宏华集团有限公司
HONGHUA GROUP LIMITED

(incorporated in the Cayman Islands with limited liability)

Stock Code: 196

Annual Report 2018

CONTENTS

CORPORATE INFORMATION

BOARD OF DIRECTORS

EXECUTIVE DIRECTORS

Chen Yajun *(Chairman, resigned with effect from 24 August 2018)*
Jin Liliang *(Chairman, appointed with effect from 24 August 2018)*
Zhang Mi *(Vice Chairman)*
Ren Jie

NON-EXECUTIVE DIRECTORS

Han Guangrong
Chen Wenle

INDEPENDENT NON-EXECUTIVE DIRECTORS

Liu Xiaofeng
Qi Daqing *(Resigned with effect from 1 January 2018)*
Chen Guoming
Su Mei
Poon Chiu Kwok
Chang Qing
Wu Yuwu *(Appointed with effect from 1 January 2018)*

SECRETARY OF BOARD OF DIRECTORS

He Bin *(Resigned with effect from 30 August 2018)*
Zhuang Wenmin *(Appointed with effect from 30 August 2018)*

BOARD COMMITTEES

AUDIT COMMITTEE

Wu Yuwu *(Committee Chairman, appointed with effect from 1 January 2018)*
Qi Daqing *(Committee Chairman, resigned with effect from 1 January 2018)*
Liu Xiaofeng
Chen Guoming
Su Mei
Poon Chiu Kwok
Chang Qing

REMUNERATION COMMITTEE

Liu Xiaofeng *(Committee Chairman)*
Zhang Mi
Qi Daqing *(Resigned with effect from 1 January 2018)*
Chen Yajun *(Resigned with effect from 24 August 2018)*
Jin Liliang *(Appointed with effect from 24 August 2018)*
Su Mei
Wu Yuwu *(Appointed with effect from 1 January 2018)*

STRATEGIC INVESTMENT AND RISK CONTROL COMMITTEE

Chen Yajun *(Committee Chairman, resigned with effect from 24 August 2018)*
Jin Liliang *(Committee Chairman, appointed with effect from 24 August 2018)*
Zhang Mi
Ren Jie
Liu Xiaofeng
Poon Chiu Kwok
Chang Qing

JOINT COMPANY SECRETARIES

He Bin *(Resigned with effect from 30 August 2018)*
Zhuang Wenmin *(Appointed with effect from 30 August 2018)*
Lee Mei Yi

LEGAL ADVISOR

AS TO HONG KONG LAW

Herbert Smith Freehills *(Appointed with effect from 1 June 2018)*

PRINCIPAL BANKERS

Bank of China Limited
Industrial and Commercial Bank of China Limited
Industrial Bank Co., Ltd.
China CITIC Bank Co., Ltd.
Ping An Bank Co., Ltd.
Heng Feng Bank Co., Ltd.
China Merchants Bank Co., Ltd.
The Export-Import Bank of China
China Development Bank
Industrial and Commercial Bank of China (Asia) Limited
China CITIC Bank International
China Development Fund Co., Ltd.

AUDITOR

PricewaterhouseCoopers
Certified Public Accountants
22nd Floor, Prince's Building
Central
Hong Kong

REGISTERED OFFICE

Clifton House, 75 Fort Street
PO Box 1350
Grand Cayman, KY1-1108
Cayman Islands

HEAD OFFICE

99 East Road, Information Park
Jinniu District
Chengdu, Sichuan, PRC
Post code: 610036

PLACE OF BUSINESS IN HONG KONG

Room 2508, Harcourt House
39 Gloucester Road
Wan Chai
Hong Kong

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Estera Trust (Cayman) Limited
Clifton House, 75 Fort Street
PO Box 1350
Grand Cayman, KY1-1108
Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
Shops 1712–1716
17th Floor Hopewell Centre
183 Queen's Road East
Wan Chai
Hong Kong

STOCK CODE

The Stock Exchange of Hong Kong Limited: 0196

WEBSITE

http://www.hh-gltd.com

FINANCIAL HIGHLIGHTS

	2018 RMB'000	2017 RMB'000	Changes
Operating results			
Revenue from continuing operations	**4,205,162**	2,175,856	93.3%
Operating profit/(loss) from continuing operations	**339,431**	(103,374)	428.4%
Profit/(Loss) before income tax from continuing operations	**143,582**	(346,545)	141.4%
Profit/(loss) attributable to owners of the company	**82,287**	(1,239,368)	106.6%
Profit/(loss) per share from continuing and discontinued operations attributable to owners of the Company (expressed in RMB cents per share)			
Basic profit/(loss) per share	**1.55**	(26.50)	105.8%
Diluted profit/(loss) per share	**1.55**	(26.50)	105.8%
Financial position			
Total non-current assets	**4,772,175**	2,334,095	104.5%
Total current assets	**5,544,922**	7,732,449	–28.3%
Total assets	**10,317,097**	10,066,544	2.5%
Total current liabilities	**5,374,100**	3,938,579	36.4%
Total non-current liabilities	**624,086**	1,950,315	–68.0%
Total liabilities	**5,998,186**	5,888,894	1.9%
Total equity	**4,318,911**	4,177,650	3.4%
Key financial ratios*			
Gross Margin from continuing operations	**25.7%**	29.2%	–11.8%
Net Margin from continuing operations	**2.0%**	–57.0%	103.4%
Return on average assets	**0.8%**	–11.6%	106.9%
return on average equity	**2.0%**	–31.3%	106.5%
Current ratio	**1.03**	1.96	–93.1%
Quick ratio	**0.74**	1.50	–76.2%
Total debt/Total assets	**30.2%**	32.9%	–8.2%
Total liabilities/Total assets	**58.1%**	58.5%	–0.6%

CHAIRMAN'S STATEMENT

CHAIRMAN'S STATEMENT

DEAR SHAREHOLDERS AND FRIENDS,

Firstly, on behalf of the Board of Directors of Honghua Group Limited, I would like to express my sincere gratitude to all shareholders and friends for their attention and support.

In 2018, affected by increasing supply and weakening demand, international oil prices waxed and waned. Domestically, the government consistently implemented energy reform policies and intensified efforts in natural gas exploration and development, causing domestic shale gas production and demand to increase significantly. Faced with such a macro-environment, Honghua, as a global leader in the oil and gas equipment manufacturing industry, benefited from the increase in upstream capital expenditure. In addition, on the back of the synergies brought by our major shareholder, China Aerospace Science and Industry Corporation Limited ("CASIC"), Honghua expanded to the domestic central enterprise gas and oil market successfully and lowered financing cost. In 2018, we completed the disposal of our offshore business, enabling us to better focus on our principal business. We have consistently adhered to the challenging internal core positioning in four major aspects set by CASIC, aligning ourselves to developing trends and preparing for rejuvenation.

Due to the continuous increase in natural gas demand in China and the recovery of the global economy, we have reasons to believe that all these elements will bring new opportunities for Honghua in its business and other areas. In 2019, Honghua will aim at becoming a global leader in equipment and technology for oil and gas exploration and development, and an integrated supplier offering a full range of energy services and solutions with comprehensive competitive strengths. It will seize development opportunities arising from transformation and upgrade, focus on three major strategic transformation tasks including "industry structure adjustment", "development model transformation "and "operation quality enhancement", maintain excellent performance momentum, insist on innovation, research and development, and achieve stable improvement in core technology capability, market share and profitability.

Lastly, we would like to extend our sincere gratitude to shareholders and friends for their long-term support. We are also grateful to the directors, the management team and all the staff of Honghua for their commitment. Your perseverance will see Honghua pursuing a new stage in its development.

Chairman
Jin Liliang

28 March 2019

MANAGEMENT DISCUSSION AND ANALYSIS

MANAGEMENT DISCUSSION AND ANALYSIS

In 2018, the Group's revenue from continuing operations amounted to approximately RMB4,205 million, representing an increase of 93.2% from RMB2,176 million for Last Year. Gross profit from continuing operations was approximately RMB1,082 million, representing an increase of 70.4% from RMB635 million for Last Year. The profit attributable to equity shareholders was approximately RMB82 million.

MARKET REVIEW

In 2018, crude oil prices fell sharply in the fourth quarter after edging up in the preceding three quarters. At the end of 2017, the Organization of the Petroleum Exporting Countries ("OPEC") signed an agreement with Russia to cut oil production, while OPEC countries including Saudi Arabia maintained high compliance rates in oil cuts. With rising oil prices due to geopolitical conflicts, the United States announced in May 2018 that it would resume sanctions against Iran, further pushing up oil prices. Then, Venezuela's economy continued to deteriorate, dragging down crude oil production. Oil prices have entered a downward trend since October 2018. On the supply side, the United States has not cut off all Iranian crude oil exports. As oil prices rose, OPEC crude oil production returned to pre-production cut levels. Meanwhile, on the demand side, the major crude oil importing countries were experiencing economic slowdown amid the weak global outlook, slowing the growth of oil demand across the globe. From the financial perspective, the ongoing U.S. rate hikes led to a decline in market risk appetite, and crude oil as a risky asset was under pressure to some extent. In 2018, the United States overtook Russia as the world's largest energy producer and had greater sway over the international oil market. Meanwhile, U.S. shale oil and gas production increased significantly. According to the U.S. Energy Information Administration ("EIA"), U.S. shale oil production has exceeded WTI production since 2014. Since then, the gap between the two has been widening.

Domestically, as oil prices rebounded and dependence on imported oil and gas increased, domestic oil companies stepped up efforts in exploration and development of conventional and unconventional oil and gas to enhance national energy security and reduce dependence on oil and gas imports as far as possible. In addition, policies were issued to encourage the development of domestic shale gas. In March 2018, the Ministry of Finance and the State Administration of Taxation issued the Notice on Reducing Resource Tax on Shale Gas to cut resource tax on shale gas by 30% (based on the prescribed rate of 60%) from 1 April 2018 to 31 March 2021. In August 2018, the State Council issued the Several Opinions on Promoting the Coordinated and Stable Development of Natural Gas, proposing to intensify domestic exploration and development efforts and calling for oil and gas companies to invest more in domestic exploration and development, so as to achieve a natural gas output of more than 200 billion m3 in China by the end of 2020. According to the requirements set forth in this document, China's natural gas production is planned to grow at a compound annual growth rate of 49% from 2018 to 2020. Under such market dynamics, domestic demand for shale gas and natural gas exploration equipment will see a substantial growth.

In 2018, China Aerospace Science and Industry Corporation ("CASIC"), the largest shareholder of the Group, began to bring synergy to Honghua. As a mega state-owned high-tech central enterprise, CASIC has helped Honghua secure more orders and achieve business synergy and business model innovations, including building up the innovative "lease-driven" sales channel, developing new business growth drivers, and returning to the domestic oil and gas market dominated by central enterprises. In 2018, Honghua co-founded an energy industry technology centre with the Second, Third, Fourth, Tenth Research Institutes of CASIC and Aerosun Corporation; cooperated with Sichuan Aerospace Cloud Technology Co. Ltd., a subsidiary of CASIC, to build a cloud monitoring platform; and worked with the Sichuan branch of Aerospace Science & Industry Inertial Technology Co., Ltd. to develop an intelligent MWD system. According to its strategic development and positioning in the energy equipment industry, CASIC has positioned Honghua as "the main platform for energy equipment development", "one of its key equipment manufacturers", "one of its major affiliates for international operations" and "an overseas investment and financing platform". Based on this strategic positioning in four core areas, Honghua will strive to become a global leader in equipment and technology for oil and gas exploration and development, and an integrated supplier offering a full range of energy services and solutions with comprehensive competitive strengths during the 13th Five-Year Plan period.

BUSINESS REVIEW

1. LAND DRILLING RIGS AND RELATED PRODUCT BUSINESS SEGMENT

In 2018, oil and gas industry recovered significantly. Combining market synergies after CASIC's becoming a shareholder, Honghua's new orders for land equipment increased dramatically and sales achieved a significant rise. Global oil and gas drilling activities' activation rate also increased slightly in 2018. According to statistics from Baker Hughes Inc., an American oil field technology service company, as at December 2018, there were 2,244 active drilling rigs (excluding China's land drilling rigs and Russia's drilling rigs) globally, representing a year-on-year increase of 7.42% compared with the figure for 2017, and providing a positive environment for Honghua's business development.

