cayman Islands on 14 August 2006 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961 as consolidated and revised) of the Cayman Islands. The Company's shares have been listed on the Main Board of the Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 26 July 2007.

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

## 2 Basis of preparation

### (a) Statement of compliance

These financial statements have been prepared in accordance with all applicable International Financial Reporting Standards ("IFRSs"), which collective term includes all applicable individual International Financial Reporting Standards, International Accounting Standards ("IASs") and Interpretations issued by the International Accounting Standards Board ("IASB"). These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out in note 3.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Company. Note 4 provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these financial statements.

### (b) Basis of measurement

The consolidated financial statements of the Group as at and for the year ended 31 December 2016 comprise the Company and its subsidiaries and the Group's interests in associates and joint ventures.

The measurement basis used in the preparation of the financial statements is the historical cost basis except as set out in the accounting policies hereunder.

### (c) Accounting estimates and judgements

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRSs that have significant effect on the financial statements and major sources of estimation uncertainty are discussed in note 35.

## 3 Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, and have been applied consistently by the Group entities, except as explained in note 4, which addresses changes in accounting policies.

### (a) Subsidiaries and non-controlling interests

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. When assessing whether the Group has power, only substantive rights (held by the Group and other parties) are considered.

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances, transactions and cash flows and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Non-controlling interests represent the equity in a subsidiary not attributable directly or indirectly to the Company, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. For each business combination, the Group can elect to measure any non-controlling interests either at fair value or at the non-controlling interests' proportionate share of the subsidiary's net identifiable assets.

Non-controlling interests are presented in the consolidated statement of financial position within equity, separately from equity attributable to the equity shareholders of the Company. Non-controlling interests in the results of the Group are presented on the face of the consolidated statement of profit or loss and other comprehensive income as an allocation of the total profit or loss and total comprehensive income for the year between non-controlling interests and the equity shareholders of the Company. Loans from holders of non-controlling interests and other contractual obligations towards these holders are presented as financial liabilities in the consolidated statement of financial position in accordance with notes 3(j) and (k) depending on the nature of the liability.

Changes in the Group's interests in a subsidiary that do not result in a loss of control are accounted for as equity transactions, whereby adjustments are made to the amounts of controlling and non-controlling interests within consolidated equity to reflect the change in relative interests, but no adjustments are made to goodwill and no gain or loss is recognised.

When the Group loses control of a subsidiary, it is accounted for as a disposal of the entire interest in that subsidiary, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former subsidiary at the date when control is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset (see note 3(d)) or, when appropriate, the cost on initial recognition of an investment in an associate or joint ventures (see note 3(b)).

In the Company's statement of financial position, an investment in a subsidiary is stated at cost less impairment losses (see note 3(g)), unless the investment is classified as held for sale (or included in a disposal group that is classified as held for sale).

## 3 Significant accounting policies (continued)

### (b) Associates and joint ventures

An associate is an entity in which the Group or Company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A joint venture is an arrangement whereby the Group or Company and other parties contractually agree to share control of the arrangement, and have rights to the net assets of the arrangement.

An investment in an associate or a joint venture is accounted for in the consolidated financial statements under the equity method, unless it is classified as held for sale (or included in a disposal group that is classified as held for sale). Under the equity method, the investment is initially recorded at cost, adjusted for any excess of the Group's share of the acquisition-date fair values of the investee's identifiable net assets over the cost of the investment (if any). Thereafter, the investment is adjusted for the post acquisition change in the Group's share of the investee's net assets and any impairment loss relating to the investment (see notes 3(c) and (g)). Any acquisition-date excess over cost, the Group's share of the post-acquisition, post-tax results of the investees and any impairment losses for the year are recognised in the consolidated statement of profit or loss, whereas the Group's share of the post-acquisition post-tax items of the investees' other comprehensive income is recognised in the consolidated statement of profit or loss and other comprehensive income.

When the Group's share of losses exceeds its interest in the associate or the joint venture, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the investee. For this purpose, the Group's interest is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate or the joint venture.

Unrealised profits and losses resulting from transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in the investee, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

If an investment in an associate becomes an investment in a joint venture or vice versa, retained interest is not remeasured. Instead, the investment continues to be accounted for under the equity method.

In all other cases, when the Group ceases to have significant influence over an associate or joint control over a joint venture, it is accounted for as a disposal of the entire interest in that investee, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former investee at the date when significant influence or joint control is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset (see note 3(d)).

In the Company's statement of financial position, investments in associates and joint ventures are stated at cost less impairment losses (see note 3(g)), unless classified as held for sale (or included in a disposal group that is classified as held for sale).

## 3 Significant accounting policies (continued)

### (c) Goodwill

Goodwill represents the excess of

(i) the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the Group's previously held equity interest in the acquiree; over

(ii) the net fair value of the acquiree's identifiable assets and liabilities measured as at the acquisition date.

When (ii) is greater than (i), then this excess is recognised immediately in profit or loss as a gain on a bargain purchase.

Goodwill is stated at cost less accumulated impairment losses. Goodwill arising on a business combination is allocated to each cash-generating unit, or groups of cash generating units, that is expected to benefit from the synergies of the combination and is tested annually for impairment (see note 3(g)).

On disposal of a cash generating unit during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

### (d) Other investments in equity securities

The Group's and the Company's policies for investments in equity securities, other than investments in subsidiaries, associates and joint ventures, are as follows:

Investments in equity securities are initially stated at fair value, which is their transaction price unless it is determined that the fair value at initial recognition differs from the transaction price and that fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets. Cost includes attributable transaction costs.

The Group's investments in equity securities are classified as available-for-sale financial assets. At the end of each reporting period the fair value is remeasured, with any resultant gain or loss being recognised in other comprehensive income and accumulated separately in equity in the fair value reserve. As an exception to this, investments in equity securities that do not have a quoted price in an active market for an identical instrument and whose fair value cannot otherwise be reliably measured are recognised in the statement of financial position at cost less impairment losses (see note 3(g)). Dividend income from equity securities calculated using the effective interest method are recognised in profit or loss in accordance with the policies set out in notes 3(p)(iii).

When the investments are derecognised or impaired (see note 3(g)), the cumulative gain or loss recognised in equity is reclassified to profit or loss. Investments are recognised/derecognised on the date the Group commits to purchase/sell the investments or they expire.

## 3 Significant accounting policies (continued)

### (e) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment losses (see note 3(g)).

The cost of self-constructed items of property, plant and equipment includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads and borrowing costs.

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, using the straight line method over their estimated useful lives as follows:

| | |
|---|---|
| — Plant and buildings | 20 years |
| — Machinery | 10-20 years |
| — Motor vehicles | 8 years |
| — Office equipment and others | 5 years |

Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

Construction in progress represents plant and buildings under construction and equipment pending installation, and is stated at cost less impairment losses (see note 3(g)). Cost comprises direct costs of construction as well as interest charges during the year of construction and installation. Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use, notwithstanding any delays in the issue of the relevant commissioning certificates by the relevant authorities in the PRC.

No depreciation is provided in respect of construction in progress until it is substantially complete and ready for its intended use.

## 3 Significant accounting policies (continued)

### (f) Leased assets

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

#### *(i) Classification of assets leased to the Group*

Assets that are held by the Group under leases which transfer to the Group substantially all the risks and rewards of ownership are classified as being held under finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases.

#### *(ii) Operating lease charges*

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in profit or loss as an integral part of the aggregate net lease payments made. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

Lease prepayments in the consolidated statement of financial position represent the cost of land use rights paid to the People's Republic of China (the "PRC") land bureau. Land use rights are carried at cost less accumulated amortisation and accumulated impairment losses (see note 3(g)). Amortisation is charged to the consolidated statement of profit or loss on a straight-line basis over the respective periods of the rights.

### (g) Impairment of assets

#### *(i) Impairment of investments in equity securities and other receivables*

Investments in equity securities and other current and non-current receivables that are stated at cost or amortised cost or are classified as available-for-sale securities are reviewed at the end of each reporting period to determine whether there is objective evidence of impairment. Objective evidence of impairment includes observable data that comes to the attention of the Group about one or more of the following loss events:

— significant financial difficulty of the debtor;

— a breach of contract, such as a default or delinquency in interest or principal payments;

— it becoming probable that the debtor will enter bankruptcy or other financial reorganisation;

— significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor; and

— a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

# 3 Significant accounting policies (continued)

## (g) Impairment of assets (continued)

### *(i) Impairment of investments in equity securities and other receivables (continued)*

If any such evidence exists, any impairment loss is determined and recognised as follows:

- For investments in associates and joint ventures accounted for under the equity method in the consolidated financial statements (see note 3(b)), the impairment loss is measured by comparing the recoverable amount of the investment with its carrying amount in accordance with note 3(g)(ii). The impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount in accordance with note 3(g)(ii).

- For unquoted equity securities carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material. Impairment losses for equity securities carried at cost are not reversed.

- For trade and other current receivables and other financial assets carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets), where the effect of discounting is material. This assessment is made collectively where these financial assets share similar risk characteristics, such as similar past due status, and have not been individually assessed as impaired. Future cash flows for financial assets which are assessed for impairment collectively are based on historical loss experience for assets with credit risk characteristics similar to the collective group.

  If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through profit or loss. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

- For available-for-sale securities, the cumulative loss that has been recognised in the fair value reserve is reclassified to profit or loss. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in profit or loss.

  Impairment losses recognised in profit or loss in respect of available-for-sale equity securities are not reversed through profit or loss. Any subsequent increase in the fair value of such assets is recognised in other comprehensive income.

  Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss.

## 3 Significant accounting policies (continued)

### (g) Impairment of assets (continued)

#### *(i) Impairment of investments in equity securities and other receivables (continued)*

Impairment losses are written off against the corresponding assets directly, except for impairment losses recognised in respect of trade debtors and bills receivable included within trade and other receivables, whose recovery is considered doubtful but not remote. In this case, the impairment losses for doubtful debts are recorded using an allowance account. When the Group is satisfied that recovery is remote, the amount considered irrecoverable is written off against trade debtors and bills receivable directly and any amounts held in the allowance account relating to that debt are reversed. Subsequent recoveries of amounts previously charged to the allowance account are reversed against the allowance account. Other changes in the allowance account and subsequent recoveries of amounts previously written off directly are recognised in profit or loss.

#### *(ii) Impairment of other assets*

Internal and external sources of information are reviewed at the end of each reporting period to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

— property, plant and equipment;

— intangible assets;

— prepayments for leasehold land classified as being held under an operating lease;

— goodwill; and

— investments in subsidiaries, associates and joint ventures in the Company's statement of financial position.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment:

— *Calculation of recoverable amount*

The recoverable amount of an asset is the greater of its fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

— *Recognition of impairment losses*

An impairment loss is recognised in profit or loss if the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs of disposal (if measurable) or value in use (if determinable).

## 3 Significant accounting policies (continued)

### (g) Impairment of assets (continued)

#### *(ii) Impairment of other assets (continued)*

— *Reversals of impairment losses*

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss in the year in which the reversals are recognised.

#### *(iii) Interim financial reporting and impairment*

Under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the Group is required to prepare an interim financial report in compliance with IAS 34, Interim financial reporting, in respect of the first six months of the financial year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the financial year (see notes 3 (g)(i) and 3 (g)(ii)).

Impairment losses recognised in an interim period in respect of goodwill, available-for-sale equity securities and unquoted equity securities carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the financial year to which the interim period relates. Consequently, if the fair value of an available-for-sale equity security increases in the remainder of the annual period, or in any other period subsequently, the increase is recognised in other comprehensive income and not profit or loss.

### (h) Inventories

Inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

## 3 Significant accounting policies (continued)

### (i) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost using the effective interest method, less allowance for impairment of doubtful debts (see note 3(g)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less allowance for impairment of doubtful debts.

### (j) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value being recognised in profit or loss over the period of the borrowings, together with any interest and fees payable, using the effective interest method.

### (k) Trade and other payables

Trade and other payables are initially recognised at fair value and subsequently stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

### (l) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

### (m) Employee benefits

#### *(i) Short term employee benefits and contributions to defined contribution retirement plans*

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

#### *(ii) 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).

## 3 Significant accounting policies (continued)

### (n) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognized in profit or loss except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the end of the reporting period. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

## 3 Significant accounting policies (continued)

### (n) Income tax (continued)

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities, if the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

— in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

— in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

  — the same taxable entity; or

  — different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

### (o) Provisions and contingent liabilities

Provisions are recognised for other liabilities of uncertain timing or amount when the Group or the Company has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

### (p) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

#### *(i) Sales of goods*

Revenue is recognised when goods are delivered at the customers' premises which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

#### *(ii) Dividends*

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established.

## 3 Significant accounting policies (continued)

### (p) Revenue recognition (continued)

#### *(iii) Interest income*

Interest income is recognised as it accrues using the effective interest method.

#### *(iv) Government grants*

Government grants are recognised in the statement of financial position initially when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as income in profit or loss on a systematic basis in the same periods in which the expenses are incurred. A government grant related to an asset is recognised initially as deferred income and amortised to profit or loss on a straight-line basis over the useful life of the asset.

### (q) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the end of the reporting period. Exchange gains and losses are recognised in profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was measured.

The results of foreign operations are translated into Renminbi ("RMB") at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Statement of financial position items are translated into RMB at the closing foreign exchange rates at the end of the reporting period. The resulting exchange differences are recognised in other comprehensive income and accumulated separately in equity in the exchange reserve.

On disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation is reclassified from equity to profit or loss when the profit or loss on disposal is recognised.

### (r) Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset. Other borrowing costs are expensed in the period in which they are incurred.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

## 3 Significant accounting policies (continued)

### (s) Related parties

(a) A person, or a close member of that person's family, is related to the Group if that person:

(i) has control or joint control over the Group;

(ii) has significant influence over the Group; or

(iii) is a member of the key management personnel of the Group or the Group's parent.

(b) An entity is related to the Group if any of the following conditions applies:

(i) The entity and the Group are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) The entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group.

(vi) The entity is controlled or jointly controlled by a person identified in (i).

(vii) A person identified in (i)(a) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

(viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the Group or to the Group's parent.

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

### (t) Segment reporting

Operating segments, and the amounts of each segment item reported in the financial statements, are identified from the financial information provided regularly to the Chairman (the chief operating decision maker) for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

## 4 Changes in accounting policies

The IASB has issued a number of amendments to IFRSs that are first effective for the current accounting period of the Group. None of these developments are relevant to the Group's results and financial position for the current or prior periods have been prepared or presented.

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

## 5 Revenue and segment reporting

Revenue represents mainly the sales value of high alloy steel, (including die steel ("DS") and high speed steel ("HSS")), cutting tools (formerly categorised as HSS cutting tools), titanium alloy and trading of goods after eliminating intercompany transactions.

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

| | |
|---|---|
| – *DS* | The DS segment manufactures and sells the material that used in die set manufacturing industry. |
| – *HSS* | The HSS segment manufactures and sells the material that used in tools manufacturing industry. |
| – *Cutting tools* | The cutting tools segment manufactures and sells HSS and carbide cutting tools for the tool industry. |
| – *Titanium alloy* | The titanium alloy segment manufactures and sells titanium alloy for the titanium industry. |
| – *Trading of goods* | The trading of goods segment sells general carbon steel products that are not within our production capacity. |

### (a) Segment results, assets and liabilities

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

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

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

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

## 5 Revenue and segment reporting (continued)

### (a) Segment results, assets and liabilities (continued)

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

Information regarding the Group's reportable segments as provided to the Chairman (the chief operating decision maker) for the purposes of resource allocation and assessment of segment performance for the years ended 31 December 2016 and 2015 is set out below.

| | Year ended and as at 31 December 2016 | | | | | |
|---|---|---|---|---|---|---|
| | DS<br>RMB'000 | HSS<br>RMB'000 | Cutting tools<br>RMB'000 | Titanium alloy<br>RMB'000 | Trading of goods<br>RMB'000 | Total<br>RMB'000 |
| Revenue from external customers | 1,262,376 | 395,239 | 527,821 | 234,295 | 956,403 | 3,376,134 |
| Inter-segment revenue | – | 341,150 | – | – | – | 341,150 |
| **Reportable segment revenue** | 1,262,376 | 736,389 | 527,821 | 234,295 | 956,403 | 3,717,284 |
| **Reportable segment profit (adjusted EBIT)** | 156,592 | 64,934 | 49,567 | 32,965 | 1,870 | 305,928 |
| **Reportable segment assets** | 3,040,930 | 2,136,121 | 1,328,101 | 436,820 | 11 | 6,941,983 |
| **Reportable segment liabilities** | 591,689 | 342,342 | 178,869 | 45,026 | – | 1,157,926 |

| | Year ended and as at 31 December 2015 | | | | | |
|---|---|---|---|---|---|---|
| | DS<br>RMB'000 | HSS<br>RMB'000 | Cutting tools<br>RMB'000 | Titanium alloy<br>RMB'000 | Trading of goods<br>RMB'000 | Total<br>RMB'000 |
| Revenue from external customers | 1,017,875 | 678,679 | 514,857 | 173,361 | 1,044,625 | 3,429,397 |
| Inter-segment revenue | – | 235,536 | – | – | – | 235,536 |
| **Reportable segment revenue** | 1,017,875 | 914,215 | 514,857 | 173,361 | 1,044,625 | 3,664,933 |
| **Reportable segment profit (adjusted EBIT)** | 114,747 | 119,966 | 64,456 | 22,511 | 1,801 | 323,481 |
| **Reportable segment assets** | 3,153,877 | 2,271,620 | 1,330,523 | 334,402 | 1,953 | 7,092,375 |
| **Reportable segment liabilities** | 543,883 | 596,742 | 207,943 | 19,861 | – | 1,368,429 |

# 5 Revenue and segment reporting (continued)

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

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| **Revenue** | | |
| Reportable segment revenue | 3,717,284 | 3,664,933 |
| Elimination of inter-segment revenue | (341,150) | (235,536) |
| Consolidated revenue | 3,376,134 | 3,429,397 |

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| **Profit** | | |
| Reportable segment profit | 305,928 | 323,481 |
| Net finance costs | (103,299) | (140,719) |
| Share of profits of associates | 7,751 | 5,857 |
| Share of (losses)/profits of joint ventures | (551) | 6,820 |
| Unallocated head office and corporate expenses | (78,913) | (110,234) |
| Consolidated profit before taxation | 130,916 | 85,205 |

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| **Assets** | | |
| Reportable segment assets | 6,941,983 | 7,092,375 |
| Trade and other receivables (note 21) | – | 3,192 |
| Interest in associates | 46,484 | 38,503 |
| Interest in joint ventures | 25,343 | 24,509 |
| Other financial assets | 96,300 | 10,000 |
| Deferred tax assets | 30,146 | 20,089 |
| Pledged deposits | 180,180 | 445,389 |
| Time deposits | 640,000 | 400,000 |
| Cash and cash equivalents | 259,546 | 323,486 |
| Unallocated head office and corporate assets | 75,922 | 26,429 |
| Consolidated total assets | 8,295,904 | 8,383,972 |

## 5 Revenue and segment reporting (continued)

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

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| **Liabilities** | | |
| Reportable segment liabilities | **1,157,926** | 1,368,429 |
| Interest-bearing borrowings | **2,888,912** | 3,066,874 |
| Current taxation | **1,560** | – |
| Deferred tax liabilities | **55,153** | 44,146 |
| Unallocated head office and corporate liabilities | **36,919** | 28,236 |
| Consolidated total liabilities | **4,140,470** | 4,507,685 |

### (c) Geographical information

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

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

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| **Revenue** | | |
| The PRC | **2,293,882** | 2,429,261 |
| North America | **385,198** | 335,144 |
| Europe | **471,536** | 417,166 |
| Asia (other than the PRC) | **182,559** | 198,636 |
| Others | **42,959** | 49,190 |
| Total | **3,376,134** | 3,429,397 |

For the year ended 31 December 2016, the Group's customer base is diversified and includes one customer (2015: one customer) with whom transactions have exceeded 10% but were less than 30% of the Group's revenue.

## 6 Other income

| | note | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|---|
| Government grants | (i) | **36,013** | 6,808 |
| Net foreign exchange gain | | **–** | 7,632 |
| Dividend income from unlisted securities | | **–** | 800 |
| Reversal of impairment loss on non-current receivables | | **–** | 312 |
| Reversal of impairment loss on trade receivables | 21(b) | **39,308** | – |
| Others | | **978** | 3,772 |
| | | **76,299** | 19,324 |

Note:

(i) The subsidiaries of the Group, including Jiangsu Tiangong Tools Company Limited ("TG Tools"), Tiangong Aihe Company Limited ("TG Aihe") and Jiangsu Tiangong Technology Company Limited ("TG Tech"), located in the PRC, collectively received unconditional grants amounting to RMB30,399,000 (2015: RMB5,646,000) from the local government to reward their contribution to local economy and encourage technology innovation. TG Tools and TG Tech also recognised amortisation of government grants related to assets of RMB5,614,000 (2015: RMB1,162,000) during the year ended 31 December 2016 (see note 27).

## 7 Other operating expenses

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| Impairment loss on trade receivables (note 21(b)) | **–** | 10,198 |
| Net loss on disposal of property, plant and equipment | **675** | 2,541 |
| Net foreign exchange losses | **11,619** | – |
| Others | **–** | 1,415 |
| | **12,294** | 14,154 |

## 8 Profit before taxation

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

### (a) Net finance costs

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Interest income | **(9,398)** | (8,521) |
| Finance income | **(9,398)** | (8,521) |
| Interest on bank loans | **133,395** | 169,427 |
| Less: interest expense capitalised into property, plant and equipment under construction* | **(20,698)** | (20,187) |
| Finance expenses | **112,697** | 149,240 |
| Net finance costs | **103,299** | 140,719 |

* The borrowing costs have been capitalised at a rate of 4.80% per annum (2015: 4.90%).

### (b) Staff costs

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Salaries, wages and other benefits | **212,158** | 170,237 |
| Contributions to defined contribution retirement plans | **21,207** | 19,003 |
| Equity-settled share-based payment expenses (note 28) | **2,253** | – |
| | **235,618** | 189,240 |

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

## 8 Profit before taxation (continued)

### (c) Other items

| | note | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|---|
| Depreciation of property, plant and equipment | 13 | **211,877** | 190,416 |
| Amortisation of lease prepayments | 14 | **1,748** | 1,655 |
| Impairment losses on trade and other receivables (reversed)/recognised | 21(b) | **(39,308)** | 9,886 |
| Auditor's remuneration | | **2,500** | 3,050 |
| Operating lease charges | | **1,445** | 2,683 |
| Cost of inventories* | | **3,003,942** | 3,038,061 |

* Cost of inventories includes RMB350,434,000 (2015: RMB319,911,000) relating to staff costs, depreciation expenses and write-down of inventories which are also included in the respective total amounts disclosed separately above or in note 8(b) for each of these types of expenses.

## 9 Income tax in the consolidated statement of profit or loss

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

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| **Current tax** | | |
| Provision for PRC income tax (note 29(a)) | **24,645** | 12,956 |
| Provision for Hong Kong Profits Tax (note 29(a)) | **2,270** | 1,900 |
| | **26,915** | 14,856 |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | **(11,995)** | (1,782) |
| | **14,920** | 13,074 |

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

## 9 Income tax in the consolidated statement of profit or loss (continued)

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

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

TG Tools, TG Aihe and TG Tech are subject to a preferential income tax rate of 15% in 2016 available to enterprises which qualify as a High and New Technology Enterprise (2015: 15%).

The statutory corporate income tax rate applicable to the Group's other operating subsidiaries in the PRC is 25% (2015: 25%).

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

(iii) Hong Kong profits tax has been provided for Tiangong Development Hong Kong Company Limited ("TG Development") at the rate of 16.5% (2015: 16.5%) on the estimated assessable profits arising in Hong Kong for the year ended 31 December 2016.