In terms of the sales of land drilling rigs, during the period, we sold a total of 24 land drilling rigs with sales revenue of USD351.65 million, and signed 34 new orders of land drilling rigs with total value of approximately USD453.09 million, the number of new orders increased significantly over that of last year. With the existing influence in the Middle East region and relatively short delivery period, in 2018, we successfully sold land drilling rigs to multiple customers including KDC in the region, earned trust from many long-term customers and continued to expand market share in this region during the period. In the European region, we maintained close partnership with Ukraine's UGV, providing them with advanced technology products and quick and timely services. In addition, Honghua also signed land drilling rigs orders with customers in Russian-speaking and other regions.

In terms of parts and components sales, the sales amount of parts and components during the period amounted to USD235.59 million, of which sales amount of mud pumps was USD10.57 million, sales amount of top drives was USD18.94 million, sales amount of electric fracturing pumps was USD108.15 million. As at 31 December 2018, sales of Honghua mud pumps, top drives, 6000HP electric fracturing pumps and flexible water tanks increased significantly compared with the figures for 2017, of which sales of flexible water tanks increased by nearly 1600% compared with the figure for 2017. During the period, we also made progress in components sales in new markets such as Romania, Italy and Turkmenistan.

The Honghua 6000HP electric fracturing pump adopts world-first middle voltage variable frequency drive technology, featuring large power, large displacement, precise control, fast response, a wide range of speed adjustment, stable operation, high efficiency and safety, convenient operation, cost saving, transportation module saving and floor area saving, and is the most powerful electric fracturing pump in the world. In the North American region, in 2017, Honghua America entered into a fracturing pump testing agreement with TOPS and passed the testing. Honghua is well praised by customers for its quality products, excellent technology support and after-sales service. In 2018, we sold electric fracturing pumps to TOPS via financing lease, achieving a breakthrough in lease and sale of electric fracturing pumps and entering the North American market of electric fracturing pumps successfully.

In 2018, we intensified efforts to promote business models such as “sale by lease”, “financing lease” and “operational lease”, etc. for targeted customers and new products. These new-style business models, specifically designed by Honghua, lower customers’ purchase threshold and improve our market competitive strengths. With the recovery of the oil and gas industry, customers’ demand to purchase drilling equipment is on the rise, and purchase conversion rate is high, which is beneficial for developing markets to boost sales. Through the business model of lease, we have successfully strengthened our partnerships with old customers from Asia and Europe and gained access to North America’s electric fracturing pumps market. Meanwhile, we are still actively exploring business model innovation like barter trade through PDVSA projects to coordinate sales between member units of CASIC, creating new areas of business growth.

2. OIL AND GAS ENGINEERING SERVICE BUSINESS SEGMENT

In 2018, oil price rose and all major oil companies increased capital expenditure. As at 31 December 2018, we had 9 drilling engineering teams achieving approximately 70,330m in footage, and oil and gas service orders of approximately USD86.89 million in total. Since CASIC’s becoming a shareholder of Honghua, Honghua and CASIC gave full play to synergies in the aspect of oilfield service, jointly developing domestic and international markets and achieving significant breakthroughs.

In 2018, Honghua aligned itself to the trend of industry development, focusing on shale gas business. For the past year, Honghua was implementing multiple integrated platform service projects of shale gas in Sichuan area, achieving symbolic breakthroughs in oil and gas engineering service from drilling and fracturing only to EPC service for Honghua’s shale gas service. In the future, customers will continue to invest in these exemplary districts to accelerate their planned deployment of shale gas production capacity and facilities. On the back of this, Honghua’s oil and gas engineering service business is expected to achieve rapid expansion in China’s shale gas and oil and gas market. In addition to Sichuan area, Honghua also signed shale gas development projects in Guizhou. This is the first time that Honghua enters the Guizhou shale gas market, a move that is of great market strategic significance.

In order to make greater contribution to the Made in China 2025 initiative, we strengthened our cooperation with research institutions on project research in 2018, the Earth Crust No.1 10,000m drilling rig jointly developed with Jilin University successfully completed the state-level drilling task under the Songke 2 scientific research project.

Since the second half of 2018, Honghua oil and gas engineering business complied with the development strategy and operation plan of "contracting domestically and expanding globally", increasing the proportion of the overseas market in Honghua's total revenue gradually. During the period, Honghua also achieved tremendous success in improving efficiency, controlling cost and collecting payment. Aligning itself with future development strategies, Honghua strives to become a comprehensive service company that balances domestic and overseas development and combines well-drilling service with technology service.

3. OFFSHORE DRILLING RIGS AND RELATED BUSINESS SEGMENT

In 2018, Honghua completed the divestment of its offshore business. Considering the significant development of liquified natural gas (LNG) in the future, we had laid out projects like offshore platform-based liquefied natural gas (PLNG) plant, offshore LNG platform-based storage and regasification unit (PSRU) and new fender system for protection (FSP) of LNG liquid cargo, etc. in the sector in advance, and will continue to participate in the development of LNG business via shareholding in the future. Through the disposal of offshore business, we can further enhance deployment of resources, focus on developing principal business, improve core competitiveness, concentrate resources in promoting land oil and gas equipment manufacturing and general engineering service, ride on the wave of disruptive reform in the equipment manufacturing industry featuring interconnectivity, artificial intelligence and sustainability, and strive to promote business related to shale gas development.

ENVIRONMENTAL POLICIES AND PERFORMANCE

For the year ended 31 December 2018, Honghua's business operation made continuous efforts in mitigating pollution of the environment and conserving natural resources through its policies and guidelines. No non-compliance in relation to environmental and social aspects was recorded. Engagement with stakeholders has resulted in heightened concerns on key material issues, which include (i) air emission, (ii) waste and effluent, (iii) employment, (iv) occupational health and safety, and (v) product quality. These aspects had already been managed by us and we will continue to keep close communication with stakeholders for advancing environmental, social and governance management. Details of Honghua's environmental policies and performance are set out in the Environmental, Social and Governance Report of this annual report.

QUALITY MANAGEMENT AND RESEARCH & DEVELOPMENT

During the period, we continued to strengthen quality control management, implemented strategies for reducing cost and enhancing efficiency and practicably improved our products' competitiveness and profitability via measures such as product design enrichment, production technology enhancement and supply chain improvement. Meanwhile, we will continue to invest in research and development to strengthen our overall competitiveness. We will seize opportunities arising from transformation and upgrade to achieve stable growth in core technology capability, market share and profitability.

During the period, we focused our product and technology R&D projects on equipment such as intelligent downhole tools, unconventional oil and gas development equipment, natural gas hydrate exploring equipment systems, shale gas auxiliary equipment and deep-sea mining devices. Among them, new products including direct drive pumps, second-generation top drives, iron drilling devices and shale gas electric fracturing systems had achieved sale and lease on a massive scale.

In 2018, Sichuan Honghua Petroleum Equipment Co., Ltd. ("Sichuan Honghua"), a wholly-owned subsidiary of Honghua, was named Natural Gas Hydrate Technology Innovation Alliance Member by China National Offshore Oil Corporation, a state-established key laboratory unit of natural gas hydrate. This approval indicated that Honghua is the only domestic R&D corporation focusing on developing eco-friendly natural gas hydrate solid fluidisation mining equipment, and it also suggested that Honghua, as a leading research unit in natural gas hydrate, will undertake an increasing number of important research projects related to natural gas hydrate development technology and equipment. In 2018, Zhang Mi, President of Honghua, was invited to present at the World Natural Gas Hydrate R&D Conference & Chinese Engineering Technology Forum of the Chinese Academy of Engineering and delivered a keynote report. At the conference, President Zhang Mi made a keynote report titled Natural Gas Hydrate Solid Fluidisation Development and Exploration and shared Honghua's results derived from research and development in natural gas hydrate, technology features and recent work progress with experts attending the conference. During the period, we had completed the mid-term inspection of marine hydrate development equipment system required by the Ministry of Science and Technology and went through the establishment phase of our submarine equipment projects.

In addition, in relation to the full electric fracturing system, we made substantial progress in aspects such as power solutions, pre-maintenance of equipment, digital-control and variable-frequency mixed-sand pry, command and control centre. Among them, core equipment was successfully applied in the domestic shale gas development sector, consolidating Honghua's share in the domestic shale gas service market.

As at 31 December 2018, Honghua applied for 613 patents accumulatively, of which 444 patents were granted. During the period, Honghua applied for 69 patents in total, and 36 patents were granted, with 19 of them being invention patents.

HUMAN RESOURCES MANAGEMENT

During the period, Honghua made impressive progress in aspects such as adjusting staff structure, incentivising science talents, introducing technology elites, controlling personnel risk internally and enhancing the E-HR system. Significant achievements had been made in the establishment of a mature human resources system. As at 31 December 2018, Honghua's had a total of 3,711 employees, increasing by 10 year on year, with 578 being R&D staff, increasing by 100 year on year. During the period, Honghua newly recruited 4 senior engineers, 48 associate senior engineers, 111 engineers and 1 senior technician.

In relation to talent development strategy, Honghua implemented a total of 551 training projects during the period and class hours reached 7,269 hours, covering approximately 60% of employees. Honghua has established on-line and off-line calibrated training systems, focusing on providing quality courses including leadership enhancement, technology development and research, international market expansion, cost reduction and efficiency improvement, project management and QHSE, firmly improving the leadership of management personnel at different levels and the professional standards of different types of staff.

Following the gradual implementation of industry structure adjustment and strategy deployment, Honghua has specified its human resources management goals and key work requirements in 2019, enhancing human resources management system further, continuing to consolidate various foundation work in management, strengthening corporate solidarity and competitiveness, improving employees' sense of achievement, happiness and security, and ensuring value creation in human resources.

OUTLOOK

In 2018, oil prices fluctuated considerably. Overall, oil prices are still on the rise. Despite the lengthy oil price recovery, the industry may recover further in tandem with the global economy in 2019. In respect of major economies, the booming shale oil and gas industry in the U.S. and the Chinese government's support for natural gas exploration and development will support our ongoing business growth. With the advancement of technology, more and more oil and gas companies will use new technologies to save production costs and improve production efficiency. In 2019, Honghua will aim at becoming a global leader in equipment and technology for oil and gas exploration and development, and an integrated supplier offering a full range of energy services and solutions with comprehensive competitive strengths. It will seize development opportunities arising from transformation and upgrade, focus on three major strategic transformation tasks including "industry structure adjustment", "development model transformation" and "operation quality enhancement", maintain excellent performance momentum, and achieve stable improvement in core technology capability, market share and profitability.

The introduction of CASIC as a strategic shareholder has brought synergies to Honghua. At present, Honghua is working with multiple subsidiaries of CASIC to carry out key technology projects, including the construction of an energy industry technology centre. We will also work with CASIC to step up efforts in promoting innovative business models such as "sale by lease", "finance lease" and "operating lease", which will help Honghua further enrich its business models and explore domestic and overseas markets with growing sales. Meanwhile, Honghua will continue to strengthen cooperation with large state-owned banks and tap into the support from substantial shareholders to expand its low-cost financing channels. In 2019, Honghua will continue to strengthen all-round cooperation with CASIC and its subsidiaries to improve coordinated development, complement each other in technology and the industrial chain, jointly develop the market, and promote substantial progress in going global.

In 2019, Honghua will continue to focus on natural gas exploration and application business in line with the development trends of the domestic natural gas market. China's shale gas development is still in the early fledging period. While keeping abreast of the industry trends, Honghua will actively promote a set of self-developed solutions for shale gas development featuring "Internet first, pumping gas with gas, combination of gas and electricity, assembly-line operation and factory-like production", and continue to scale up the application of high value-added products such as electric fracturing equipment, flexible water tanks and automatic machines. In terms of oil and gas engineering services, a good marketing background will also help Honghua upgrade its EPC capabilities for the oil and gas engineering service business segment and expand the domestic shale gas market.