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

| | **2016**<br>**RMB'000** | 2015<br>RMB'000 |
|---|---|---|
| Profit before taxation | **130,916** | 85,205 |
| Notional tax on profit before taxation, calculated using the PRC statutory tax rate of 25% (2015: 25%) | **32,729** | 21,301 |
| Effect of preferential tax rates | **(12,027)** | (2,910) |
| Effect of different tax rates | **(1,169)** | (1,037) |
| Tax effect of non-deductible expenses | **1,517** | 163 |
| Tax effect of non-taxable income | **(548)** | (2,011) |
| Tax effect of bonus deduction for research and development expenses | **(4,500)** | (4,500) |
| Recognition of previously unrecognised deductible temporary difference | **(2,112)** | – |
| Under-provision in respect of prior year | **1,030** | 2,068 |
| Actual tax expense | **14,920** | 13,074 |

## 10 Directors' emoluments

Directors' emoluments disclosed pursuant to section 383 (1) of the Hong Kong Companies Ordinance and Part 2 of the Companies (Disclosure of Information about Benefits of Directors) Regulation are as follows:

### Year ended 31 December 2016

| | Directors' fees RMB'000 | Salaries, allowances and benefits in kind RMB'000 | Contributions to retirement benefit schemes RMB'000 | Bonuses RMB'000 | Share-based payments *(note)* RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|
| **Executive directors** | | | | | | |
| Zhu Xiaokun | – | 168 | 13 | 7,500 | 304 | 7,985 |
| Wu Suojun | – | 149 | 13 | 250 | 111 | 523 |
| Yan Ronghua | – | 154 | 13 | 220 | 69 | 456 |
| Jiang Guangqing | – | 121 | 13 | 200 | 41 | 375 |
| **Independent non-executive directors** | | | | | | |
| Wang Xuesong (appointed on 3 September 2016) | 27 | – | – | – | – | 27 |
| Yin Shuming (resigned on 3 September 2016) | 28 | – | – | – | – | 28 |
| Gao Xiang | 36 | – | – | – | – | 36 |
| Lee Cheuk Yin, Dannis | 82 | – | – | – | – | 82 |
| **Total** | 173 | 592 | 52 | 8,170 | 525 | 9,512 |

## 10 Directors' emoluments (continued)

### Year ended 31 December 2015

| | Directors' fees RMB'000 | Salaries, allowances and benefits in kind RMB'000 | Contributions to retirement benefit schemes RMB'000 | Bonuses RMB'000 | Share-based payments *(note)* RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|
| **Executive directors** | | | | | | |
| Zhu Xiaokun | – | 128 | 14 | 7,500 | – | 7,642 |
| Wu Suojun | – | 134 | 13 | 43 | – | 190 |
| Yan Ronghua | – | 135 | 13 | 41 | – | 189 |
| Jiang Guangqing | – | 113 | 13 | 42 | – | 168 |
| **Independent non-executive directors** | | | | | | |
| Yin Shuming | 48 | – | – | – | – | 48 |
| Gao Xiang | 36 | – | – | – | – | 36 |
| Lee Cheuk Yin, Dannis | 76 | – | – | – | – | 76 |
| **Total** | 160 | 510 | 53 | 7,626 | – | 8,349 |

Note:

These represent the estimated value of share options granted to the directors under the Company's share option scheme. The value of these share options is measured according to the Group's accounting policies for share-based payment transactions as set out in note 3(m)(ii).

The details of these benefits in kind, including the principal terms and number of options granted, are disclosed under the paragraph "Share option scheme" in the directors' report and note 28.

## 11 Individuals with highest emoluments

Of the five individuals with the highest emoluments, three (2015: two) are directors whose emoluments are disclosed in note 10. The aggregate of the emoluments in respect of the other two (2015: three) individuals are as follows:

| | **2016 RMB'000** | 2015 RMB'000 |
|---|---|---|
| Salaries, allowances and benefits in kind | **1,028** | 830 |
| Share-based payments | **111** | – |
| Bonuses | **286** | 515 |
| Contributions to retirement benefit schemes | **22** | 22 |
| | **1,447** | 1,367 |

The emoluments of the two (2015: three) individuals with the highest emoluments are within the band of nil to HKD1,000,000.

(Expressed in Renminbi unless otherwise indicated)

## 12 Earnings per share

### (a) Basic earnings per share

The calculation of basic earnings per share is based on the profit attributable to ordinary equity shareholders of the Company of RMB110,571,000 (2015: RMB72,623,000) and the weighted average of 2,220,080,000 ordinary shares (2015: 2,220,080,000 shares) in issue during the year:

***Weighted average number of ordinary shares***

| | **2016** | 2015 |
|---|---|---|
| Issued and weighted average number of ordinary shares at 1 January and 31 December | **2,220,080,000** | 2,220,080,000 |

### (b) Diluted earnings per share

The calculation of diluted earnings per share is based on the profit attributable to ordinary equity shareholders of the Company of RMB110,571,000 (2015: RMB72,623,000) and the weighted average number of ordinary shares of 2,222,429,272 shares (2015: 2,220,080,000 shares), calculated as follows:

***Weighted average number of ordinary shares (diluted)***

| | **2016** | 2015 |
|---|---|---|
| Weighted average number of ordinary shares at 31 December | **2,220,080,000** | 2,220,080,000 |
| Effect of equity settled share-based transactions (note 28) | **2,349,272** | – |
| Weighted average number of ordinary shares (diluted) at 31 December | **2,222,429,272** | 2,220,080,000 |

The calculation of diluted earnings per share for the year ended 31 December 2016 did not include the potential effects of 22,147,000 (2015: 34,284,000) shares options and 40,000,000 (2015: 40,000,000) shares warrants during the year as they have anti-dilutive effects on the basic earnings per share for the year.

## 13 Property, plant and equipment

| | Plant and buildings RMB'000 | Machinery RMB'000 | Motor vehicles RMB'000 | Office equipment and others RMB'000 | Construction in progress RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|
| **Cost:** | | | | | | |
| Balance at 1 January 2015 | 766,341 | 2,469,390 | 10,913 | 39,644 | 509,182 | 3,795,470 |
| Additions | 2,562 | 104,611 | – | 656 | 333,278 | 441,107 |
| Transfer from construction in process | 123,223 | 427,672 | – | – | (550,895) | – |
| Disposals | – | (62,249) | (1,040) | (20) | – | (63,309) |
| Balance at 31 December 2015 | 892,126 | 2,939,424 | 9,873 | 40,280 | 291,565 | 4,173,268 |
| Additions | 242 | 64,494 | 1,982 | 742 | 356,318 | 423,778 |
| Transfer from construction in process | 81,416 | 24,499 | – | – | (105,915) | – |
| Disposals | (7,476) | (28,145) | (668) | (413) | – | (36,702) |
| Balance at 31 December 2016 | 966,308 | 3,000,272 | 11,187 | 40,609 | 541,968 | 4,560,344 |
| **Accumulated depreciation:** | | | | | | |
| Balance at 1 January 2015 | (169,745) | (597,136) | (2,891) | (26,971) | – | (796,743) |
| Charge for the year | (36,770) | (147,004) | (1,188) | (5,454) | – | (190,416) |
| Written back on disposals | – | 57,097 | 324 | 12 | – | 57,433 |
| Balance at 31 December 2015 | (206,515) | (687,043) | (3,755) | (32,413) | – | (929,726) |
| Charge for the year | (40,692) | (165,777) | (1,218) | (4,190) | – | (211,877) |
| Written back on disposals | 1,918 | 23,038 | 74 | 393 | – | 25,423 |
| Balance at 31 December 2016 | (245,289) | (829,782) | (4,899) | (36,210) | – | (1,116,180) |
| **Net book value:** | | | | | | |
| At 31 December 2016 | 721,019 | 2,170,490 | 6,288 | 4,399 | 541,968 | 3,444,164 |
| At 31 December 2015 | 685,611 | 2,252,381 | 6,118 | 7,867 | 291,565 | 3,243,542 |

(i) All plant and buildings are located in the PRC.

(ii) Pursuant to the lease agreements entered into between the Group and Jiangsu Tiangong Group Company Limited ("TG Group") on 6 January 2010, the Group is required to pay RMB600,000 per annum for the lease of office premises from the TG Group effective from 1 January 2010 to 31 December 2016, and to pay RMB400,000 per annum for the lease of amenity facilities from the TG Group effective from 1 January 2010 to 31 December 2016 (see note 33(b)).

## 14 Lease prepayments

| | RMB'000 |
|---|---|
| **Cost:** | |
| At 1 January 2015 | 89,132 |
| Additions | 515 |
| At 31 December 2015 | 89,647 |
| Additions | – |
| At 31 December 2016 | 89,647 |
| **Accumulated amortisation:** | |
| At 1 January 2015 | (13,620) |
| Charge for the year | (1,655) |
| At 31 December 2015 | (15,275) |
| Charge for the year | (1,748) |
| At 31 December 2016 | (17,023) |
| **Net book value:** | |
| At 31 December 2016 | 72,624 |
| At 31 December 2015 | 74,372 |

The amortisation charge for the year is included in "administration expenses" in the consolidated statement of profit or loss.

## 15 Goodwill

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| **Cost:** | | |
| Balance at 1 January | **21,959** | 22,086 |
| Disposal of a subsidiary | **–** | (127) |
| Balance at 31 December | **21,959** | 21,959 |
| **Accumulated impairment losses:** | | |
| Balance at 31 December 2015 and 2016 | **–** | – |
| **Carrying amount:** | | |
| At 31 December | **21,959** | 21,959 |

For the purpose of impairment testing, goodwill is allocated to the Group's operating divisions which represent the lowest level within the Group at which the goodwill is monitored for internal management purposes.

Goodwill is allocated to the Group's CGUs identified according to the reportable segments as follows:

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| DS & HSS | **21,959** | 21,959 |

The recoverable amounts of the CGUs were determined based on value-in-use calculations. The key assumptions for the value-in-use calculations are those regarding the discount rate, growth rate of revenue and gross margin. The Group prepared cash flow forecasts derived from the two-year financial budgets and extrapolated cash flows for the following thirteen years based on an estimated growth rate of revenue of 4%–10% (2015: 3%–10%), a discount rate of 9.34% (2015: 9.15%) and a gross margin of 10%–15% (2015: 10%–18%). The growth rate used does not exceed the long-term average growth rate for the business in which the CGU operates.

Management determined the budgeted gross margin and growth rate of revenue based on past performance and its expectation for market development. The discount rates used are after-tax and reflect specific risks relating to the relevant segments.

The recoverable amounts of the CGUs are higher than their carrying amounts based on value-in-use calculations. Accordingly, no impairment of goodwill is recognised in the consolidated statement of profit or loss.

(Expressed in Renminbi unless otherwise indicated)

## 16 Interests in subsidiaries

The following list contains only the subsidiaries which principally affected the results, assets or liabilities of the Group. The class of shares held is ordinary unless otherwise stated.

| Name of company | | Place and date of incorporation | Proportion of ownership interest Direct | Proportion of ownership interest Indirect | Issued and fully paid-up/registered capital | Principal activity |
|---|---|---|---|---|---|---|
| China Tiangong Company Limited | | British Virgin Islands, 14 August 2006 | 100% | – | USD–/ USD50,000 | Investment holding |
| TG Tools | (i) | The PRC, 7 July 1997 | – | 100% | RMB1,810,000,000/ RMB1,810,000,000 | Manufacture and sale of high speed steel and cutting and drilling tools |
| TG Aihe | (ii) | The PRC, 5 December 2003 | – | 100% | RMB723,038,000/ RMB723,038,000 | Manufacture and sale of die steel |
| Danyang Tianfa Forging Company Limited ("Tianfa Forging") | (ii) | The PRC, 11 October 2000 | – | 100% | USD18,600,000/ USD18,600,000 | Precision forging and sale of high speed steel |
| China Tiangong (Hong Kong) Company Limited ("CTCL(HK)") | | Hong Kong, 13 June 2008 | – | 100% | HKD1/ HKD1 | Investment holding |
| TG Tech | (iii) | The PRC, 27 January 2010 | – | 74.03% | RMB405,000,000/ RMB405,000,000 | Manufacture and sale of alloy, steel, cutting and drilling tools and titanium-related products |
| TG Development | | Hong Kong, 15 February 2012 | – | 100% | USD5,500,000/ USD5,500,000 | Trading of alloy, steel, cutting and drilling tools and titanium-related products |
| Jiangsu Tiangong Mould Steel R&D Center Company Limited ("TG R&D") | (iv) | The PRC, 5 March 2012 | – | 100% | RMB5,000,000/ RMB5,000,000 | Research and development of alloy, steel, and titanium-related products |
| Jiangsu Tiangong International Trading Company Limited ("International Trading") | (iv) | The PRC, 6 March 2014 | – | 100% | RMB20,000,000/ RMB50,000,000 | Trading of chemical goods, silicon iron, aluminum and billet steel |
| Jurong Tiangong New Materials Technology Company Limited ("TG New Materials") | (iv) | The PRC, 29 July 2015 | – | 100% | RMB–/ RMB300,000,000 | Research and development, manufacture and sale of high speed steel, and die steel related products |
| Danyang Tianjia Tools Technology Company Limited ("Tianjia Tech") | (v) | The PRC, 25 January 2016 | – | 100% | HKD–/ HKD10,000,000 | Research and development, distribution and sale of cutting tools related products |
| Danyang Taifeng Precision Machinery Tools Company Limited ("Taifeng Precision") | (v) | The PRC, 5 February 2016 | – | 100% | RMB–/ RMB8,000,000 | Research and development, manufacture, distribution and sale of cutting tools related products |

## 16 Interests in subsidiaries (continued)

Note:

(i) TG Tools is a wholly foreign-owned enterprise incorporated in the PRC.