Over the years, Honghua has been pursuing technological innovations in various fields, ride on the wave of disruptive reform in the equipment manufacturing industry featuring interconnectivity, artificial intelligence and sustainability, and employing the "Energy Plus Internet" model to develop products. Thanks to these efforts, it has developed a series of VR products and smart downhole tools. In 2019, Honghua will launch major R&D projects for the development of, among other things, automated drilling rigs and intelligent fracturing systems, strengthen the research of new industrial opportunities, consolidate core technology capabilities, and enhance industrial development capacity, so as to build up strength for its mid- and long-term industrial transformation.

As at 8 March 2019, we had land rigs and related product backlogs of approximately RMB5,730 million, which included land drilling rigs backlogs of approximately RMB2,470 million.

As at 8 March 2019, we had oil and gas engineering service backlogs of approximately RMB390 million.

FINANCIAL REVIEW

During the Year, the Group's gross profit and profit attributable to shareholders of the Company amounted to approximately RMB1,082 million and RMB82 million respectively, and gross margin and net margin amounted to 25.7% and 2.0% respectively. Last Year, gross profit and loss attributable to shareholders of the Company amounted to approximately RMB635 million and RMB1,239 million respectively, and gross margin and net margin amounted to 29.2% and -57.0% respectively. Profit attributable to shareholders for the year increased more significantly than that for Last Year, which was mainly attributable to a remarkable increase in the Group's business income and a significant improvement in the Group's profit attributable to shareholders resulting from the recovery of the global oil and gas market in 2018. Meanwhile, the disposal of the offshore drilling rig business sector resulted in significantly lower loss of the Year as compared with that for Last Year.

TURNOVER

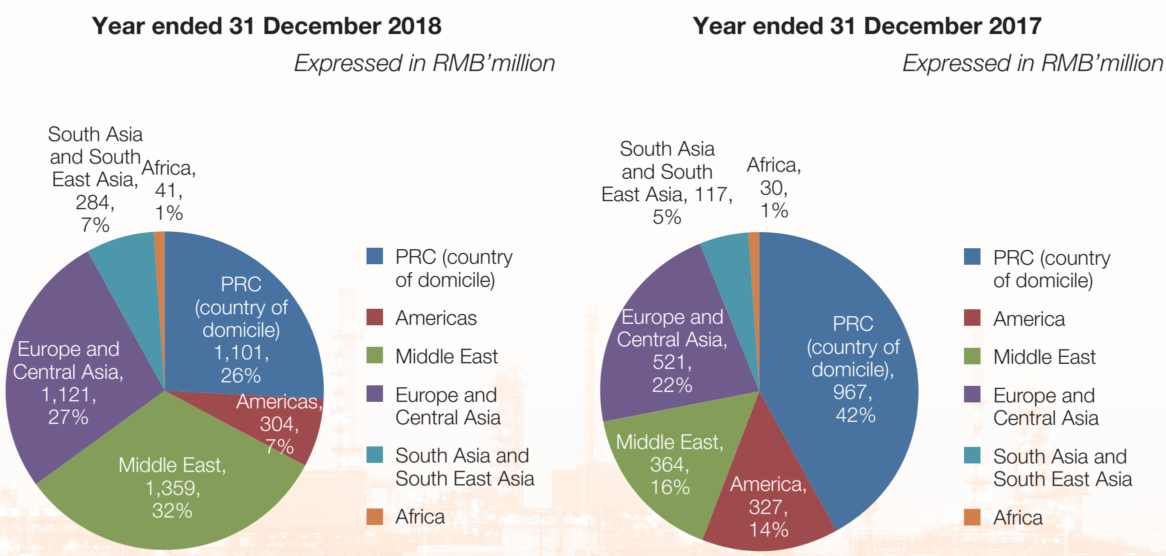
During the Year, the Group's turnover from continuing operations amounted to approximately RMB4,205 million, representing an increase of RMB2,029 million or 93.2% from RMB2,176 million for Last Year. Benefitting from the recovery of the global oil and gas industry, increased synergies arising from CASIC's shareholding and other positive factors, the Group recorded a more noticeable year-on-year increase in sales of land drilling rigs, parts and components, and other business sectors. In particular, the sales revenue from new products such as electric fracturing pumps and flexible water tanks continued to grow steadily. The Group's revenue from oil-related services also witnessed a slight year-on-year increase. In general, the Group's revenue increased significantly year on year.

(a) Revenue by Geographical Area

The Group's revenue by geographical area during the Year: (1) The Group's export revenue increased by RMB1,750 million with that for Last Year to approximately RMB3,109 million, accounting for approximately 73.8% of total revenue; (2) Sales revenue in mainland China increased by RMB135 million compared with that for Last Year to approximately RMB1,101 million, accounting for approximately 26.2% of total revenue.

The Group's sales revenue by region is affected by oil and gas exploration activities across different areas of the world. Faced with the operational situation featuring fluctuation adjustments in the oil and gas industry market, the Group continued to focus on technology innovation, improved the quality of products and services, and concentrated on international business development while strictly controlling operating costs. Meanwhile, the Group will make an effort to develop the domestic market by leveraging the platform advantage of CASIC so as to form a new source of business growth.

Revenue by Geographical Area



(b) *Revenue by Business Sector*

The Group's business is divided into land drilling rigs, offshore drilling rigs, parts and components and others, and oil and gas engineering services.

During the Year, the Group's sales revenue from land drilling rigs amounted to approximately RMB2,327 million, representing an increase of RMB1,908 million or 455.4% from approximately RMB419 million for Last Year.

During the Year, the Group's sales revenue from offshore drilling rigs amounted to approximately RMB5 million, representing a decrease of RMB155 million or 96.9% from approximately RMB160 million for Last Year.

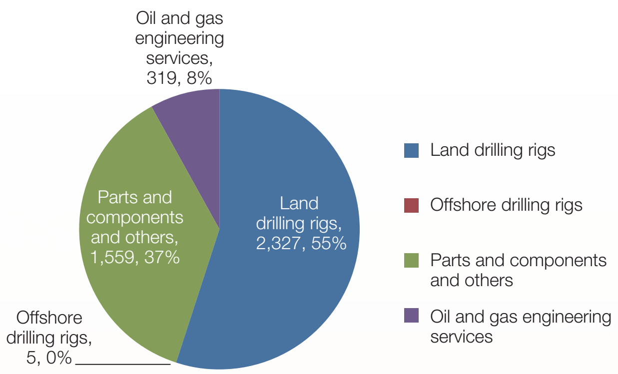
During the Year, the Group's sales revenue from parts and components and others amounted to approximately RMB1,559 million, representing a decrease of RMB20 million or 1.3% from approximately RMB1,579 million for Last Year.

During the Year, the Group's revenue from oil and gas engineering services amounted to approximately RMB319 million, representing an increase of RMB151 million or 89.9% from approximately RMB168 million for Last Year.

Revenue by Business Sector

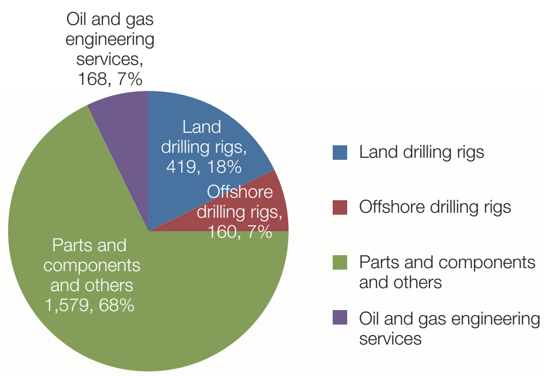
Year ended 31 December 2018

Expressed in RMB'million



Year ended 31 December 2017

Expressed in RMB'million



COST OF SALES

During the Year, the Group's cost of sales from continuing operations amounted to approximately RMB3,123 million, representing an increase of RMB1,582 million or approximately 102.7% from RMB1,541 million for Last Year. Such increase was mainly attributable to the expansion of sales scale. Adhering to the principle of prudence, the Group allocated approximately RMB88 million for inventory impairment provision. Despite the Group's strict cost control and measures adopted to reduce costs and improve efficiency which began to bear fruit, the increase in sales cost was still slightly higher than that in sales income.

GROSS PROFIT AND GROSS MARGIN

During the Year, the Group's gross profit from continuing operations amounted to approximately RMB1,082 million, representing an increase of RMB447 million or 70.4% from RMB635 million for Last Year.

During the Year, the Group's overall gross margin from continuing operations amounted to 25.7%, representing a decrease of 3.5 percentage points from 29.2% for Last Year, which was mainly attributable to changes in the Group's product sales structure. Driven by the gradual recovery of the oil and gas industry, the sales proportion of the Group's land drilling rigs recorded a significant year-on-year increase of 37 percentage points while gross margin growth was limited. Meanwhile, the sales proportion of parts and components and other business sectors with high gross margin decreased by 31 percentage points for the year.

EXPENSES FOR THE YEAR

During the Year, the Group's sales expenses from continuing operations amounted to approximately RMB313 million, representing an increase of RMB80 million or 34.3% from RMB233 million for Last Year, which was mainly attributable to the Group's sales growth and the corresponding increase in relevant commission and transportation costs.

During the Year, the Group's administrative expenses from continuing operations amounted to approximately RMB469 million, representing an increase of RMB47 million or approximately 11.1% from RMB422 million for Last Year. The year-on-year increase of administrative expenses was attributable to higher year-on-year growth of research and development expenses of the Group for the Year although the Group's measures to reduce costs and improve efficiency began to bear fruit, and items such as labour costs, conference fees and business trip expenses saw a significant drop.

During the Year, the Group's net financial expenses from continuing operations amounted to approximately RMB163 million, representing a decrease of RMB51 million or 23.8% from net financial expenses of approximately RMB214 million for Last Year. It was mainly because the Group prepaid part of its senior notes and other interest-bearing debts with CASIC's financial support, and thus further improved its debt structure. Meanwhile, due to the impact of exchange rate variation, the Group recorded a lower year-on-year currency exchange loss during the Year.

PROFIT BEFORE TAX

During the Year, the Group's profit before tax from continuing operations amounted to approximately RMB144 million, representing an increase of RMB491 million or 141.5% from a loss before tax of RMB347 million for Last Year.

INCOME TAX EXPENSE

The Group's income tax expense from continuing operations for the Year amounted to approximately RMB34 million compared with the income tax expense of approximately RMB49 million for Last Year.

PROFIT FOR THE YEAR

The Group's profit for the Year amounted to approximately RMB97 million compared with a loss of approximately RMB1,230 million for Last Year, in which profit attributable to owners of the Company and profit attributable to non-controlling interests amounted to approximately RMB82 million and approximately RMB15 million respectively. Net margin for the Year amounted to 2.0% compared with a net margin of -57.0% for Last Year.

EARNINGS BEFORE INTEREST, TAX, DEPRECIATION AND AMORTIZATION ("EBITDA") AND EBITDA MARGIN

EBITDA for the Year amounted to approximately RMB493 million compared with approximately RMB-557 million for Last Year, which was mainly attributable to the significant increase in revenue from the Group's land drilling rig business on the back of the recovery of the market. EBITDA margin amounted to 11.7% compared with -24.0% for Last Year.

DIVIDENDS

As at 31 December 2018, the Board did not recommend distribution of annual dividends.

SOURCES OF FUNDS AND PARTICULARS OF BORROWINGS

The Group's principal sources of funds include cash from operations, bank borrowings and debt securities financing.

As at 31 December 2018, the Group's borrowings for continuing operations decreased by RMB196 million to approximately RMB3,120 million compared with that as at 31 December 2017. In particular, borrowings repayable within one year increased by RMB1,111 million or 77.5% to approximately RMB2,545 million compared with that as at 31 December 2017.

DEPOSITS AND CASH FLOW

As at 31 December 2018, the Group's cash and cash equivalents from continuing operations decreased by approximately RMB415 million to approximately RMB686 million compared with that as at 31 December 2017.

During the Year, the Group's net cash inflow from operating activities amounted to approximately RMB463 million, net cash outflow from investing activities amounted to approximately RMB431 million, and net cash outflow from financing activities amounted to approximately RMB482 million.

ASSET STRUCTURE AND CHANGES THEREOF

As at 31 December 2018, total assets of the Group amounted to approximately RMB10,317 million. In particular, current assets decreased by RMB2,188 million to approximately RMB5,545 million compared with that as at 31 December 2017, accounting for approximately 53.7% of total assets, which was mainly attributable to the decrease in inventory and cash assets; non-current assets increased by RMB2,438 million to approximately RMB4,772 million compared with that as at 31 December 2017, accounting for approximately 46.3% of total assets, which was mainly attributable to the increase in long-term receivables.