(ii) TG Aihe and Tianfa Forging are incorporated in the PRC as sino-foreign equity joint ventures.

(iii) TG Tech is incorporated in the PRC as a domestic company.

On 7 March 2016, TG Tech entered into a subscription agreement with Nanjing Iron & Steel Co., Ltd. for a subscription, subject to certain conditions and adjustments (if applicable), of 40 million TG Tech placing shares at the placing price of RMB1.24 per share for a cash consideration of up to approximately RMB49.6 million. The placing was completed on 6 April 2016 and the equity interests held by the Group in TG Tech were diluted by 11.76% from 100% to 88.24% of the enlarged share capital of TG Tech.

On 6 June 2016, TG Tech entered into a subscription agreement with Nanjing Iron & Steel Co., Ltd. and TG Tech's directors and management for a subscription, subject to certain conditions and adjustments (if applicable), of 65 million TG Tech placing shares at the placing price of RMB1.24 per share for a cash consideration of up to RMB80.6 million. The placing was completed on 7 November 2016 and the equity interests held by the Group in TG Tech were diluted by 14.17% points from 88.24% to 74.07% of the enlarged share capital of TG Tech.

On 8 December 2016, Tianfa Forging sold 0.04% of its equity interests in TG Tech at a consideration of RMB398,790. Equity interests held by the Group in TG Tech decreased from 74.07% to 74.03%.

(iv) TG R&D, International Trading and TG New Materials are incorporated in the PRC as domestic companies.

(v) On 25 January 2016, CTCL(HK) established a wholly owned subsidiary, Tianjia Tech, as a wholly foreign-owned enterprise, which is engaged in the research and development, distribution and sale of cutting tools related products. Up to the date of this report, CTCL(HK) has not paid any capital into Tianjia Tech.

On 5 February 2016, Tianjia Tech established a wholly owned subsidiary, Taifeng Precision, as a domestic company, which is engaged in the research and development, manufacture, distribution and sale of cutting tools related products. Up to the date of this report, Tianjia Tech has not paid any capital into Taifeng Precision.

The following table lists out the information relating to TG Tech, the only subsidiary of the Group which has a material non-controlling interest ("NCI"). The summarised financial information presented below represents the amounts before any inter-company elimination.

| | **2016**<br>**RMB'000** | 2015<br>RMB'000 |
|---|---|---|
| NCI percentage | **25.97%** | – |
| Current assets | **400,023** | – |
| Non-current assets | **198,011** | – |
| Current liabilities | **(37,398)** | – |
| Non-current liabilities | **(30,334)** | – |
| Net assets | **530,302** | – |
| Carrying amount of NCI | **137,719** | – |
| Revenue | **257,848** | – |
| Profit for the year | **28,598** | – |
| Total comprehensive income | **28,598** | – |
| Profit allocated to NCI | **5,425** | – |
| Dividend paid to NCI | **–** | – |
| Cash flows from operating activities | **(37,664)** | – |
| Cash flows from investing activities | **(7,133)** | – |
| Cash flows from financing activities | **129,698** | – |

(Expressed in Renminbi unless otherwise indicated)

## 17 Interest in associates

The following list contains the particulars of associates, all of which are unlisted corporate entities whose market price is not available:

| | | | | | Proportion of ownership interest | | | |
|---|---|---|---|---|---|---|---|---|
| Name of associate | | Form of business structure | Place of incorporation and business | Issued and fully paid-up/ registered capital | Group's effective interest | Held by the Company | Held by a subsidiary | Principle activity |
| Jiangsu Tianrun Huafa Logistics Company Limited ("Tianrun Huafa") | (i) | Incorporated | The PRC | RMB5,000,000/ RMB5,000,000 | 40% | – | 40% | Logistics and freight |
| Xinzhenggong Company Limited ("XZG") | (ii) | Incorporated | Taiwan | TWD200,000,000/ TWD200,000,000 | 25% | – | 25% | Sale of special steel related products |
| SB Specialty Metals Holdings LLC ("SBSMH") | (iii) | Incorporated | United States of America | USD8,625,000/ USD8,625,000 | 19.8% | 19.8% | – | Sale of special steel related products |
| Fusion TG Canada Inc ("TGC") | (iv) | Incorporated | Canada | CAD6,000,000/ CAD6,000,000 | 10% | 10% | – | Sale of special steel related products |
| Jiangsu Ningxing Tiangong Mould Company Limited ("JS NXTG") | (v) | Incorporated | The PRC | RMB5,000,000/ RMB10,000,000 | 30% | – | 30% | Sale of special steel related products |
| Shenzhen 51 Mocai Technology Company Limited ("51 Mocai") | (vi) | Incorporated | The PRC | RMB–/ RMB50,000,000 | 10% | – | 10% | Sale of moulding materials |

Note:

(i) Tianrun Huafa is one of the transportation agencies of the Group in the PRC.

(ii) XZG is the sole distributor of TG Tools' products in Taiwan.

(iii) SBSMH, a distributor of special steel products in the USA, enables the Group to have exposure to this market through local experience.

(iv) On 7 October 2016, the Company formed an associate, TGC, with two independent individuals in Canada. The associate is principally engaged in sales of special steel related products. As at 31 December 2016, both parties have fully paid up the registered capital.

(v) On 2 November 2016, TG Aihe formed an associate, JS NXTG, with Ningbo Ningxing Special Steel Limited Group Co., Ltd. in KunShan, Jiangsu. The associate is principally engaged in sales of steel related products. As at 31 December 2016, both parties have paid half of the registered capital.

(vi) On 20 December 2016, TG Aihe formed an associate, 51 Mocai, with three corporations in Shenzhen. The associate is principally engaged in the e-commerce of mould steels. As at 31 December 2016, the investors have not contributed any capital into 51 Mocai.

All of the above associates are accounted for using the equity method in the consolidated financial statements.

## 17 Interest in associates (continued)

Aggregate information of associates that are not individually material:

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| Aggregate carrying amount of individually immaterial associates in the consolidated financial statements | **46,484** | 38,503 |
| Aggregate amounts of the Group's share of those associates' | | |
| – Profit from continuing operations | **7,751** | 5,857 |
| – Other comprehensive income | **(2,619)** | (1,351) |
| Total comprehensive income | **5,132** | 4,506 |

## 18 Interest in joint ventures

Details of the Group's interest in joint ventures as at 31 December 2016, which are accounted for using the equity method in the consolidated financial statements, are set out below:

| Name of joint ventures | | Form of business structure | Place of incorporation and business | Particulars of issued and paid up capital and securities | Proportion of ownership interest: Group's effective interest | Held by the Company | Held by a subsidiary | Principle activity |
|---|---|---|---|---|---|---|---|---|
| TGT Special Steel Company Limited ("TGT") | (i) | Incorporated | The Republic of Korea | 1,000,000 shares of USD1 each | 70% | – | 70% | Sale of special steel related products |
| TGK Special Steel PVT Limited ("TGK") | (ii) | Incorporated | India | 2,000,000 shares of USD1 each | 50% | – | 50% | Sale of special steel related products |
| Czechtools and Materials S.R.O. ("CTM") | (iii) | Incorporated | Czech Republic | 2,500,000 shares of CZK1 each | 50% | – | 50% | Sale of special steel related products |
| Five Star Special Steel Europe S.R.L ("FSS") | (iv) | Incorporated | Italy | 100,000 shares of EUR1 each | 60% | – | 60% | Sale of special steel related products |
| TG Middle East Celik San Ltd. ("TME") | (v) | Incorporated | Turkey | 100,000 shares of EUR1 each | 50% | – | 50% | Sale of special steel related products |

## 18 Interest in joint ventures (continued)

Note:

(i) TGT is the sole distributor of the Group's special steel products in Korea.

According to the TGT's Articles of Association, no single shareholder is in a position to control the shareholders' meeting and no single director appointed by either shareholder is in a position to control the Board of Directors. Therefore, although the Group holds 70% of equity interests in TGT, management of the Group consider that the Group does not have the ability to use its power over TGT to affect its returns through its involvement and deemed TGT to be a joint venture of the Group rather than a subsidiary.

(ii) TGK is the sole distributor of the Group's special steel products in India.

(iii) CTM is the sole distributor of the Group's special steel products in the Czech Republic.

(iv) FSS is the sole distributor of the Group's special steel products in Italy.

(v) TME is the sole distributor of the Group's special steel products in Turkey.

(vi) On 12 December 2016, the Group sold all of its equity interest in a joint venture, Tiangong South East Asia PTE. Ltd., at a consideration of RMB656,000. No gain or loss was recognised from this disposal.

Aggregate information of joint ventures that are not individually material:

| | **2016 RMB'000** | 2015 RMB'000 |
|---|---|---|
| Aggregate carrying amount of individually immaterial joint ventures in the consolidated financial statements | **25,343** | 24,509 |
| Aggregate amounts of the Group's share of those joint ventures' | | |
| – (Loss)/profit from continuing operations | **(551)** | 6,820 |
| – Other comprehensive income | **(630)** | (623) |
| Total comprehensive (loss)/income | **(1,181)** | 6,197 |

## 19 Other financial assets

| | Note | **2016 RMB'000** | 2015 RMB'000 |
|---|---|---|---|
| Available-for-sale securities – listed in the PRC | 31(e)/(i) | **96,300** | 10,000 |
| – unlisted | (ii) | **–** | – |
| | | **96,300** | 10,000 |

Note:

(i) As at 31 December 2015, the available-for-sale securities was stated at cost less impairment loss as there was no quoted market price in an active market for the investments. As at 31 December 2016, the available-for-sale securities was stated as fair value due to listing of relevant equity shares. Fair value measurement of available-for-sale securities is disclosed in note 31. Available-for-sale security of RMB96,300,000 (2015: Nil) has been pledged to a bank as security for the Group to borrow bank loans as discussed in note 25.

(ii) On 22 November 2016, TG Tools entered into an investment agreement with Citma Metals Co Ltd to incorporate a new corporation in Mexico, namely Aceros T&C. The corporation is principally engaged in the sale of special steel related products. Equity interest held by TG Tools in Aceros T&C is 15%. Up to the date of this report, TG Tools has not contributed any capital into Aceros T&C.

## 20 Inventories

(a) Inventories in the consolidated statement of financial position comprise:

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Raw materials | **35,044** | 23,151 |
| Work in progress | **909,531** | 890,092 |
| Finished goods | **957,200** | 973,400 |
| | **1,901,775** | 1,886,643 |

(b) The analysis of the amount of inventories recognised as an expense and included in profit or loss is as follows:

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Carrying amount of inventories sold | **2,988,899** | 3,034,587 |
| Provision for write-down of inventories | **15,043** | 3,474 |
| | **3,003,942** | 3,038,061 |

## 21 Trade and other receivables

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Trade receivables | **988,696** | 1,217,005 |
| Bills receivables | **416,596** | 529,771 |
| Less: impairment losses (note 21(b)) | **(37,310)** | (76,618) |
| Net trade and bills receivables | **1,367,982** | 1,670,158 |
| Prepayments | **125,342** | 186,298 |
| Current taxation (note 29) | **–** | 3,192 |
| Non-trade receivables | **84,059** | 41,969 |
| Less: impairment losses on non-trade receivables | **–** | (6,137) |
| Net prepayments and non-trade receivables | **209,401** | 225,322 |
| | **1,577,383** | 1,895,480 |

## 21 Trade and other receivables (continued)

Substantially all of the trade receivables are expected to be recovered within one year.

Trade receivables of RMB147,748,000 (2015: RMB91,509,000) have been pledged to a bank as security for the Group to borrow bank loans as disclosed in note 25.

The Group's exposure to credit and currency risks related to trade and other receivables are disclosed in note 31.

### (a) Ageing analysis

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

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Within 3 months | **1,118,311** | 1,246,347 |
| 4 to 6 months | **144,452** | 279,986 |
| 7 to 12 months | **74,003** | 76,963 |
| 1 to 2 years | **17,319** | 54,985 |
| Over 2 years | **13,897** | 11,877 |
| | **1,367,982** | 1,670,158 |

Trade and bills receivables are due from 90 to 180 days from the date of billing. Further details on the Group's credit policy are set out in note 31.