LIABILITIES

As at 31 December 2018, total liabilities of the Group amounted to approximately RMB5,998 million. In particular, total current liabilities increased by RMB1,436 million to approximately RMB5,374 million compared with that as at 31 December 2017, accounting for approximately 89.6% of total liabilities; total non-current liabilities decreased by RMB1,326 million to approximately RMB624 million compared with that as at 31 December 2017, accounting for approximately 10.4% of total liabilities. As at 31 December 2018, the Group's gearing ratio was approximately 58.1%, decreasing by 0.4 percentage point compared with that as at 31 December 2017.

EQUITY

As at 31 December 2018, total equity amounted to approximately RMB4,319 million, representing an increase of RMB141 million compared with that as at 31 December 2017. Total equity attributable to owners of the Company amounted to approximately RMB4,129 million, representing an increase of RMB118 million compared with that as at 31 December 2017. Non-controlling interests totaled approximately RMB190 million, representing an increase of RMB23 million compared with that as at 31 December 2017. During the Year, the Company's basic profit per share and diluted profit per share amounted to approximately RMB1.55 cents and RMB1.55 cents respectively.

CAPITAL EXPENDITURE, MAJOR INVESTMENTS AND CAPITAL COMMITMENTS

During the Year, the Group's total capital expenditure on infrastructure and technical improvements amounted to approximately RMB347 million, representing an increase of approximately RMB152 million compared with that for Last Year.

As at 31 December 2018, the Group had capital commitments of approximately RMB12 million, which were used for the optimization of its business and production capacity.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Mr. Chen Yajun (陳亞軍先生), aged 56, has been an Executive Director of the Company and Chairman of the Board since 29 March 2017 and resigned with effect from 24 August 2018. Mr. Chen joined in CASIC Group since 1988 and had leaderships in the second institute, the forth research institute of CASIC Group and China Aerospace Automotive Co., Ltd. respectively. Mr. Chen obtained Bachelor's degree and Master's degree from Beijing Institute of Technology in 1985 and 1988 respectively.

Positions held by Mr. Chen in the Company's subsidiaries are set forth in the table below.

Subsidiary	Position	Term of Office
Honghua Holdings Limited	Chairman	Since 19 August 2017 to 29 December 2018
Honghua (China) Investment Co., Ltd.	Chairman	Since 21 July 2017 to 10 October 2018

Mr. Jin Liliang (金立亮先生), aged 52, has been an Executive Director of the Company and Chairman of the Board since 24 August 2018. Mr. Jin joined in China Aerospace Science and Industry Corporation Limited in 1993. He was a vice president of a subsidiary of China Aerospace Science and Industry Corporation Limited. Mr. Jin has rich experience of corporate operation and management. He holds a master's degree of Engineering from Harbin Institute of Technology.

Positions held by Mr. Chen in the Company's subsidiaries are set forth in the table below.

Subsidiary	Position	Term of Office
Honghua Holdings Limited	Chairman	Since 29 December 2018
Honghua (China) Investment Co., Ltd.	Chairman	Since 10 October 2018

Mr. Zhang Mi (張弭先生), aged 62, has been an Executive Director since June 2007, the Chairman of the Company from June 2007 to March 2017 and the vice Chairman of the Company since March 2017. He is also President of the Company. Positions held by Mr. Zhang in the Company's subsidiaries are set forth in the table below.

Subsidiary	Position	Term of Office
Honghua Holdings Limited	Director	Since 18 August 2006
	Chairman	Since 8 September 2009 to 19 August 2017
	Chief Executive Officer	Since 8 September 2009
Sichuan Honghua Petroleum Equipment Co., Ltd.	Director	Since 31 December 1997
Honghua International Co., Ltd.	Director	Since 13 January 2004
Honghua Offshore Oil & Gas Equipment (Jiangsu) Co., Ltd.	Chairman	Since 8 June 2009
Shanghai Honghua Offshore Oil & Gas Equipment Co., Ltd.	Executive Director	Since 9 September 2009
Honghua (China) Investment Co, Ltd.	Chairman	Since 14 January 2010 to 21 July 2017
	General manager	Since 14 January 2010
Honghua Oil & Gas Engineering Services Co. Ltd.	Director	Since 14 April 2009
Honghua America, LLC.	Chairman	Since 11 October 2004
Gansu Hongteng Oil & Gas Equipment	Director	Since 28 December 2011

Mr. Zhang graduated from the Sichuan Petroleum Administration Vocational University in 1982, with a diploma in machinery manufacture, design and equipment. He graduated from the Party Institute of Sichuan Provincial Committee Correspondence College in 1998, with a degree in Economics and Management. In 2004 he then obtained a senior engineer qualification granted by the Committee for Evaluation of Senior Technical Positions of the China National Petroleum Corp. He has been receiving special subsidies granted by the State Council of the PRC government since February 2007, for his significant contribution to the development of machinery engineering in the PRC.

In 2005, Mr. Zhang was awarded the Sichuan Province Prize for Outstanding Talent in Innovation (四川省第三屆傑出創新人才獎), by the Sichuan Provincial Party Committee and the Sichuan Provincial People's Government. In 2007, he was granted the May 1 Labor Medal of Sichuan Province (四川省五一勞動獎章) by the Sichuan Provincial Federation of Trade Unions in 2007. Mr. Zhang was rewarded as Leading Entrepreneur of Foreign Trading and Export Enterprises in Sichuan for 2009. In 2015, he was rewarded as a national model worker.

Mr. Ren Jie (任杰先生), aged 52, has been an Executive Director of the Company since 18 January 2008. He has been the senior vice-president of the Company since 1 January 2016. In 1990, Mr. Ren earned a Bachelor's degree in mining machinery from Southwest Petroleum University, located in Sichuan Province, specializing in petroleum and natural gas. In 1995, Mr. Ren obtained an engineering qualification, granted by the China National Petroleum Corp., Sichuan Petroleum Administration. In November 2007, he also became a member of the 5th Edition Committee of the Oil Field Equipment Journal, and in 2012, he earned a Doctor's degree in Mechanical Design and Theory from Southwest Petroleum University. Mr. Ren is employed as a senior engineer by Sichuan Honghua Petroleum Equipment Co., Ltd.

Positions held by Mr. Ren in the Company's subsidiaries are set forth in the table below.

Subsidiary	Position	Term of Office
Honghua Holdings Limited	Director	Since 18 August 2006
Sichuan Honghua Petroleum Equipment Co., Ltd.	Director	Since 31 December 1997
	General Manager	Since 1 July 2013
	Chairman	Since 1 January 2018
Honghua International Co., Ltd.	Director	Since 13 January 2004
Sichuan Honghua Electric Co.,Ltd.	Director	Since 1 August 2009
Honghua (China) Investment Co., Ltd.	Director	Since 14 January 2010
Newco (H.K.) Limited	Director	Since 22 June 2008
	Chairman, and General Manager	Since 22 September 2009
Honghua America, LLC.	Director	Since 10 October 2008
Sichuan Honghua International (H.K.) Limited	Director	Since 25 June 2010

NON-EXECUTIVE DIRECTORS

Mr. Han Guangrong (韓廣榮先生), aged 57, has been a Non-executive Director of the Company since 29 March 2017. Mr. Han is currently the deputy director of the international-business department of CASIC and the vice chairman of Aerospace Hi-tech Holding Group Co., Ltd. Mr. Han joined in CASIC Group since 1984 and had leaderships in the third institute of CASIC Group and CASIC. Mr. Han obtained Bachelor of engineering degree from Harbin Institute of Technology and Master of engineering degree from Beihang University in 1984 and 1997 respectively.

Mr. Chen Wenle (陳文樂先生), aged 39, has been the Non-executive Director of the Company since 29 March 2017. Mr. Chen is currently the Chief Economic manager and the director of corporate plan and development department of Shenzhen Aerospace Industry Technology Research Institute Co., Ltd. and chairman of Aerospace Yinshan Electrical Co., Ltd. Mr. Chen has worked in Shum Yip Group Limited and joined in CASIC Group in 2011. Mr. Chen obtained Bachelor of finance degree from Shandong University in 2003 and Master of economics degree from Shanghai University of Finance and Economics in 2006.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Liu Xiaofeng (劉曉峰先生), aged 56, has been an Independent Non-executive Director of the Company since 18 January 2008. He is currently an independent non-executive director of Kun Lun Energy Company Limited and Cinda International Holdings Limited. He was a managing director of China Resources Capital Holdings Company Limited. He has years of experience in corporate finance and has worked with various international financial institutions since 1993, including, NM Rothschild & Sons, JP Morgan and DBS. Mr. Liu obtained a Master's degree and a Ph.D. from the Faculty of Economics, University of Cambridge in 1988 and 1993 respectively, a Master of Science degree in Development Studies from the University of Bath, England, in 1987, and a Bachelor of Economics degree from Southwestern University of Finance and Economics in 1983.

Mr. Chen Guoming (陳國明先生), aged 56, has been an Independent Non-executive Director of the Company since 18 January 2008. He is now a Professor, a Ph.D. candidate supervisor, a member of the Academic Committee, the Chief officer of Research Centre of Security technique of the Offshore Oil & Gas Equipment, the Chief officer of Professor Committee in the Department of Mechanical and Electrical Engineering of China University of Petroleum. Currently, Mr. Chen is the Chief officer of Shandong Key Laboratory of Petroleum Mechanical Engineering; a member of the Quality & Reliability Committee of China Petroleum Society, the Offshore Engineering Committee of China Naval Architects and Marine Engineers' Society and China Mechanical Engineering Society; and a member of the Editorial Committee of the Journal of "Petroleum Machinery" (2015 nineth session, 2018 tenth session), "China Offshore Oil and Gas" (2013), "Marine Engineering and Technology" (2016) and other magazine. He has been receiving special subsidies granted by the State Council of the PRC government (政府特殊津貼) since August 2005, for his significant contribution to the development of higher education in China, and was awarded the National Labor Day Medal in 2007. In 1982, Mr. Chen graduated from the Mechanical Department of the East China Petroleum Institute with a Bachelor's Degree, and then worked as an assistant engineer in the Lanzhou General Machinery Plant from 1982 to 1983. He earned his Master's degree in 1986, from the Beijing Graduate School of East China Petroleum Institute. He then worked as a teacher in this Institute and was promoted to Associate Professor and then Professor in 1992 and 1995, respectively. He was a visiting scholar at the University of California, Berkeley, from 1996 to 1997. He obtained his Ph.D. degree in 1999, and was promoted to Ph.D. candidate supervisor in 2000.

Ms. Su Mei (蘇梅女士), aged 50, has been an Independent Non-executive Director of the Company since 29 March 2017. Ms. Su is currently the chief executive officer of Beijing YaMeiHeZhong Consultanting Co., Ltd. Ms. Su once had leaderships in Discipline Inspection Commission of Sichuan Province and Sichuan Development and Reform Commission and State-owned Assets Supervision and Administration Commission of State Council, worked as the vice-president in Sichuan Provincial Investment Group, the chairman of Sichuan Chuantou Water Group and vice-president of Joneson Group. Ms. Su obtained Doctor's degree in finance from Sichuan University in 2013, and obtained Bachelor's degree of Chinese from Shandong University in 1991.

Mr. Poon Chiu Kwok (潘昭國先生), aged 57, has been an Independent Non-executive Director of the Company since 15 June 2017. Mr. Poon is currently an executive director, vice president and company secretary of Huabao International Holdings Limited. Mr. Poon has years of experience in finance, compliance and listed companies management. Mr. Poon is currently the independent non-executive director of Sany Heavy Equipment International Holdings Company Limited, Greentown Service Group Co., Ltd., Sunac China Holdings Limited, Tonly Electronics Holdings Limited, Yuanda China Holdings Limited, Changan Minsheng APLL Logistics Co., Ltd., Jinchuan Group International Resources Co. Ltd., TUS International Limited, AUX International Holdings Limited and Yanzhou Coal Mining Company Limited. Mr. Poon is a fellow member of CPA Australia, The Institute of Chartered Secretaries and Administrators in the U.K., The Hong Kong Institute of Chartered Secretaries and a member of its Technical Consultation Panel, Audit Committee and China Foucs Group. He was granted postgraduate diploma in laws from the University of London. He holds a Master's degree in international accounting, Master's and Bachelor's degree in laws and a Bachelor's degree in business studies.