### (b) Impairment of trade and bills receivables

Impairment losses in respect of trade and bills receivables are recorded using an allowance account unless the Group is satisfied that recovery of the amount is remote, in which case the impairment loss is written-off against trade and bills receivables directly (see note 3(g)(i)).

The movement in the impairment losses during the year, including both specific and collective loss components, is as follows:

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| At 1 January | **76,618** | 66,420 |
| Impairment loss (reversed)/recognised | **(39,308)** | 10,198 |
| At 31 December | **37,310** | 76,618 |

## 21 Trade and other receivables (continued)

### (c) Trade and bills receivables that are not impaired

The ageing analysis of trade and bills receivables that are neither individually nor collectively considered to be impaired are as follows:

| | **2016**<br>**RMB'000** | 2015<br>RMB'000 |
|---|---|---|
| Neither past due nor impaired | **1,123,111** | 1,204,931 |
| Less than 3 months past due | **23,421** | 13,961 |
| 3 to 6 months past due | **2,471** | 2,556 |
| Over 6 months past due | **15,506** | 13,772 |
| Amounts past due but not impaired | **41,398** | 30,289 |
| | **1,164,509** | 1,235,220 |

Receivables that were neither past due nor impaired relate to a wide range of customers for whom there was no recent history of default.

Receivables that were past due but not impaired relate to a number of customers that have a good track record with the Group. Based on past experience, management believes that no impairment allowance is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable.

## 22 Pledged deposits

As at 31 December 2016, bank deposits of RMB180,180,000 (2015: RMB445,389,000) have been pledged to banks as security for the Group to issue bank acceptance bills and other banking facilities (as described in note 25). The pledge in respect of the bank deposits will be released upon the settlement of the related bills by the Group and the termination of related banking facilities.

The Group's exposure to credit and interest rate risks are disclosed in note 31.

## 23 Time deposits

As at 31 December 2016, time deposits of RMB640,000,000 (2015: RMB400,000,000) in the consolidated statement of financial position represent bank deposits that are over 3 months of maturity at acquisition.

The Group's exposure to credit and interest rate risks are disclosed in note 31.

## 24 Cash and cash equivalents

### (a) Cash and cash equivalents comprise:

As at 31 December 2015 and 2016, all of the Group's cash and cash equivalents in the consolidated statement of financial position and the consolidated cash flow statement represented cash at bank and cash on hand.

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Cash at bank and on hand | **259,546** | 323,486 |

### (b) Reconciliation of profit before taxation to cash generated from operations:

| | note | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|---|
| **Profit before taxation** | | **130,916** | 85,205 |
| Adjustments for: | | | |
| Depreciation | 8(c) | **211,877** | 190,416 |
| Amortisation of lease prepayments | 8(c) | **1,748** | 1,655 |
| Interest income | 8(a) | **(9,398)** | (8,521) |
| Interest on bank loans | 8(a) | **112,697** | 149,240 |
| Loss on disposal of property, plant and equipment | 7 | **675** | 2,541 |
| Dividends received from unlisted securities | 6 | **–** | (800) |
| Impairment loss (reversed)/provided for trade and non-trade receivables | 8(c) | **(39,308)** | 9,886 |
| Share of profits of associates | 17 | **(7,751)** | (5,857) |
| Share of losses/(profits) of joint ventures | 18 | **551** | (6,820) |
| Equity-settled share-based payment expenses | 8(b) | **2,253** | – |
| **Operating profit before changes in working capital** | | **404,260** | 416,945 |
| Change in inventories | | **(15,132)** | 62,429 |
| Change in trade and other receivables | | **354,213** | 166,662 |
| Change in trade and other payables | | **(226,796)** | 33,159 |
| Change in deferred income | | **386** | 31,625 |
| **Net cash generated from operations** | | **516,931** | 710,820 |

## 25 Interest-bearing borrowings

| | Note | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|---|
| **Current** | | | |
| Secured bank loans | (i) | **263,288** | 206,287 |
| Unsecured bank loans | (ii) | **1,753,755** | 2,117,856 |
| Current portion of non-current unsecured bank loans | (iii) | **661,869** | 256,753 |
| | | **2,678,912** | 2,580,896 |
| **Non-current** | | | |
| Secured bank loans | (i) | **60,000** | – |
| Unsecured bank loans | (iii) | **811,869** | 742,731 |
| Less: Current portion of non-current unsecured bank loans | (iii) | **(661,869)** | (256,753) |
| | | **210,000** | 485,978 |
| | | **2,888,912** | 3,066,874 |

(i) The secured bank loans were pledged against certain trade receivables, equity securities, sales contracts and deposits at interest rates ranging from 0.70% to 3.60% per annum (2015: 0.70% to 3.75%)

(ii) Current unsecured bank loans carried interest at annual rates ranging from 1.00% to 5.22% (2015: 1.20% to 6.16%), and were all repayable within one year.

(iii) Non-current unsecured bank loans carried interest at annual rates ranging from 2.34% to 5.75% (2015: 2.34% to 6.00%).

The current portion and non-current portion of the Group's non-current bank loans were repayable as follows:

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| Within 1 year | **661,869** | 256,753 |
| Over 1 year but less than 2 years | **210,000** | 485,978 |
| | **871,869** | 742,731 |

As at 31 December, the Group's banking facility with one bank is subject to the fulfilment of covenant relating to certain of the Group's balance sheet ratios, as are commonly found in lending arrangements with financial institutions. Further details of the Group's management of liquidity risk are set out in note 31. As at 31 December 2016, none of the covenants relating to drawn down facilities had been breached (2015: None).

## 25 Interest-bearing borrowings (continued)

More information about the Group's exposure to interest rate, foreign currency and liquidity risks is disclosed in note 31.

## 26 Trade and other payables

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| Trade and bills payable | **957,754** | 1,191,611 |
| Non-trade payables and accrued expenses | **187,375** | 155,724 |
| | **1,145,129** | 1,347,335 |

The Group's exposure to liquidity and currency risks related to trade and other payables is disclosed in note 31.

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

| | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|
| Within 3 months | **472,360** | 711,435 |
| 4 to 6 months | **405,858** | 376,429 |
| 7 to 12 months | **34,522** | 31,251 |
| 1 to 2 years | **16,182** | 56,614 |
| Over 2 years | **28,832** | 15,882 |
| | **957,754** | 1,191,611 |

## 27 Deferred income

Deferred income consists of conditional government grants received for completion of certain construction projects. During 2016, the Group received conditional government grants of RMB6,000,000 (2015: RMB32,787,000) to support the capital investments of the Group. As at 31 December 2016, the carrying amount of the deferred income in respect of government grants after amortisation (note 6 (i)) amounted to RMB49,716,000 (2015: RMB49,330,000) of which RMB43,876,000 (2015: RMB48,168,000) was classified as non-current deferred income.

(Expressed in Renminbi unless otherwise indicated)

## 28 Equity settled share-based transactions

The Group has a share option scheme which was adopted on 7 July 2007 whereby the directors of the Company are authorised, at their discretion, to invite employees of the Group, including directors of any company in the Group, to take up options at nil consideration to subscribe for shares of the Company. Each option gives the holder the right to subscribe for one ordinary share in the Company.

### (a) The terms and conditions of the grants are as follows:

| | Number of instruments | Vesting conditions | Contractual life of options |
|---|---|---|---|
| **Options granted to directors:** | | | |
| – on 18 August 2014 | 1,967,000 | Immediately on 19 August 2014 | 5 years and expires at the close business on 18 August 2019 |
| – on 22 July 2016 | 3,800,000 | Immediately on 1 January 2017 | 1 year and expires at close business on 31 December 2017 |
| **Options granted to employees:** | | | |
| – on 18 August 2014 | 20,180,000 | Immediately on 19 August 2014 | 5 years and expires at close business on 18 August 2019 |
| – on 22 July 2016 | 15,170,000 | Immediately on 1 January 2017 | 1 year and expires at close business on 31 December 2017 |
| Total share options granted | 41,117,000 | | |

### (b) The number and weighted average exercise prices of share options are as follows:

| | note | **2016** Weighted average exercise price | **2016** Number of options | 2015 Weighted average exercise price | 2015 Number of options |
|---|---|---|---|---|---|
| Outstanding at the beginning of the year | | **HKD1.925** | **34,284,000** | HKD1.925 | 34,284,000 |
| Granted during the year | 30(c)(ii) | **HKD0.600** | **18,970,000** | – | – |
| Forfeited during the year | | **HKD2.500** | **(9,057,000)** | – | – |
| | | **HKD1.275** | **(3,080,000)** | – | – |
| Outstanding at the end of the year | | **HKD1.236** | **41,117,000** | HKD1.925 | 34,284,000 |
| Exercisable at the end of the year | | **HKD1.780** | **22,147,000** | HKD1.925 | 34,284,000 |

## 28 Equity settled share-based transactions (continued)

### (b) The number and weighted average exercise prices of share options are as follows: (continued)

No share options were exercised during the year ended 31 December 2016.

The options outstanding and exercisable as at 31 December 2016 had an exercise price of HKD1.78 (2015: HKD1.78) and HKD0.60 (2015: Nil) respectively and a weighted average remaining contractual life of 1.90 years (2015: 2.56 years).

### (c) Fair values of share options and assumptions:

The fair values of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the share options granted is measured based on a binomial lattice model. The contractual life of the share option is used as an input into this model. Expectations of early exercise are incorporated into the binomial lattice model.

| | **Granted on 18 August 2014** | **Granted on 22 July 2016** |
|---|---|---|
| Fair value at grant date | HKD0.5914 per share option | HKD0.1383 per share option |
| Share price | HKD1.78 per share | HKD0.56 per share |
| Exercise price | HKD1.78 per share | HKD0.60 per share |
| Expected volatility | 48.17% | 59.58% |
| Option life | 5 years | 1 year |
| Expected dividend yield | 3.04% | 0.78% |
| Risk-free interest rate (based on Hong Kong Government Bond) | 1.22% | 0.40% |

The expected volatility is based on the historical volatility of the Company over the contractual life of the options as at the date of valuation. Expected dividend yield is based on historical dividend yield. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under service conditions. The conditions have not been taken into account in the grant-date fair value measurement of the services received. There were no market conditions associated with the share option grants.

## 29 Income tax in the consolidated statement of financial position

### (a) Current taxation in the consolidated statement of financial position represents:

| | **2016 RMB'000** | 2015 RMB'000 |
|---|---|---|
| At the beginning of the year | **(3,192)** | 60,240 |
| Provision for PRC income tax for the year | **24,645** | 12,956 |
| Provision for Hong Kong Profits Tax for the year | **2,270** | 1,900 |
| Hong Kong Profits Tax Paid | **(3,741)** | (3,650) |
| PRC income tax paid | **(18,422)** | (74,638) |
| At the end of the year | **1,560** | (3,192) |

## 29 Income tax in the consolidated statement of financial position (continued)

### (b) Deferred tax assets recognised

The components of the deferred tax assets recognised in the consolidated statement of financial position and the movements during the year are as follows:

| Deferred tax arising from: | Deductible tax losses RMB'000 | Unrealised profits RMB'000 | Provision for doubtful debts RMB'000 | Write-down of inventories RMB'000 | Recognition of previously unrecognised deductible temporary differences RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|
| At 1 January 2015 | 319 | 2,574 | 10,563 | 1,881 | – | 15,337 |
| Credited/(charged) to profit or loss | 3,395 | (95) | 931 | 521 | – | 4,752 |
| At 31 December 2015 | 3,714 | 2,479 | 11,494 | 2,402 | – | 20,089 |
| Credited/(charged) to profit or loss | 11,163 | 422 | (5,896) | 2,256 | 2,112 | 10,057 |
| At 31 December 2016 | 14,877 | 2,901 | 5,598 | 4,658 | 2,112 | 30,146 |

### (c) Deferred tax liabilities recognised and not recognised

The components of deferred tax liabilities recognised in the consolidated statement of financial position and the movements during the year are as follows:

| Deferred tax arising from: | Undistributed profits of subsidiaries RMB'000 | Deductible capitalised borrowing costs RMB'000 | Revaluation of available-for-sale securities RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| At 1 January 2015 | 10,580 | 29,529 | – | 40,109 |
| Charged to profit or loss | – | 4,037 | – | 4,037 |
| At 31 December 2015 | 10,580 | 33,566 | – | 44,146 |
| (Credited)/charged to profit or loss | (5,876) | 3,938 | – | (1,938) |
| Charged to reserves | – | – | 12,945 | 12,945 |
| At 31 December 2016 | 4,704 | 37,504 | 12,945 | 55,153 |

As at 31 December 2016, deferred tax liabilities of RMB4,704,000 (2015: RMB10,580,000) were recognised in respect of tax that would be payable on the distribution of the retained profits of the Group's PRC subsidiaries in the foreseeable future. Deferred tax liabilities of RMB116,446,000 (2015: RMB136,379,000) have not been recognised, as the Group controls the timing of the reversal of temporary differences associated with undistributed profits of these subsidiaries and it has been determined that it is probable that above undistributed profits earned by the Group's PRC subsidiaries will not be distributed in the foreseeable future.

## 30 Capital, reserves and dividends

### (a) Movements in components of equity

The reconciliation between the opening and closing balances of each component of the Group's consolidated equity is set out in the consolidated statement of changes in equity. Details of the changes in the Company's individual components of equity between the beginning and the end of the year are set out below:

| | note | Share capital RMB'000 note 30(c)(i) | Share premium RMB'000 note 30(d)(i) | Capital redemption reserve RMB'000 note 30(d)(i) | Capital reserve RMB'000 note 30(d)(ii) | Accumulated losses RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2015** | | 40,167 | 1,590,760 | 14,665 | 3,196 | (163,849) | 1,484,939 |
| **Changes in equity for 2015:** | | | | | | | |
| Total comprehensive income for the year | | – | – | – | – | 1,426 | 1,426 |
| Dividends approved in respect of the previous year | 30(b)(ii) | – | – | – | – | (96,402) | (96,402) |
| **Balance at 31 December 2015 and 1 January 2016** | | 40,167 | 1,590,760 | 14,665 | 3,196 | (258,825) | 1,389,963 |
| Total comprehensive income for the year | | – | – | – | – | (44,252) | (44,252) |
| Dividends approved in respect of the previous year | 30(b)(ii) | – | – | – | – | (14,912) | (14,912) |
| Issuance of share options | | – | – | – | 2,253 | – | 2,253 |
| Forfeiture of share options | | – | – | – | (3,772) | – | (3,772) |
| **Balance at 31 December 2016** | | 40,167 | 1,590,760 | 14,665 | 1,677 | (317,989) | 1,329,280 |

## 30 Capital, reserves and dividends (continued)

### (b) Dividends

#### *(i) Dividends payable to equity shareholders of the Company in respect of the year*

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Dividend proposed after the end of the reporting period of RMB0.0100 per ordinary share (2015: RMB0.0065 per ordinary share) | **22,114** | 14,525 |

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

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

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| Dividend in respect of the previous financial year, approved and paid during the year of RMB0.0065 per ordinary share (2015: RMB0.0418 per ordinary share) | **14,912** | 96,402 |

In respect of the final dividend for the year ended 31 December 2015, there is a difference of RMB387,000 (2014: RMB3,709,000) between the final dividend disclosed in the 2015 annual financial statements and amounts approved and paid during the year which is mainly due to the RMB/HKD exchange rate difference between the fixed middle average exchange rate on the date of the 2015 annual result announcement and the actual exchange rate applied on the date of payment.

### (c) Share capital

#### *(i) Issued and fully paid share capital*

*Authorised:*

| | 2016 and 2015<br>No. of Shares<br>('000) | <br>Amount<br>USD'000 |
|---|---|---|
| Ordinary shares of USD0.0025 each (2015: USD0.0025) | 4,000,000 | 10,000 |

## 30 Capital, reserves and dividends (continued)

### (c) Share capital

#### *(i) Issued and fully paid share capital*

*Ordinary shares issued and fully paid:*

| | 2016 and 2015 | | |
|---|---|---|---|
| | **No. of shares ('000)** | **Amount USD '000** | **RMB equivalent '000** |
| At 1 January and 31 December | **2,220,080** | **5,550** | **40,167** |

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regard to the Company's residual assets.

#### *(ii) Shares issued under share option scheme and share options issued*

On 18 August 2014, the Company granted an aggregate of 22,147,000 share options to employees of the Company to subscribe for ordinary shares of USD0.0025 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 19 August 2014 to 18 August 2019 at an exercise price of HKD1.78 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 was valued at approximately HKD0.5914 by an external appraiser. During the year ended 31 December 2016 and 2015, no share options were exercised.

On 22 July 2016, the Company granted an aggregate of 18,970,000 share options to employees of the Company to subscribe for ordinary shares of USD0.0025 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 January 2017 to 31 December 2017 at an exercise price of HKD0.60 per share.The amount payable on acceptance per grant is HKD1.00. Each share option was valued at approximately HKD0.1383 by an external appraiser. During the year ended 31 December 2016, no share options were exercised.

#### *(iii) Issuance of warrants*

On 7 February 2014, an aggregate of 40,000,000 warrants were issued to six parties 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 40,000,000 of the Company's ordinary shares at an initial exercise price of RMB2.07 per ordinary share (equivalent to approximately HKD2.65 at a fixed exchange rate of HKD1.2807) per share (subject to adjustment pursuant to the terms of the warrants) within 3 years from the date of issue. The consideration received of RMB629,000 net of direct expenses of RMB42,000 was credited to capital reserve.

During the year ended 31 December 2016 and 2015, no warrants were exercised.

There are 40,000,000 warrants outstanding and exercisable as at 31 December 2016 (2015: 40,000,000), which had an exercise price of HKD2.65 (2015: HKD2.65), and a weighted average remaining contractual life of 0.16 years (2015: 1.16 years).

## 30 Capital, reserves and dividends (continued)

### (d) Nature and purpose of reserves

#### *(i) Share premium and capital redemption reserve*

The share premium represents the difference between the par value of the shares of the Company and the proceeds received from the issuance of shares or the consideration paid for the repurchased shares of the Company. Under the Companies Law of the Cayman Islands, share premium account is distributable to shareholders of the Company provided that immediately following the date on which the dividend is proposed to be distributed, the Company will be in a position to repay its debts as they fall due in the ordinary course of business.

Capital redemption reserve represents the par value of shares repurchased by the Company pursuant to the section 37 of the Cayman Islands Companies Law.

#### *(ii) Capital reserve*

The capital reserve comprises the following:

— the waived payables due to TG Group in connection with the acquisition of land use rights and plant in 2007. These waivers of liabilities by TG Group were regarded as equity transactions and recorded in the capital reserve account, and

— the portion of the grant date fair value of unexercised share options granted to employees of the Group that has been recognised in accordance with the accounting policy adopted for share-based payments in note 3(m)(ii).

— the consideration received from issuance of warrants in accordance with the terms of warrant placing agreement entered into by the Company and the subscriber net of direct expenses.

#### *(iii) Merger reserve*

The merger reserve comprises the excess amount, arising from the Group's reorganisation of Group entities under common control in 2006 and 2007, of its share of the net identifiable assets acquired in these subsidiaries over the consideration paid. The reorganisation transactions were regarded as equity transactions and the excess of the share of the net identifiable assets over the consideration paid was transferred to the merger reserve in the consolidated financial statements.

#### *(iv) Exchange reserve*

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign equity-accounted investees. The reserve is dealt with in accordance with the accounting policies set out in notes 3(a), 3(b) and 3(q).

#### *(v) Fair value reserve*

The fair value reserve comprises the cumulative net change in the fair value of available-for sale securities held at the end of the reporting period and is dealt with in accordance with the accounting policies in notes 3(d) and 3(g).

## 30 Capital, reserves and dividends (continued)

### (d) Nature and purpose of reserves (continued)

#### *(vi) PRC statutory reserves*

Transfers from retained earnings to the following PRC statutory reserves were made in accordance with the relevant PRC rules and regulations and the articles of association of the Company's subsidiaries incorporated in the PRC and were approved by the respective boards of directors.

*General reserve fund*

The subsidiaries in the PRC are required to transfer at least 10% of their profit after taxation, as determined under the PRC accounting regulations, to the general reserve fund until the reserve balance reaches 50% of their respective registered capital. The transfer to this reserve must be made before any distribution of dividends to shareholders.

The general reserve fund can be used to make good losses or be converted into share capital by the issuance of new shares to shareholders in proportion to their existing equity holdings, provided that the balance after such conversion is not less than 25% of their registered capital.

*Enterprise expansion fund*

The enterprise expansion fund can be used to convert into share capital and to develop business.

### (e) Distributability of reserves

As at 31 December 2016, the aggregate amount of reserves available for distribution to equity shareholders of the Company was RMB1,272,771,000 (2015: RMB1,331,935,000). After the end of the reporting period, the directors proposed a final dividend of RMB0.0100 per ordinary share (2015: RMB0.0065), amounting to RMB22,114,000 (2015: RMB14,525,000). This dividend has not been recognised as a liability at the end of the reporting period.

### (f) Capital management

The Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The Group monitors its capital structure on the basis of an adjusted net debt-to-capital ratio. For this purpose, adjusted net debt is defined as total debt (which includes interest-bearing loans and borrowings) plus unaccrued proposed dividends, less cash and cash equivalents. Adjusted capital comprises all components of equity, less unaccrued proposed dividends.

During 2016, the Group's strategy was to maintain a stable adjusted net debt-to-capital ratio. In order to maintain or adjust the ratio, the Group may adjust the amount of dividends paid to shareholders, issue new shares, return capital to shareholders, raise new debt financing or sell assets to reduce debt.

## 30 Capital, reserves and dividends (continued)

### (f) Capital management (continued)

The group's adjusted net debt-to-capital ratio at 31 December 2016 and 2015 was as follows:

| | note | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|---|
| Current liabilities: | | | |
| Interest-bearing borrowings | 25 | **2,678,912** | 2,580,896 |
| Non-current liabilities: | | | |
| Interest-bearing borrowings | 25 | **210,000** | 485,978 |
| **Total debt** | | **2,888,912** | 3,066,874 |
| Add: Proposed dividends | 30(b) | **22,114** | 14,525 |
| Less: Cash and cash equivalents | 24 | **(259,546)** | (323,486) |
| **Adjusted net debt** | | **2,651,480** | 2,757,913 |
| Total equity | | **4,155,434** | 3,876,287 |
| Less: Proposed dividends | 30(b) | **(22,114)** | (14,525) |
| **Adjusted capital** | | **4,133,320** | 3,861,762 |
| **Adjusted net debt-to-capital ratio** | | **64%** | 71% |

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

## 31 Financial risk management and fair values

Exposure to credit, liquidity, currency and interest rate risks arises in the normal course of the Group's business. The Group's exposure to these risks and the financial risk management policies and practices used by the Group to manage these risks are described below.

### (a) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers and investment securities.

The Group's credit risk is primarily attributable to trade and other receivables. Management has a credit policy in place and the exposures to these credit risks are monitored on an ongoing basis.

The maximum exposure to credit risk without taking into account any collateral held is represented by the carrying amount of each financial asset in the consolidated statement of financial position after deducting any impairment allowance.

## 31 Financial risk management and fair values (continued)

### (a) Credit risk (continued)

#### *(i) Trade and other receivables*

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 grants credit terms of 90 to 180 days depending on the creditworthiness of individual customers. Normally, the Group does not obtain collateral from customers.

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer rather than the industry or country in which the customers operate and therefore significant concentrations of credit risk primarily arise when the Group has significant exposure to individual customers. As at 31 December 2016, 0% (2015: 0%) and 17% (2015: 13%) of the total trade and other receivables were due from the Group's largest customer and the five largest customers respectively.

The Group does not provide any guarantees which would expose the Group to credit risk.

Further quantitative disclosures in respect of the Group's exposure to credit risk arising from trade and other receivables are set out in note 21.

#### *(ii) Investments*

The Group limits its exposure to credit risk by only investing in liquid securities and/or only with counterparties that have a credit rating equal to or better than the Group. Management does not expect any counterparty to fail to meet its obligations.

#### *(iii) Deposits with banks*

Substantially all of the bank deposits are deposited with Chinese state-owned banks and local commercial banks. The management does not expect any losses arising from non-performance of these financial institutions.

### (b) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's policy is to regularly monitor its liquidity requirements and its compliance with lending covenants, to ensure that it maintains sufficient reserves of cash and readily realisable marketable securities and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

Typically the Group ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 60 days, including the servicing of financial obligations; this excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In addition, as at 31 December 2016, total banking and borrowing facilities available to the Group amounted to RMB5,680,224,000 (2015: RMB5,749,233,000) of which RMB3,301,007,000 (2015: RMB3,595,017,000) had been utilised.