Mr. Chang Qing (常清先生), aged 62, has been an Independent Non-executive Director of the Company since 15 June 2017. Mr. Chang is currently the chairman of Jinpeng International Futures Co., Ltd. and a professor of China Agricultural University. Mr. Chang is now acting as an independent non-executive director of Kangda International Environmental Company Limited and China Chengtong Development Group Limited. He previously served as independent non-executive directors of Tibet Summit Resources Co., Ltd., TBEA Co., Ltd., Shenwu Environmental Technology Co., Ltd. and Yuan Long Ping High-Tech Agriculture Co., Ltd. respectively. Mr. Chang graduated from the Chinese Academy of Social Sciences with a doctorate degree in agricultural economics and management in 2001, graduated from Jilin University with both a master's degree in national economics in 1985 and a bachelor's degree in economics in 1982.

Mr. Wu Yuwu (吳毓武先生), aged 58, has been an Independent Non-executive Director of the Company since 1 January 2018. Mr. Wu is currently a professor of accounting at the School of Accountancy of the Chinese University of Hong Kong. Mr. Wu has years of experience in accounting academics and research. Mr. Wu currently serves as an independent non-executive director of China Galaxy Securities Co., Ltd. He holds a Doctor's degree in accounting and a degree of Master of Business Administration.

SENIOR MANAGEMENT

Mr. Yang Yunqing (楊運青先生), aged 41, has been the Vice-president of the Company since August 2018. Mr. Yang had been working at the CASIC Group since 2001. Before joining the Company, Mr. Yang once served as the Deputy Director of the Development and Planning Department of the CASIC and has rich experiences in planning and operation management. Mr. Yang holds a Bachelor's degree from Harbin Engineering University.

Mr. Dang Nan (黨楠先生), aged 54, has been the Vice-president of the Company since March 2017. Mr. Dang had been working at the CASIC Group since 1989. Before joining the Company, Mr. Dang once served as the vice president of a subordinate unit of the CASIC. Mr. Dang holds a Master's degree from Beihang University.

Ms. Xu Xiufang (許秀芳女士), aged 47, has been the Chief Financial Officer of the Company since March 2017. Ms. Xu had been working at the CASIC Group since August 1994 and was engaged in accounting and financing. Before joining the Company, Ms. Xu once served as the chief accountant of a subordinate unit of the CASIC. Ms. Xu holds a Master's degree from Huazhong University of Science and Technology and a Bachelor's degree from Beijing Forestry University.

Ms. Yao Yuhong (姚宇紅女士), aged 50, has been the Vice president of the Company since August 2018. Ms. Yao had been working at the CASIC since 1991. Before joining the Company, Ms. Yao once served as the Deputy Director of the Asset Operation Department of the CASIC. She has rich experiences in asset operation, investment, mergers and acquisitions and financial management. Ms. Yao holds a Master's degree from the Business School of Renmin University of China.

Ms. Xu Chuan (徐川女士), aged 53, has been the Human Resources Director of the Company since December 2016. Ms. Xu joined the Company in 2001 and once served as the Vice General Manager of Honghua International Co., Ltd. (四川宏華國際科貿有限公司) and the Vice General Manager of Sichuan Honghua Petroleum Equipment Co., Ltd (四川宏華石油設備有限公司). Ms. Xu holds a Bachelor's degree from Southwest Petroleum University.

Mr. He Bin (何斌先生), aged 45, has been the secretary of Board and a Joint Company Secretary of the Company since 27 December 2013 and resigned with effect from August 2018. Mr. He has been the vice president since August 2018. Mr. He joined the Group in 2008 as the director of Strategic Investment Department and assistant president of the Company. Mr. He has more than 10 years of investment and management experience, once was engaged in venture capital, investment consulting and other related work in Samsung Company. He holds a Bachelor's degree from Renmin University of China and a Master's degree in Business Administration from University of Alberta in Canada.

Mr. Di Xiaohong (狄曉宏先生), aged 55, has been the Senior Administration Director of the Company since September 2018. Mr. Di joined the Company in January 2000 and once served as the Vice General Manager of Honghua Company. He has rich experiences in corporate management and administration.

Mr. Yuan Hai (袁海先生), aged 41, has been the Financial Controller of the Company since 26 March 2015. Mr. Yuan joined the Company in 2007. Mr. Yuan has over 14 years of experience in financial management and has been a member of Certified Management Accountant (CMA) of America since January 2016. Mr. Yuan was engaged in PricewaterhouseCoopers from 2000 to 2004, with the then last position as senior tax consultant. From 2004 to 2007, he worked in Bayer Animal Health China with the then last position as financial controller. Mr. Yuan obtained a Bachelor's degree from Southwestern University of Finance and Economics.

Ms. Zhuang Wenmin (莊文敏女士), aged 38,has been the secretary of Board and a Joint Company Secretary of the Company since August 2018. Ms. Zhuang joined in the Company since 2009, has been the director of the Legal & Securities Department of the Company since January 2016 to August 2018. She is responsible for corporate governance and compliance,risk management and legal affairs of the Company. Ms. Zhuang holds a master's degree in Law from Southwestern University of Finance and Economics.

Ms. Lee Mei Yi (李美儀女士), aged 51, has been a Joint Company Secretaries of the Company since 7 July 2015. Ms. Lee is an executive director of corporate services division of Tricor Services Limited and a fellow member of both The Hong Kong Institute of Chartered Secretaries and The Institute of Chartered Secretaries and Administrators. Ms. Lee has over 25 years' experience in company secretarial area.

CORPORATE GOVERNANCE REPORT

The Board presents this Corporate Governance Report in the Group's annual report for the year ended 31 December 2018.

The Company's corporate governance policies and practices are applied and implemented in the manners as stated in the following Corporate Governance Report:

CORPORATE GOVERNANCE PRACTICES OF THE COMPANY

The Group is committed to achieving high standards of corporate governance to safeguard the interests of Shareholders and to enhancing corporate value and accountability.

The Group strives to attain and maintain high standards of corporate governance to enhance Shareholder value and safeguard Shareholder interests. The Group's corporate governance principles emphasize a quality Board, effective internal controls and accountability to Shareholders.

The Board believes that good corporate governance practices are increasingly important for maintaining and promoting Shareholder value and investor confidence.

The Company has adopted the principles and code provisions of the Corporate Governance Code (the "CG Code") contained in Appendix 14 to the Listing Rules as the basis of the company's corporate governance practices.

The CG Code set out the principles of good corporate governance and two levels of corporate governance practices:

(a) code provisions, which listed issuers are expected to comply with or to give considered reasons for any deviation; and

(b) recommended best practices for guidance only, which listed issuers are encouraged to comply with or to give considered reasons for deviation.

The Company has devised its own code of corporate governance based on the principles and practices as set out in the CG Code.

The Company has complied with the code provisions as set out in the CG Code throughout the year ended 31 December 2018, save for certain deviation from the code provision in respect of the dismissal of the nomination committee of the Company, details of which will be explained below.

The Company reviews its corporate governance practices regularly to ensure compliance with the CG Code.

The Company is committed to enhancing its corporate governance practices appropriate to the conduct and growth of its business and to reviewing its corporate governance practices from time to time to ensure that they comply with the statutory and professional standards and align with the latest developments.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted its own code of conduct regarding Directors' dealings in the Company's securities (the "Company's Code") on terms no less exacting than the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 to the Listing Rules.

Specific enquiry has been made of all the Directors and all Directors have confirmed that they have complied with the Company's Code and the Model Code throughout the year ended 31 December 2018.

The Company has also established written guidelines no less exacting than the Model Code (the "Employees Written Guidelines") for securities transactions by employees who are likely to be in possession of unpublished inside information of the Company.

No incident of non-compliance of the Employees Written Guidelines by the employees was noted by the Company.

THE BOARD OF DIRECTORS

The Board oversees the Group's businesses, strategic decisions and performance and should take decisions objectively in the best interests of the Company.

The Board should regularly review the contribution required from a Director to perform his responsibilities to the Company, and whether the Director is spending sufficient time performing them.

BOARD COMPOSITION

The Board currently comprises 11 Directors, consisting of 3 Executive Directors, namely Mr. Jin Liliang, Mr. Zhang Mi and Mr. Ren Jie, 2 Non-executive Directors, namely Mr. Han Guangrong and Mr. Chen Wenle and 6 Independent Non-executive Directors, namely Mr. Liu Xiaofeng, Mr. Chen Guoming, Ms. Su Mei, Mr. Poon Chiu Kwok, Mr. Chang Qing and Mr. Wu Yuwu. The biographical details of Directors are set out under "Biographical Details of Directors and Senior Management" on pages 20 to 25.

None of the members of the Board is related to one another.

CHAIRMAN AND PRESIDENT (CHIEF EXECUTIVE)

The positions of Chairman and President are held by Mr. Jin Liliang and Mr. Zhang Mi respectively. The Chairman provides leadership and is responsible for the effective functioning and leadership of the Board. The President focuses on the Company's business development and daily management and operations generally.

INDEPENDENT NON-EXECUTIVE DIRECTORS

During the year ended 31 December 2018, the Board at all times met the requirements of the Listing Rules relating to the appointment of at least three Independent Non-executive Directors representing one-third of the Board.

On 1 January 2018, Mr. Qi Daqing resigned as the Independent Non-executive Directors while Mr. Wu Yuwu was appointed as the Independent Non-executive Director.

During the year ended 31 December 2018, the Company had six Independent Non-executive Directors with three of whom possessing appropriate professional qualifications or accounting or related financial management expertise so that there is a strong independent element on the Board, which can effectively make independent judgment.

The Company has received written annual confirmation from each of the Independent Non-executive Directors in respect of his independence in accordance with the independence guidelines set out in Rule 3.13 of the Listing Rules. The Company considers all Independent Non-executive Directors are independent.

APPOINTMENT AND RE-ELECTION OF DIRECTORS

Code provision A.4.1 of the CG Code stipulates that non-executive directors shall be appointed for a specific term, subject to re-election, whereas code provision A.4.2 states that all directors appointed to fill a casual vacancy shall be subject to election by shareholders at the first general meeting after appointment and that every director, including those appointed for a specific term, shall be subject to retirement by rotation at least once every three years.

Each of the Directors of the Company is appointed for a specific term of not exceeding 3 years and is subject to retirement by rotation at least once every three years.

RESPONSIBILITIES, ACCOUNTABILITIES AND CONTRIBUTIONS OF THE BOARD AND MANAGEMENT

The Board is responsible for leadership and control of the Company; is collectively responsible for directing and supervising the Company's affairs; and oversees the Group's businesses, strategic decisions and performance.

The senior management was delegated the authority and responsibility by the Board for the day-to-day management and operations of the Group. In addition, the Board directly, and indirectly through its committees, leads and provides direction to management by laying down strategies and overseeing their implementation, monitors the Group's operational and financial performance, and ensures that sound internal control and risk management systems are in place. The Board has delegated to these Board committees various responsibilities as set out in their terms of reference.

All Directors have carried out duties in good faith, in compliance with the standards of applicable laws and regulations, and act in the interests of the Company and its Shareholders at all times.

All Directors, including Non-executive Directors and Independent Non-executive Directors, have brought a wide spectrum of valuable business experience, knowledge and professionalism to the Board for its efficient and effective functioning.

The Independent Non-executive Directors are responsible for ensuring a high standard of regulatory reporting of the Company and providing a balance in the Board for bringing effective independent judgement on corporate actions and operations.

All Directors have full and timely access to all the information of the Company as well as the services and advice from the company secretary and senior management. The Directors are always provided in a timely manner with comprehensive, accurate and detailed information on the Company's operation through monthly report, business operation report, important projects report and financial report so as to enable the Directors to make decisions and perform their duties and responsibilities. The Directors may, upon request, seek independent professional advice in appropriate circumstances, at the Company's expenses for discharging their duties to the Company.