## 31 Financial risk management and fair values (continued)

### (b) Liquidity risk (continued)

The following tables show the remaining contractual maturities at the end of the reporting period of the Group's non-derivative financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the end of the reporting period) and the earliest date the Group can be required to pay:

| | | 2016 Contractual undiscounted cash outflow | | | | |
|---|---|---|---|---|---|---|
| | notes | Within 1 year or on demand RMB'000 | More than 1 year but less than 2 years RMB'000 | More than 2 years but less than 3 years RMB'000 | Total RMB'000 | Carrying amount at 31 December RMB'000 |
| Interest-bearing borrowings | 25 | **2,718,510** | **217,328** | **–** | **2,935,838** | **2,888,912** |
| Trade and other payables | 26 | **1,145,129** | **–** | **–** | **1,145,129** | **1,145,129** |
| | | **3,863,639** | **217,328** | **–** | **4,080,967** | **4,034,041** |

| | | 2015 Contractual undiscounted cash outflow | | | | |
|---|---|---|---|---|---|---|
| | notes | Within 1 year or on demand RMB'000 | More than 1 year but less than 2 years RMB'000 | More than 2 years but less than 3 years RMB'000 | Total RMB'000 | Carrying amount at 31 December RMB'000 |
| Interest-bearing borrowings | 25 | 2,627,408 | 491,234 | – | 3,118,642 | 3,066,874 |
| Trade and other payables | 26 | 1,347,335 | – | – | 1,347,335 | 1,347,335 |
| | | 3,974,743 | 491,234 | – | 4,465,977 | 4,414,209 |

### (c) Currency risk

The Group is exposed to currency risk primarily through sales, purchases and borrowings which give rise to receivables, payables, borrowings and cash balances that are denominated in a foreign currency, i.e. a currency other than the functional currency of the operations to which the transactions relate. The currencies giving rise to this risk are primarily United States dollars (USD), Euros (EUR) and Hong Kong Dollars (HKD).

RMB is not freely convertible into foreign currencies. All foreign exchange transactions involving RMB must take place through the People's Bank of China or other institutions authorised to buy and sell foreign exchange. The exchange rate adopted for the foreign exchange transactions are the rates of exchange quoted by the People's Bank of China.

## 31 Financial risk management and fair values (continued)

### (c) Currency risk

#### *(i) Exposure to currency risk*

The following table details the Group's exposure at the end of the reporting period to currency risk arising from recognised assets or liabilities denominated in a currency other than the functional currency of the entity to which they relate. For presentation purposes, the amounts of the exposure are shown in RMB, translated using the spot rate at the year end date. Differences resulting from the translation of the financial statements of foreign equity-accounted investees into the Group's presentation currency are excluded.

| | **2016 Exposure to foreign currencies (expressed in RMB)** | | | 2015 Exposure to foreign currencies (expressed in RMB) | | |
|---|---|---|---|---|---|---|
| | **USD RMB'000** | **EUR RMB'000** | **HKD RMB'000** | USD RMB'000 | EUR RMB'000 | HKD RMB'000 |
| Trade and other receivables | **60,930** | **109,571** | **–** | 94,724 | 88,615 | – |
| Cash and cash equivalents | **7,620** | **16,631** | **5,919** | 7,635 | 3,533 | 9,602 |
| Trade and other payables | **(22,791)** | **(111,322)** | **–** | (12,980) | (21,611) | – |
| Interest-bearing borrowings | **(252,854)** | **(253,929)** | **–** | (405,201) | (133,188) | – |
| Net exposure arising from recognised assets and liabilities | **(207,095)** | **(239,049)** | **5,919** | (315,822) | (62,651) | 9,602 |

# 31 Financial risk management and fair values (continued)

## (c) Currency risk (continued)

### *(ii) Sensitivity analysis*

The following table indicates the instantaneous change in the Group's profit after tax (and retained profits) that would arise if foreign exchange rates to which the Group has significant exposure at the end of the reporting period had increased at that date, assuming all other risk variables remained constant.

| | **2016** | | 2015 | |
|---|---|---|---|---|
| | **Increase in foreign exchange rates** | **Increase/ (decrease) in profit after tax and retained profits RMB'000** | Increase in foreign exchange rates | Increase/ (decrease) in profit after tax and retained profits RMB'000 |
| USD | **5%** | **(9,010)** | 5% | (12,408) |
| EUR | **10%** | **(20,122)** | 10% | (1,757) |
| HKD | **5%** | **292** | 5% | 425 |

Decrease in foreign exchange rates would have had the equal but opposite effect to the amounts shown above, on the basis that all other variables remained constant.

Results of the analysis as presented in the above table represent an aggregation of the instantaneous effects on each of the Group entities' profit after tax and equity measured in the respective functional currencies, translated into RMB at the exchange rate ruling at the end of the reporting period for presentation purposes.

The sensitivity analysis assumes that the change in foreign exchange rates had been applied to re-measure those financial instruments held by the Group which expose the Group to foreign currency risk at the end of the reporting period. The analysis excludes differences that would result from the translation of the financial statements of foreign equity-accounted investees into the Group's presentation currency. The analysis is performed on the same basis as for 2015.

## (d) Interest rate risk

The Group's interest rate risk arises primarily from interest-bearing borrowings, pledged deposits and time deposits.

Pledged bank deposits are not held for speculative purposes but are placed to satisfy conditions for the Group to issue bank acceptance bills and other banking facilities.

Interest-bearing borrowings issued at variable rates and at fixed rates expose the Group to cash flow interest rate risk and fair value interest rate risk respectively. The interest rates and terms of repayment of the interest-bearing borrowings of the Group are disclosed in note 25.

## 31 Financial risk management and fair values (continued)

### (d) Interest rate risk

#### *(i) Interest rate profile*

The following table details the interest rate profile of the Group's interest-bearing financial instruments at the end of the reporting period:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Effective interest rate % | RMB'000 | Effective interest rate % | RMB'000 |
| **Fixed rate instruments** | | | | |
| Interest-bearing borrowings | 0.70%–5.50% | (1,271,738) | 0.70%–6.16% | (1,328,637) |
| Pledged deposits | 1.15%–1.75% | 180,180 | 1.15%–3.30% | 445,389 |
| Time deposits | 1.35%–1.75% | 640,000 | 1.55%–2.17% | 400,000 |
| | | (451,558) | | (483,248) |
| **Variable rate instruments** | | | | |
| Interest-bearing borrowings | 1.00%–5.75% | (1,617,174) | 1.20%–6.00% | (1,738,237) |

#### *(ii) Sensitivity analysis*

At 31 December 2016, it is estimated that a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, would have decreased/increased the Group's profit after tax and retained profits by approximately RMB14,113,619 (2015: RMB13,279,880).

The sensitivity analysis above indicates the instantaneous change in the Group's profit after tax (and retained profits) that would arise assuming that the change in interest rates had occurred at the end of the reporting period and had been applied to re-measure those financial instruments held by the Group which expose the Group to fair value interest rate risk at the end of the reporting period. In respect of the exposure to cash flow interest rate risk arising from floating rate non-derivative instruments held by the Group at the end of the reporting period, the impact on the Group's profit after tax (and retained profits) is estimated as an annualised impact on interest expense or income of such a change in interest rates. The analysis is performed on the same basis for 2015.

## 31 Financial risk management and fair values (continued)

### (e) Fair values measurement

#### *(i) Financial assets measured at fair value*

The following table presents the fair value of the Group's financial instruments measured at the end of the reporting period on a recurring basis, categorised into the three-level fair value hierarchy as defined in IFRS 13, *Fair value measurement*. The level into which a fair value measurement is classified is determined with reference to the observability and significance of the inputs used in the valuation technique as follows:

- Level 1 valuations: Fair value measured using only Level 1 inputs i.e. unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date

- Level 2 valuations: Fair value measured using Level 2 inputs i.e. observable inputs which fail to meet Level 1, and not using significant unobservable inputs. Unobservable inputs are inputs for which market data are not available.

- Level 3 valuations: Fair value measured using significant unobservable inputs.

Available-for-sale equity securities (listed) as mentioned in note 19 is measured at fair value determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. As all significant inputs are observable, the instrument is included in Level 2.

#### *(ii) Financial assets and liabilities carried at other than fair value*

Except for available-for-sale equity securities (listed) mentioned in note 31(e)(i), all financial instruments measured at other than fair value are carried at cost or amortised cost that are not materially different from their fair values as at 31 December 2016 and 2015 due to either the short maturities of these financial instruments or variable market interest rates for long-term bank borrowings.

## 32 Commitments

### (a) Capital commitments outstanding as at 31 December 2016 not provided for in the consolidated financial statements were as follows:

| | **2016**<br>**RMB'000** | 2015<br>RMB'000 |
|---|---|---|
| Contracted for | **56,921** | 45,449 |
| Authorised but not contracted for | **152,277** | 422,496 |
| | **209,198** | 467,945 |

### (b) As at 31 December 2016, the total future minimum lease payments under non-cancellable operating leases were payable as follows:

| | **2016**<br>**RMB'000** | 2015<br>RMB'000 |
|---|---|---|
| Within 1 year | **1,468** | 2,198 |

## 32 Commitments (continued)

### (b) As at 31 December 2016, the total future minimum lease payments under non-cancellable operating leases were payable as follows: (continued)

The Group leases certain properties located in the PRC and Hong Kong as the Group's offices under operating leases. The leases run for initial periods of 1–3 years.

### (c) Investment commitments

As at 31 December 2016, the Group had an outstanding commitment of RMB5,000,000 and MXN150,000 (equivalent to RMB5,023) in respect of its investment in a newly established associate as mentioned in note 17 and a newly established foreign entity as mentioned in note 19, respectively, which is not provided for in the consolidated financial statements.

## 33 Material related party transactions

### (a) Key management personnel remuneration

Key management personnel remuneration represents amounts paid to the Company's directors as disclosed in note 10 and the highest paid employees as disclosed in note 11.

### (b) Transactions with related companies

The Group has transactions with a company controlled by the controlling shareholder ("controlling shareholder's company"), immediate parent, associates and joint ventures. The following is a summary of principal related party transactions carried out by the Group with these related parties for the years presented.

#### *(i) Significant related party transactions*

| | **2016 RMB'000** | 2015 RMB'000 |
|---|---|---|
| **Sale of goods to:** | | |
| Joint ventures | **249,584** | 249,802 |
| Associates | **60,997** | 26,845 |
| | **310,581** | 276,647 |
| **Freight expense to:** | | |
| Associates | **2,250** | 11,984 |
| **Lease expense to:** | | |
| Controlling shareholder's company | **1,000** | 1,000 |
| **Lease income from:** | | |
| Associates | **–** | 50 |

The directors of the Company are of the opinion that the above transactions with related parties were conducted in the ordinary course of business and on normal commercial terms or in accordance with the terms of the agreements governing such transactions.

## 33 Material related party transactions (continued)

### (b) Transactions with related companies (continued)

#### *(ii) Significant related party balances*

| | 2016<br>RMB'000 | 2015<br>RMB'000 |
|---|---|---|
| **Trade and other receivables due from** | | |
| Joint ventures | **178,977** | 151,775 |
| Associates | **19,049** | 8,012 |
| | **198,026** | 159,787 |
| **Trade and other payables due to** | | |
| Associates | **11,015** | 5,033 |
| Controlling shareholder's company | **–** | 500 |
| | **11,015** | 5,533 |

### (c) Applicability of the Listing Rules relating to connected transactions

The related party transactions in respect of lease expenses paid to the controlling shareholder's company mentioned in note 33(b) above constitute connected transactions or continuing connected transactions as defined in Chapter 14A of the Listing Rules. However they are exempt from the disclosure requirements in Chapter 14A of the Listing Rules. Apart from these transactions, none of the other related party transactions mentioned in note 33 fall under the definition of a connected transaction or continuing connected transactions as defined in Chapter 14A of the Listing Rules.

## 34 Company-level statement of financial position

| | note | 2016 RMB'000 | 2015 RMB'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | | **11** | 11 |
| Investments in subsidiaries | | **1,324,580** | 1,472,994 |
| Interest in associates | | **30,376** | 24,121 |
| | | **1,354,967** | 1,497,126 |
| **Current assets** | | | |
| Cash and cash equivalents | | **5,640** | 8,034 |
| | | **5,640** | 8,034 |
| **Current liabilities** | | | |
| Interest-bearing borrowings | | **31,216** | 83,612 |
| Trade and other payables | | **111** | 2,108 |
| | | **31,327** | 85,720 |
| **Net current liabilities** | | **(25,687)** | (77,686) |
| **Total assets less current liabilities** | | **1,329,280** | 1,419,440 |
| **Non-current liabilities** | | | |
| Interest-bearing borrowings | | **–** | 29,477 |
| | | **–** | 29,477 |
| **Net assets** | | **1,329,280** | 1,389,963 |
| **Capital and reserves** | | | |
| Share capital | 30(a)/(c) | **40,167** | 40,167 |
| Reserves | 30(a) | **1,289,113** | 1,349,796 |
| **Total equity** | | **1,329,280** | 1,389,963 |

Approved and authorised for issue by the board of directors on 28 March 2017.

**Zhu Xiaokun** *Director*

**Yan Ronghua** *Director*

## 35 Accounting estimates and judgements

Note 15, 28(c) and 31(e) contain information about the assumptions and their risk factors relating to goodwill impairment, fair value of share options granted and financial instruments. Other judgements made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment are as follows:

### (a) Impairment losses on trade and other receivables

Impairment losses for trade and other receivables are assessed and provided based on the directors' regular review of the ageing analysis and past collection history of each individual customer. A considerable level of judgement is exercised by the directors when assessing the creditworthiness and collectability of each receivable. Any increase or decrease in the provision for bad and doubtful debts would affect the consolidated statement of profit or loss in future years.

### (b) Depreciation

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives, after taking into account the estimated residual value. The Group reviews annually the useful life of an asset and its residual value, if any. The depreciation expense for future periods is adjusted if there are significant changes from previous estimates.

### (c) Net realisable value of inventories

Net realisable value of inventories is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses. These estimates are based on current market conditions and historical experience of distributing and selling products of a similar nature. They could change significantly as a result of competitor actions in response to severe industry cycles or other changes in market conditions. Management reassess the estimations at each end of the reporting period.

### (d) Income taxes

Determining income tax provisions involves judgement regarding the future tax treatment of certain transactions. The Group carefully evaluates the tax implications of transactions and tax provisions are set up accordingly. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislation. Deferred tax assets are recognised for temporary deductible differences. As those deferred tax assets can only be recognised to the extent that it is probable that future taxable profit will be available against which the unused tax credits can be utilised, management's judgement is required to assess the probability of future taxable profits. Management's assessment is constantly reviewed and additional deferred tax assets are recognised if it becomes probable that future taxable profits will allow the deferred tax asset to be recovered.

## 36 Immediate and ultimate controlling party

At 31 December 2016, the directors consider the immediate parent and ultimate controlling party of the Group to be Tiangong Holdings Company Limited, which is incorporated in British Virgin Islands. This entity does not produce financial statements available for public use.

(Expressed in Renminbi unless otherwise indicated)

## 37 Non-adjusting events after the reporting period

On 9 March 2017, CTCL(HK) established a wholly owned subsidiary, Jiangsu Tiangong Investment Management Company Limited ("TG Investment"), which is engaged in investment management and management consulting. Up to the date of this report, CTCL(HK) has not contributed any capital into TG Investment.

After 31 December 2016, the directors proposed a final dividend of RMB0.0100 per ordinary share on 28 March 2017. Further details are disclosed in note 30(b).

## 38 Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 December 2016

Up to the date of issue of these financial statements, the IASB has issued a few amendments and new standards which are not yet effective for the year ended 31 December 2016 and which have not been adopted in these financial statements. These include the following which may be relevant to the Group.

| | **Effective for accounting periods beginning on or after** |
|---|---|
| Amendments to IAS 7, *Statement of cash flows: Disclosure initiative* | 1 January 2017 |
| Amendments to IAS 12, *Income taxes – Recognition of deferred tax assets for unrealised losses* | 1 January 2017 |
| IFRS 15, *Revenue from contracts with customers* | 1 January 2018 |
| IFRS 9, *Financial instruments* | 1 January 2018 |
| Amendments to IFRS 2, *Share-based payment: Classification and measurement of share-based payment transactions* | 1 January 2018 |
| IFRS 16, *Leases* | 1 January 2019 |

The Group is in the process of making an assessment of what the impact of these amendments and new standards is expected to be in the period of initial application. So far the Group has identified some aspects of the new standards which may have a significant impact on the consolidated financial statements. Further details of the expected impacts are discussed below. As the Group has not completed its assessment, further impacts may be identified in due course and will be taken into consideration when determining whether to adopt any of these new requirements before their effective date and which transitional approach to take, where there are alternative approaches allowed under the new standards.

### IFRS 9, Financial instruments

IFRS 9 will replace the current standard on accounting for financial instruments,IAS 39, Financial instruments: Recognition and measurement. IFRS 9 introduces new requirements for classification and measurement of financial assets, calculation of impairment of financial assets and hedge accounting. On the other hand, IFRS 9 incorporates without substantive changes the requirements of IAS 39 for recognition and derecognition of financial instruments and the classification of financial liabilities. Expected impacts of the new requirements on the Group's financial statements are as follows:

## 38 Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 December 2016 (continued)

**IFRS 9, Financial instruments (continued)**

***(a) Classification and measurement***

IFRS 9 contains three principal classification categories for financial assets: measured at (1) amortised cost, (2) fair value through profit or loss ("FVTPL") and (3) fair value through other comprehensive income ("FVTOCI") as follows:

- The classification of debt instruments is determined based on the entity's business model for managing the financial assets and the contractual cash flow characteristics of the asset. If a debt instrument is classified as FVTOCI then effective interest, impairments and gains/losses on disposal will be recognised in profit or loss.

- For equity securities, the classification is FVTPL regardless of the entity's business model. The only exception is if the equity security is not held for trading and the entity irrevocably elects to designate that security as FVTOCI. If an equity security is designated as FVTOCI, then only dividend income from that security will be recognised in profit or loss. Gains, losses and impairments on that security will be recognised in other comprehensive income without recycling.

Based on the preliminary assessment, the Group expects that its financial assets currently measured at amortised cost and FVTOCI will continue with their respective classification and measurements upon the adoption of IFRS 9.

With respect to the Group's financial assets currently classified as "available-for-sale", these are investments in equity securities which the Group may classify as either FVTPL or irrevocably elect to designate as FVTOCI (without recycling) on transition to IFRS 9. The Group has not yet decided whether it will irrevocably designate these investments as FVTOCI or classify them as FVTPL. Either classification would give rise to a change in accounting policy as the current accounting policy for available-for-sale equity investments is to recognise fair value changes in other comprehensive income until disposal or impairment, when gains or losses are recycled to profit or loss in accordance with the Group's policies set out in notes 3(d) and 3(g). This change in policy will have no impact on the Group's net assets and total comprehensive income but will impact on reported performance amounts such as profit and earnings per share.

The classification and measurement requirements for financial liabilities under IFRS 9 are largely unchanged from IAS 39, except that IFRS 9 requires the fair value change of a financial liability designated at FVTPL that is attributable to changes of that financial liability's own credit risk to be recognised in other comprehensive income (without reclassification to profit or loss). The Group currently does not have any financial liabilities designated at FVTPL and therefore this new requirement may not have any impact on the Group on adoption of IFRS 9.

***(b) Impairment***

The new impairment model in IFRS 9 replaces the "incurred loss" model in IAS 39 with an "expected credit loss" model. Under the expected credit loss model, it will no longer be necessary for a loss event to occur before an impairment loss is recognised. Instead, an entity is required to recognise and measure expected credit losses as either 12-month expected credit losses or lifetime expected credit losses, depending on the asset and the facts and circumstances. This new impairment model may result in an earlier recognition of credit losses on the Group's trade receivables and other financial assets. However, a more detailed analysis is required to determine the extent of the impact.

# Financial Information Summary

| | Year ended 31 December | | | | |
|---|---|---|---|---|---|
| | **2016** | 2015 | 2014 | 2013 | 2012 |
| | **RMB'000** | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| **Revenue** | **3,376,134** | 3,429,397 | 4,535,670 | 3,396,670 | 3,118,251 |
| Profit before taxation | **130,916** | 85,205 | 544,168 | 608,719 | 536,900 |
| Income tax | **(14,920)** | (13,074) | (81,421) | (138,617) | (92,008) |
| Profit for the year | **115,996** | 72,131 | 462,747 | 470,102 | 444,892 |
| Other comprehensive (loss)/ income for the year | **45,713** | (27,787) | (1,404) | (2,030) | 677 |
| **Attributable to:** | | | | | |
| Equity shareholders of the Company | **156,284** | 44,836 | 462,062 | 467,697 | 445,569 |
| Non-controlling interests | **5,425** | (492) | (719) | 375 | — |
| Earnings per share (RMB) | | | | | |
| Basic (RMB) | **0.050** | 0.033 | 0.230 | 0.242 | 0.244 |

| | As at 31 December | | | | |
|---|---|---|---|---|---|
| | **2016** | 2015 | 2014 | 2013 | 2012 |
| | **RMB'000** | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| **Assets** | | | | | |
| Non-current assets | **3,737,020** | 3,432,974 | 3,168,657 | 2,635,765 | 2,309,276 |
| Current assets | **4,558,884** | 4,950,998 | 5,196,180 | 4,524,539 | 3,791,579 |
| Total assets | **8,295,904** | 8,383,972 | 8,364,837 | 7,160,304 | 6,100,855 |
| **Liabilities** | | | | | |
| Non-current liabilities | **309,029** | 578,292 | 689,801 | 405,589 | 235,225 |
| Current liabilities | **3,831,441** | 3,929,393 | 3,745,215 | 3,576,244 | 3,078,347 |
| Total liabilities | **4,140,470** | 4,507,685 | 4,435,016 | 3,981,833 | 3,313,572 |
| **Equity** | | | | | |
| Total equity | **4,155,434** | 3,876,287 | 3,929,821 | 3,178,471 | 2,787,283 |

Note:

The results of the Group for the four financial years ended 31 December 2012, 2013, 2014 and 2015 and its assets and liabilities were extracted from previous annual reports, which also set forth the details of the basis of presentation of the combined accounts.

# Corporate Information

## Registered Name
Tiangong International Company Limited

## Chinese Name
天工國際有限公司

## Stock Code
Hong Kong Stock Exchange: 826

## Board of Directors
### Executive Directors
Mr. Zhu Xiaokun *(Chairman)*
Mr. Wu Suojun *(Chief Executive Officer)*
Mr. Yan Ronghua
Mr. Jiang Guangqing

### Independent Non-executive Directors
Mr. Gao Xiang
Mr. Lee Cheuk Yin, Dannis
Mr. Wang Xuesong

## Company Secretary
Mr. Lee Johnly

## Authorized Representatives
Mr. Lee Cheuk Yin, Dannis
Mr. Lee Johnly

## Audit Committee
Mr. Lee Cheuk Yin, Dannis *(Chairman)*
Mr. Gao Xiang
Mr. Wang Xuesong

## Remuneration Committee
Mr. Wang Xuesong *(Chairman)*
Mr. Zhu Xiaokun
Mr. Gao Xiang
Mr. Lee Cheuk Yin, Dannis

## Nomination Committee
Mr. Gao Xiang *(Chairman)*
Mr. Zhu Xiaokun
Mr. Wang Xuesong
Mr. Lee Cheuk Yin, Dannis

## Registered Office in the Cayman Islands
P.O. Box 309
G.T. Ugland House
South Church Street, George Town
Grand Cayman, Cayman Islands

## Registered Office in Hong Kong
Unit 1303
13/F Jubilee Centre
18 Fenwick Street
Wanchai
Hong Kong

## Principal Place of Business
Danbei Town
Danyang City
Jiangsu Province
The PRC

## Auditors
KPMG
*Certified Public Accountants*
8th Floor
Prince's Building
10 Chater Road
Central
Hong Kong

## Hong Kong Legal Adviser
Reed Smith Richards Butler
20th Floor, Alexandra House
18 Chater Road
Central Hong Kong

## Principal Share Registrar and Transfer Office
Royal Bank of Canada Trust Company (Cayman) Limited
4th Floor, Royal Bank House
24 Shedden Road, George Town
Grand Cayman KY1-1110, Cayman Islands

## Hong Kong Branch Share Registrar and Transfer Office in Hong Kong
Computershare Hong Kong Investor Services Limited
Shops 1712–1716, 17th Floor
Hopewell Center
183 Queen's Road East
Wanchai
Hong Kong

## Principal Bankers
China Construction Bank Corporation
Industrial and Commercial Bank of China Limited
Bank of China Limited
Agricultural Bank of China Limited