The Directors shall disclose to the Company details of other offices held by them.

The Board reserves for its decision all major matters relating to policy matters, strategies and budgets, internal control and risk management, material transactions (in particular those that may involve conflict of interests), financial information, appointment of directors and other significant operational matters of the Company. Responsibilities relating to implementing decisions of the Board, directing and co-ordinating the daily operation and management of the Company are delegated to the management.

BOARD DIVERSITY

With effect from 1 January 2019, Rule 13.92 of the Listing Rule stipulates that the Board shall have a policy concerning the diversity of board members, and should disclose the policy or a summary of the policy in the corporate governance report.

The Company has adopted Board Diversity Policy for setting out the approach to achieve diversity on the Board and the board diversity policy has been made available on the Company's website. The Company recognizes and embraces the benefits of having a diverse Board and sees increasing diversity at the Board level as an essential element in maintaining the Company's competitive advantage.

In assessing the Board composition, the Board would take into account various aspects set out in the Board diversity policy, including but not limited to gender, age, cultural and educational background, professional qualifications, skills, knowledge and industry and regional experience.

The Board will review the Board Diversity Policy, as appropriate, to ensure its effectiveness.

DIRECTOR NOMINATION POLICY

The Company has adopted a Director Nomination Policy which sets out the selection criteria and process and the Board succession planning considerations in relation to nomination and appointment of Directors of the Company and aims to ensure that the Board has a balance of skills, experience and diversity of perspectives appropriate to the Company and the continuity of the Board and appropriate leadership at Board level.

The Director Nomination Policy sets out the factors for assessing the suitability and the potential contribution to the Board of a proposed candidate, including but not limited to the following:

- Character and integrity;
- Qualifications including professional qualifications, skills, knowledge and experience that are relevant to the Company's business and corporate strategy;
- Diversity in all aspects, including but not limited to gender, age, cultural and educational background, ethnicity, professional experience, skills, knowledge and length of service;
- Requirements of Independent Non-executive Directors on the Board and independence of the proposed Independent Non-executive Directors in accordance with the Listing Rules; and
- Commitment in respect of available time and relevant interest to discharge duties as a member of the Board and Board committees of the Company.

The Director Nomination Policy also sets out the procedures for the selection and appointment of new Directors and re-election of Directors at general meetings.

The Board will review the Director Nomination Policy, as appropriate, to ensure its effectiveness.

TRAINING INDUCTION AND CONTINUOUS PROFESSIONAL DEVELOPMENT OF DIRECTORS

Directors shall keep abreast of regulatory developments and changes in order to effectively perform their responsibilities and to ensure that their contribution to the Board remains informed and relevant.

Every newly appointed director will receive formal, comprehensive and tailored made induction on the first occasion of his/her appointment, so as to ensure that he/she has adequate understanding of the business and operations and governance of the Company and that he/she is fully aware of his/her responsibilities and obligations under the Listing Rules and relevant statutory requirements.

Directors should participate in appropriate continuous professional development to develop and refresh their knowledge and skills to ensure that their contribution to the Board remains informed and relevant. Internally-facilitated briefings for Directors would be arranged and reading material on relevant topics will be issued to Directors where appropriate. All Directors are encouraged to attend relevant training courses at the Company's expenses.

All the Directors have actively participated in the continuous professional development by way of attending seminar and/or conferences and/or forums and/or reading materials.

During the year ended 31 December 2018, the following Directors attended seminars/training sessions/in-house briefing/reading materials:

Directors	Attending seminar and/or conferences and/or forums	Reading journals, updates, articles and/or materials, etc.
Executive Directors		
Jin Liliang (appointed with effect from 24 August 2018)	✓	✓
Chen Yajun (resigned with effect from 24 August 2018)	✓	✓
Zhang Mi	✓	✓
Ren Jie	✓	✓
Non-Executive Directors		
Han Guangrong	✓	✓
Chen Wenle	✓	✓
Independent Non-Executive Directors		
Liu Xiaofeng	✓	✓
Qi Daqing (resigned with effect from 1 January 2018)	✓	✓
Chen Guoming	✓	✓
Su Mei	✓	✓
Poon Chiu Kwok	✓	✓
Chang Qing	✓	✓
Wu Yuwu (appointed with effect from 1 January 2018)	✓	✓

BOARD COMMITTEES

The Board has established 3 committees, namely, the Audit Committee, Remuneration Committee and Strategic Investment and Risk Control Committee for overseeing particular aspects of the Company's affairs. All Board committees of the Company are established with specific written terms of reference which deal clearly with their authority and duties. The terms of reference of the Board committees are posted on the Company's website and the Stock Exchange's website and are available to Shareholders upon request.

The list of the chairman and members of each Board committee is set out under "Corporate Information" on page 2.

AUDIT COMMITTEE

On 1 January 2018, Mr. Qi Daqing resigned as the Chairman of the Audit Committee while Mr. Wu Yuwu was appointed as the Chairman of the Audit Committee.

During the year ended 31 December 2018, the Audit Committee comprised six Independent Non-executive Directors, namely Mr. Wu Yuwu (Chairman), Mr. Liu Xiaofeng, Mr. Chen Guoming, Ms. Su Mei, Mr. Poon Chiu Kwok and Mr. Chang Qing. Three of Independent Non-executive Directors possess the appropriate professional qualifications or accounting or related financial management expertise.

The main duties of the Audit Committee include the following:

- To review the financial statements and reports and consider any significant or unusual items raised by the staff responsible for the accounting and financial reporting function or external auditors before submission to the Board;

- To review the relationship with the external auditors by reference to the work performed by the auditors, their fees and terms of engagement, and make recommendations to the Board on the appointment, re-appointment and removal of external auditors;

- To review the adequacy and effectiveness of the Company's financial reporting system, internal control system and risk management system and associated procedures and internal audit function; and

- To review the compliance of the corporate governance issues, the corporate governance report and the corporate governance policy.

The Audit Committee provides supervision on the internal control system of the Group and reports to the Board on any material issues, and makes recommendations to the Board.

During the Year under review, the Audit Committee has reviewed the Group's annual results and annual report for the year ended 31 December 2018, the financial reporting and compliance procedures, the report from the management on the Company's internal control and risk management systems and processes, the compliance of the corporate governance issues, the corporate governance report and the corporate policy.

The Audit Committee held two meetings during the year ended 31 December 2018 and the attendance records are set out under "Directors' Attendance Records" on page 35.

REMUNERATION COMMITTEE

On 1 January 2018, Mr. Qi Daqing resigned as the member of the Remuneration Committee while Mr. Wu Yuwu was appointed as the member of the Remuneration Committee.

During the period from 1 January 2018 to 24 August 2018, the Remuneration Committee comprised 5 members, Mr. Liu Xiaofeng (Chairman), Mr. Zhang Mi, Mr. Chen Yajun, Ms. Su Mei and Mr. Wu Yuwu.

On 24 August 2018, Mr. Chen Yajun resigned as the member of the Remuneration Committee while Mr. Jin Liliang was appointed as the member of the Remuneration Committee.

The Remuneration Committee currently comprises 5 members, Mr. Liu Xiaofeng (Chairman), Mr. Zhang Mi, Mr. Jin Liliang, Ms. Su Mei and Mr. Wu Yuwu, the majority of them are Independent Non-executive Directors.

The primary objectives of the Remuneration Committee include the following:

- To make recommendations to the Board on the remuneration policy and structure of the Directors and the senior management, the incentive mechanism, and the establishment of procedures for developing the remuneration policy and the incentive mechanism;

- To review and approve the remuneration packages of the Executive Directors and the senior management by reference to the performance of the individual and the Company as well as market practice and conditions; and

- To review and approve the compensation arrangements for the Executive Directors and the senior management in connection with (i) any loss or termination of their office or appointment and (ii) any dismissal or removal of directors for misconduct to ensure such arrangements are determined in accordance with contractual terms and that such compensation is reasonable and appropriate.

The Remuneration Committee normally meets at least once a year for reviewing and making recommendation to the Board on the remuneration policy and structure and determining the annual remuneration packages of the Executive Directors and the senior management and other related matters.

The Remuneration Committee didn't hold meeting during the year ended 31 December 2018.

Details of the remuneration of the senior management by band are set out in note 36 in the Notes to the Audited Financial Statements for the year ended 31 December 2018.

The remuneration policies of the Group focus on the efficiency of the employees and the position-value index, with reference to the individual ability and experience of an employee as well as the market value of the labour market, and emphasize on incentive-orientation and also the establishment of a fair and competitive remuneration system. For long-term incentive policies, the Company has adopted the Share Option Scheme and Restricted Share Award Scheme for eligible participants. Details are set out under the paragraphs headed "Share Option Scheme" and "Restricted Share Award Scheme" in the Report of the Directors.

The basis of determining the emolument of Directors is on various considerations, including Directors' capability, knowledge and experience, participation to the Board, job duties and responsibilities and is also made reference to the market practices and conditions. Except Mr. Jin Liliang, the Chairman of the Board, whose remuneration consists of annual basic remuneration and annual performance appraisal remuneration, the remuneration of the Executive Directors is based on their administrative management positions. Independent Non-executive Directors are entitled to a fixed emolument package. Non-executive Directors may be entitled to a fixed remuneration under the service contract.

STRATEGIC INVESTMENT AND RISK CONTROL COMMITTEE

During the period from 1 January 2018 to 24 August 2018, the Strategic Investment and Risk Control Committee comprised 6 members, Mr. Chen Yajun (Chairman), Mr. Zhang Mi, Mr. Ren Jie, Mr. Liu Xiaofeng, Mr. Poon Chiu Kwok and Mr. Chang Qing.

On 24 August 2018, Mr. Chen Yajun resigned as the Chairman of the Strategic Investment and Risk Control Committee while Mr. Jin Liliang was appointed as the Chairman of the Strategic Investment and Risk Control Committee.

The Strategic Investment and Risk Control Committee currently comprises 6 members, Mr. Jin Liliang (Chairman), Mr. Zhang Mi, Mr. Ren Jie, Mr. Liu Xiaofeng, Mr. Poon Chiu Kwok and Mr. Chang Qing.

The main duties of the Strategic Investment and Risk Control Committee include the following:

- To review the investment strategies of the Company;
- To review the investment risk control of the Company; and
- To recommend investment strategies and risk control policy and practices to the Board.

The Strategic Investment and Risk Control Committee normally meets at least once a year for reviewing the investment and risk control issues. The Strategic Investment and Risk Control Committee held a meeting during the year ended 31 December 2018 and the attendance records are set out under "Directors' Attendance Records" on page 35.

DISMISSAL OF NOMINATION COMMITTEE

Code provision A.5.1 of the CG Code stipulates that issuers should establish a nomination committee which is chaired by the chairman of the board or an independent non-executive director and comprises a majority of independent non-executive directors.

The Nomination Committee was dismissed on 19 March 2013. The Board has taken over the duties of Nomination Committee in reviewing its own structure, size and composition regularly and taken into consideration of the board diversity policy to ensure that it has a balance of expertise, skills, experience and diversity board members appropriate for the requirements of the business of the Company.

ATTENDANCE RECORD OF DIRECTORS AND COMMITTEE MEMBERS

During the year ended 31 December 2018, eight Board meetings were held for reviewing and approving the financial and operating performance, and considering and approving the overall strategies and policies of the Company.

The summary of the attendance records of each Director at the meetings of the Board, the Audit Committee, the Remuneration Committee, the Strategic Investment and Risk Control Committee and the General Meetings during the year ended 31 December 2018 are set out below:

	Attendance/Number of Meetings					
Name of Director	Board	Audit Committee	Remuneration Committee	Strategic Investment and Risk Control Committee	Annual General Meeting	Extraordinary General Meeting
Chen Yajun [a]	03/08	–	–	01/01	01/01	–
Jin Liliang [b]	03/08	–	–	–	0/01	01/01
Zhang Mi	07/08	–	–	01/01	0/01	0/01
Ren Jie	08/08	–	–	01/01	0/01	0/01
Han Guangrong	06/08	–	–	01/01	0/01	0/01
Chen Wenle	06/08	–	–	01/01	0/01	0/01
Liu Xiaofeng	08/08	02/02	–	01/01	01/01	01/01
Qi Daqing [c]	–	–	–	–	0/01	–
Chen Guoming	08/08	02/02	–	01/01	0/01	0/01
Su Mei	07/08	02/02	–	01/01	0/01	0/01
Poon Chiu Kwok	08/08	02/02	–	01/01	0/01	01/01
Chang Qing	08/08	02/02	–	01/01	0/01	0/01
Wu Yuwu [d]	08/08	02/02	–	01/01	0/01	0/01

[a] resigned with effect from 24 August 2018

[b] appointed with effect from 24 August 2018

[c] resigned with effect from 1 January 2018

[d] appointed with effect from 1 January 2018

Apart from regular Board meetings, the Chairman also held meetings with the Non-executive Directors (including Independent Non-executive Directors) without the presence of Executive Directors during the year.

DIRECTORS' RESPONSIBILITY IN RESPECT OF THE FINANCIAL STATEMENTS

The Directors acknowledge their responsibility for preparing the financial statements of the Company for the year ended 31 December 2018.

The Directors are not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern.

The statement of the independent auditors of the Company about their reporting responsibilities on the financial statements is set out in the Independent Auditors' Report on pages 81 to 88.

Where appropriate, a statement from the Audit Committee explaining its recommendation regarding the selection, appointment, resignation or dismissal of external auditors and the reasons why the Board has taken a different view from that of the Audit Committee.

AUDITORS' REMUNERATION

During the year ended 31 December 2018, the remuneration paid to the Company's external auditors, Messrs PricewaterhouseCoopers, is set out below:

Service Category	Fees (in Renminbi)
Audit Services	3,910,000
Non-audit Services	
— Reviewing interim financial statements	1,200,000
— Other	80,000
Total	5,190,000

The auditors' remuneration disclosed in note 8 to the consolidated financial statements included the remuneration paid to PricewaterhouseCoopers as detailed above.

RISK MANAGEMENT AND INTERNAL CONTROLS

The Board acknowledges its responsibility for the risk management and internal control systems and reviewing their effectiveness. 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 has the overall responsibility for evaluating and determining the nature and extent of the risks it is willing to take in achieving the Company's strategic objectives, and establishing and maintaining appropriate and effective risk management and internal control systems.

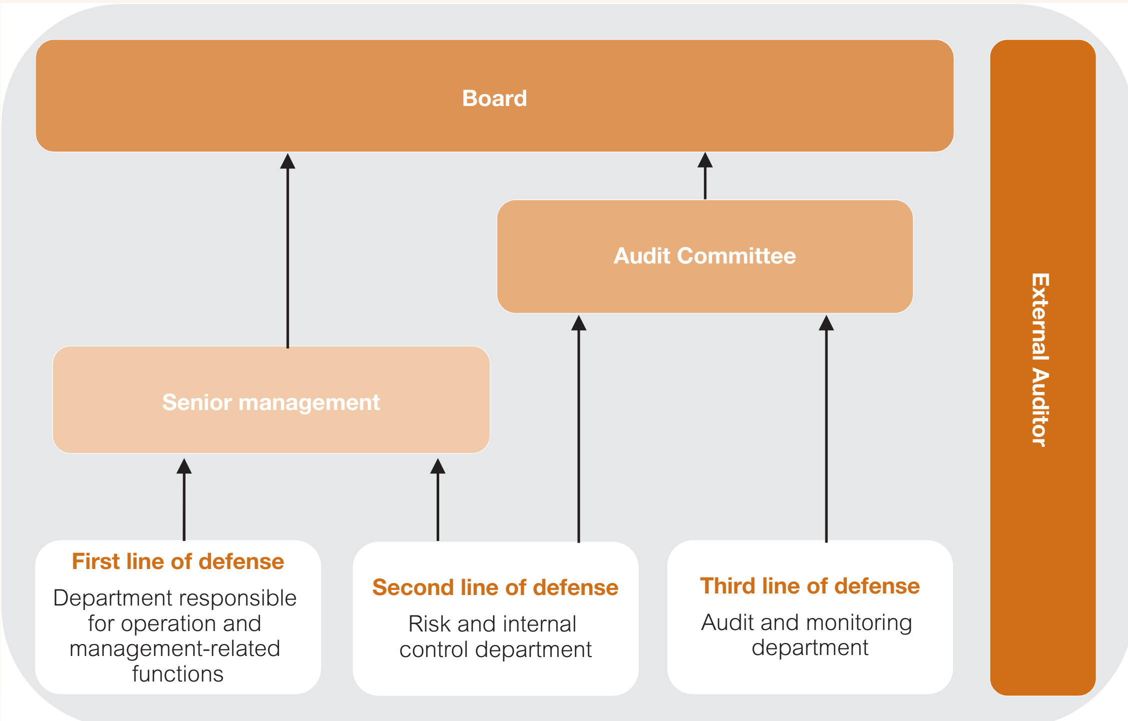
The Audit Committee assists the Board in leading the management and overseeing their design, implementation and monitoring of the risk management and internal control systems.

The Company has established and formulated appropriate policies and checks to ensure that there is no unauthorized use or disposal of asset. Reliable financial and accounting records are maintained in accordance with relevant rules and regulations, relevant accounting standards and regulatory reporting requirements. Material risks which may affect the performance of the Company are properly identified and managed. Such systems and internal controls can only provide reasonable and not absolute assurance against material misstatement or loss and are designed to manage rather than eliminate the risk of failure to achieve business objectives.

RISK MANAGEMENT AND INTERNAL CONTROL FRAMEWORK

The Company has established a risk management organizational structure with clear responsibility rank and reporting program. The risk and internal control department and the audit and monitoring department assist the Board and the Audit Committee in the continuous review of effectiveness of the Company's risk management and internal control system. The Directors regularly receive information on material risks which may affect the performance of the Company from the senior management and the Audit Committee.

The Company has adopted the following "three lines of defense" model as the guideline of risk management structure:



As the first line of defense, each department and subsidiary of the Company responsible for operation and management and internal control-related functions are the frontline of risk exposure and shall actively analyze the possibility and severity of potential/actual risks in the course of ordinary business activity. They also carry out preliminary risk information collection and identification, actively implement risk solution, participate in the development of risk management culture and receive guidance and supervision from the risk and internal control department. The management of the Company, as supported by the risk and internal control department and the audit and monitoring department, is responsible for the design, execution and monitoring of the risk management and internal control system and submits regular report on the effectiveness of such systems to the Board. The management has confirmed to the Board the effectiveness of the issuer's risk management and internal control system.

As the second line of defense, the risk and internal control department and the risk control panel of the Company are primarily responsible for the coordinated planning and development, maintenance and improvement of the risk management and internal control system. They evaluate and formulate ongoing enhancement on the compliance and reasonableness of the principal business procedures and the risk management mechanism and risk control capability of the Company and its subordinated entities. In accordance with the Company's strategic goal and business plan, they devise or arrange relevant department to devise risk management system, internal control system, risk management and internal control manual and management measures, including setting up evaluation mechanism of risk management, evaluation mechanism of effectiveness of internal control, recommendation of risk management strategy and internal control improvement, and report to the management and the Audit Committee.

As the third line of defense, the Audit Committee and the audit and monitoring department of the Company are primarily responsible for the follow-up scrutiny, audit and monitoring of the tasks assigned to the first and second line of defense and reporting to the Board. The audit and monitoring department is responsible for performing independent review of the adequacy and effectiveness of the risk management and internal control systems, examining key issues in relation to the accounting practices and all material controls and providing its findings and recommendations for improvement to the Audit Committee.

The risk and internal control department and the audit and monitoring department have adopted an audit method based on risk and control. With their operation plan throughout the year, the audit and monitoring department and the risk and internal control department cover every major task and program of the operation and business of the Company and service units. They also conduct extraordinary review as requested by the management and the result of audit work are submitted to the Audit Committee and the executive and senior management of the Company. The risk and internal control department and the audit and monitoring department conduct examination and follow-up on audit matters to strive for proper execution and report to the management of the Company (as the case may be) and the Audit Committee regularly.

RISK MANAGEMENT AND INTERNAL CONTROL MEASURES

The Company has adopted several policies and programs to evaluate and prudently boost the effectiveness of the risk management and internal control system, including the requirement on the executive management of the Company to conduct evaluation and verify in person the proper and effective operation of such matters every year. The Company believes that such measure shall strengthen future corporate governance and business practice.

In 2018, the Company adopted the following key effective measures to strengthen our risk management system:

- The Company consolidated and optimized our entire governance policy in order to enhance the fundamental Governance, including provisional procedures on the management of investment projects, annual key project, information and equity investment evaluation;

- The Company's internal audit and internal control assessment incorporated risk management to the state of audit planning, and prepared the sufficiency and effectiveness assessment report for the year based on the Company's comprehensive risk analysis;

- Furthermore, the Company has established a comprehensive risk management system and devised rules and regulations on risk management and handbook on internal control. It established a clear set of risk management method based on six steps including objective determination, risk identification, risk assessment, risk response, control measure and continuous monitoring. Further risk management and control work will focus on continuous implementation of the system. Building on the standardization of risk management and control system, procedure and authority, we will optimize the inspection mechanism for internal control so as to achieve informatization of risk management and control indicators, enabling the Company's operation and management to better align with risk management and control. We also strived for sound and effective operation of the internal control system by establishing a mature risk management and control model to safeguard strategic development of the Company.

The risk and internal control department and the audit and monitoring department report their work in respect of the sufficiency and effectiveness of the risk management and internal control for the previous period to the Board and the Audit Committee at every regular meeting throughout the year, including but not limited to highlighting any failure in the implementation of these control procedures or any material deficiencies of the procedures.

The risk and internal control department takes the lead in the risk management process of the Company by identifying and assessing the material risks within the Group. The management will then discuss, agree and implement relevant risk management measures and corresponding responsive measures. Relevant risk assessment results are reported to the Board and the Audit Committee.

REVIEW OF RISK MANAGEMENT AND INTERNAL CONTROL EFFECTIVENESS

The Audit Committee and the Board were not aware of any key findings that would have any substantive impact on the business or financial condition of the Company, and of the opinion that the existing risk management and internal control system is appropriate and effective in terms of sufficiency of resources, qualification and experience of staff, training program and financial budget, internal audit and financial report.

The Management reported to the Board and the Audit Committee on the effectiveness of the risk management and internal control system of the year as at 31 December 2018.

The Board, as supported by the Audit Committee as well as the management report and the internal audit findings, reviewed the risk management and internal control systems, including the financial, operational and compliance controls, for the year ended 31 December 2018, and considered that such systems are effective and adequate. The annual review also covered the financial reporting and internal audit function and staff qualifications, experiences and relevant resources.

INTERNAL AUDIT

The Company has specially established an internal audit and supervision department responsible for the internal control of the Group.

The internal audit and supervision department conducts regular supervision and examination over the business of the Group and also carries out the special supervision and examination for significant projects to regulate the management of the Group.

The internal audit and supervision department reports its work to the Audit Committee on a periodical basis while the Audit Committee reviews and approves the internal audit reports and the annual plan for internal audit annually. The audit opinions will be reported to the Board through the Audit Committee.

The Company has set up an independent reporting channel through which the staff of the Company can report the corrupt conducts of other staffs of the Company directly to the internal audit and supervision department, so that the Company can be held harmless from frauds and other misconducts.

INFORMATION DISCLOSURE

The Company has formulated a set of continuing disclosure obligation procedures in response to the inside information provisions under the SFO and the Listing Rules.

The Company proactively publishes voluntary announcements for the matters of significance involving the current development status of the Company so that Shareholders and investors can be timely aware of the current status of the business development of the Company.

COMPANY SECRETARY

Ms. Lee Mei Yi of Tricor Services Limited, an external service provider, has been appointed by the Company as one of its Joint Company Secretaries since 7 July 2015. The primary contact person at the Company is Mr. He Bin, one of the Joint Company Secretaries of the Company, who resigned on 30 August 2018. The current primary contact person at the Company is Ms. Zhuang Wenmin who was appointed on 30 August 2018 as one of the Joint Company Secretaries of the Company.

All Directors have access to the advice and services of the Joint Company Secretaries on corporate governance and board practices and matters.

Mr. He Bin (resigned on 30 August 2018), the former Joint Company Secretary, and Ms. Zhuang Wenmin (appointed on 30 August 2018) and Ms. Lee Mei Yi, the current Joint Company Secretaries, have complied with Rule 3.29 of the Listing Rules by taking no less than 15 hours of the relevant professional training during the Year.

SHAREHOLDERS' RIGHTS

To safeguard Shareholder interests and rights, separate resolutions are proposed for each substantially separate issue at Shareholders' meetings, including the election of individual Directors.

All resolutions put forward at Shareholders' meetings will be taken by poll pursuant to the Listing Rules and poll results will be posted on the websites of the Company and of the Stock Exchange after Shareholders' meeting.

CONVENING AN EXTRAORDINARY GENERAL MEETING BY SHAREHOLDERS

The Board may, whenever it thinks fit, convene an extraordinary general meeting. Extraordinary general meetings may be convened by the Board on requisition of one or more Shareholders holding, at the date of deposit of the requisition, not less than one tenth of the paid up capital of the Company having the right of voting at general meetings. Such requisition shall be made in writing to the Board or the Secretary for the purpose of requiring an extraordinary general meeting to be called by the Board for the transaction of any business specified in such requisition. Such meeting shall be held within 2 months after the deposit of such requisition. If within 21 days of such deposit, the Board fails to proceed to convene such meeting, the requisitionist(s) himself (themselves) may do so in the same manner, and all reasonable expenses incurred by the requisitionist(s) as a result of the failure of the Board shall be reimbursed to the requisitionist(s) by the Company.

PUTTING FORWARD PROPOSALS AT GENERAL MEETINGS

There is no provision allowing Shareholders to move new resolutions at general meetings under the Cayman Islands Companies Law or the Articles of Association of the Company. Shareholders who wish to move a resolution may request the Company to convene a general meeting following the procedures set out in the preceding paragraph.

PUTTING FORWARD ENQUIRIES TO THE BOARD

For putting forward any enquiries to the Board of the Company, Shareholders may send written enquiries to the Company.

Note: The Company will not normally deal with verbal or anonymous enquiries.

CONTACT DETAILS

Shareholders may send their enquiries or requests as mentioned above to the following:

Address: Room 2508, Harcourt House, 39 Gloucester Road, Wan Chai, Hong Kong

Email: shareholder@hhcp.com.cn

For the avoidance of doubt, Shareholders must deposit and send the original duly signed written requisition, notice or statement, or enquiry (as the case may be) to the above address or 99 East Road, Information Park, Jinniu District, Chengdu, Shichuan, People's Republic of China and provide their full name, contact details and identification in order to give effect thereto. Shareholders' information may be disclosed as required by law.

COMMUNICATION WITH SHAREHOLDERS AND INVESTORS

The general meetings of the Company provide a forum for communication between the Board and the Shareholders. The Chairman of the Board as well as chairmen of the Audit Committee, Remuneration Committee and Strategic Investment and Risk Control Committee or, in their absence, other members of the respective committees normally attend the annual general meetings and other relevant Shareholders' meetings to answer questions of Shareholders. Notices to Shareholders for annual general meetings and all other general meetings will be sent to the Shareholders before such meetings pursuant to the requirement of the Listing Rules.

Information relating to the Company's financial results, corporate details, major projects and events are disseminated through publications of interim and annual reports, announcements, circulars and other corporate communications and publications available on the websites of the Stock Exchange and the Company.

During the Year under review, the Company has not made any changes to its Articles of Association. An up-to-date version of the Company's Articles of Association is also available on the websites of the Stock Exchange and the Company.

To promote effective communication, the Company maintains a website at http://www.hh-gltd.com, where up-to date information and updates on the Company's business operations and developments, financial information, corporate governance practices and other information are available for public access.

DIVIDEND POLICY

The Company has adopted a dividend policy (the "Dividend Policy"). With an emphasis on providing reasonable investment return to its Shareholders, the Company strives to implement a sustained and stable dividend policy by considering the current actual operating conditions of the Company, the sustainability and the interests of the Shareholders as a whole.

The Company may distribute dividends to the Shareholders in cash, in shares or in other forms as the Board considers appropriate.

According to the Dividend Policy, subject to the relevant criteria, based on the audited annual statements and the net profit attributable to the Shareholders for the Year and on the premise that the distributable profit is positive and there is sufficient working capital, the Company may distribute annual dividends to the Shareholders in cash in proportion to at least 30% of the annual distributable profit in principle.

In deciding whether to propose a dividend and in determining the dividend amount, the Board shall consider the following factors as a whole: the financial results, the cash flows, the future operations and revenue, the capital requirements and capital expenditure plan, the Shareholders' interests of the Company and its subsidiaries as well as any other relevant factors.

The Board will review the Dividend Policy from time to time and may exercise at its sole and absolute discretion to update, amend and/or modify the Dividend Policy at any time as it seems fit and necessary. There is no assurance that dividends will be paid in any particular amount for any given period.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT

SCOPE AND REPORTING PERIOD

This is the third Environmental, Social and Governance ("ESG") report by the Honghua Group Limited ("the Group"), highlighting its ESG performance, with disclosure reference made to the ESG Reporting Guide as described in Appendix 27 of the Listing Rules and Guidance set out by The Stock Exchange of Hong Kong Limited.

The Group is a large-scale equipment manufacturer and drilling service provider, specializing in research, design, manufacture and set-assembly of drilling rigs, offshore engineering and oil & gas exploitation and production equipment.

This ESG report covers the Group's overall environmental and social performances of its major business operations which contribute to the Group's most significant environmental and social impacts. These include the business operations Honghua Group Limited and its subsidiaries Honghua (China) Investment Co., Ltd. and Sichuan Honghua Petroleum Equipment Co., Ltd. in (i) the head office in Chengdu, (ii) the office and (iii) the manufacturing plant in Guanghan, Sichuan Province of the People's Republic of China ("PRC"), from 1 January 2018 to 31 December 2018, unless otherwise stated. The reporting scope of this ESG report remained unchanged compared to the last reporting period.

STAKEHOLDER ENGAGEMENT AND MATERIALITY

The Group values input and feedback of its stakeholders as they bring invaluable directions for continuous development to the Group. Internal and external stakeholders have been involved in regular engagement activities to share views regarding the Group's operation and performances. The Group has specifically engaged the board members, senior management, frontline staff, suppliers and clients to gain further insights on ESG material aspects and challenges in the reporting period. Through meetings and surveys, the Group and its stakeholders identified the following top five material aspects:

- Air emission;
- Waste and effluent;
- Employment;
- Occupational health and safety; and
- Product quality.

The above aspects were strictly managed through strict compliance with the relevant laws and regulations, the Group's policies and guidelines. Management of the aspects have been described in separate sections below. The Group will continue to identify areas of improvement for the concerned aspects and keep close communication with its stakeholders to share and exchange ideas for advancing the Group's ESG management.

STAKEHOLDERS' FEEDBACK

The Group welcomes stakeholders' feedback on our ESG approach and performance. Please give your suggestions or share your views with us via email at shareholder@hhcp.com.cn.

THE GROUP'S SUSTAINABILITY VISION AND COMMITMENT

As a largest exporter of land drilling rigs in China and one of the largest land drilling rig manufacturers in the world, the Group is committed to leading the industry with the highest standards.

ESG management is of great importance in the Group's business operation. The Group incorporates ESG considerations into its operation and is devoted to:

- Ensuring occupational health and safety of employees;
- Creating a green work environment;
- Improving capabilities of employees; and
- Enriching corporate culture to strengthen bond among employees.

The Board of the Group understands that a sound ESG management structure is essential to the Group's development. Apart from pursuing continuous growth and success, the Group strives for excellence in its ESG management. The Group also communicates with its stakeholders in an open and transparent manner so as to enhance stakeholders' understanding towards the Group's operation.

STANDARDS AND CERTIFICATIONS

As a licensed manufacturer under the American Petroleum Institute ("API") Monogram program, the Group conforms to the specifications set out by the API. The Group's quality management system complies with the ISO 9001: 2008 and GB/T 19001-2008 standards and its design, manufacture and service of drilling rigs and associated components conform with the API Specification Q1.

A. ENVIRONMENTAL

The Group operates in accordance with its policies formulated for environmental and resources management, which are also in compliance with all applicable national laws and regulations including the Environmental Protection Law, the Atmospheric Pollution Prevention and Control Law, the Water Pollution Prevention and Control Law and the Law on Prevention, Control of Environmental Pollution by Solid Waste and Soil Pollution Prevention and Control Law of the PRC. All emissions and discharges meet the national statutory standards. There were no major non-compliances related to air emissions, water discharges and disposal of wastes.

Compared to the last reporting period, the overall generation of hazardous and non-hazardous waste had increased due to the increased production volume in the reporting period.

A1. Emissions

A1.1. Air Pollutant Emissions

The Group consumed natural gas, liquified petroleum gas ("LPG"), petrol and diesel in the reporting period, which contributed to the emission of 1,172.96 kg of nitrogen oxides ("NOx"), 13.95 kg sulphur oxides ("SOx") and 17.58 kg respiratory suspended particles ("PM"). Emissions from the Group's operation were treated before releasing into the atmospheric air.

A1.2. Greenhouse Gas Emissions

Scope of Greenhouse Gas Emissions	Emission Sources	Emission (in tonnes of carbon dioxide equivalent "tCO_2e")	Total Emission (in percentage)
Scope 1 Direct Emission			
Combustion of fuel for stationary source	Natural gas	3,553.15	43%
	LPG	4,426.89	
	Diesel	1,097.72	
Combustion of fuel for mobile sources	Petrol	1,165.11	
	Diesel	780.77	
Scope 2 Energy Indirect Emission			
Purchased energy		13,042.21	54%
Purchased natural gas		962.22	
Scope 3 Other Indirect Emission			
Paper waste disposal		33.56	3%
Electricity used for freshwater processing		57.47	
Electricity used for sewage processing		20.77	
Business air travel		656.65	
Total		25,796.52	100%

Note 1: Emission factors were made reference to Appendix 27 of the Main Board Listing Rules and their referred documentation as set out by Hong Kong Exchanges and Clearing Limited, unless stated otherwise.

Note 2: Emission factors for combustion of natural gas and LPG for stationary source were made reference to GHG Emissions from Stationary Combustion (Chinese), provided by the Greenhouse Gas Protocol.

Note 3: Combined margin emission factor of 0.65 tCO_2/MWh was used for purchased electricity in Sichuan Province of the PRC.

The Group's activities contributed to 25,796.52 tonnes of carbon dioxide equivalent (emission intensity: 0.11 tCO_2e/m^2) (including carbon dioxide, methane and nitrous oxides) emitted in the reporting period.

A1.3. Hazardous Waste

Hazardous wastes generated were stored in designated container and collected by qualified licensed collectors. A total of 113.17 tonnes of hazardous wastes was generated in the reporting period.

Hazardous Wastes	Wastes Generated (in tonnes)	Wastes Generated (in percentage)
Waste mineral oil	83.73	74%
Waste containers with oil paint	24.17	21%
Waste activated carbon	3.12	3%
Oil-containing wraps	1.00	1%
Oil-containing gloves	1.00	1%
Developing and fixing solution	0.15	<1%
TOTAL	113.17	100%

A1.4. Non-hazardous Waste

A total of 7,636.72 tonnes of non-hazardous wastes was generated by the Group during the reporting period. Non-hazardous wastes were collected by qualified collectors.

Non-hazardous Wastes	Wastes Generated (in tonnes)	Wastes Generated (in percentage)
Scrap steel	4,748.91	62%
Scrap iron filings	1,501.88	20%
Commercial waste	1,120.00	15%
Waste wood materials	120.00	1%
Ash from sandblasting	120.00	1%
Waste paper	19.10	<1%
Waste wire coil	4.20	<1%
Waste lighting	1.62	<1%
Scrap copper wire	1.00	<1%
TOTAL	7,636.71	100%

A1.5. Measures to Mitigate Emissions

The health, safety and environmental ("HSE") policies of the Group were formulated with the objectives of pursuing occupational health and production safety, minimizing environmental pollution, and sustaining continuous improvement. Emissions and discharges are closely monitored, analysed, and inspected regularly by qualified specialists. If any accidents causing disruption or damages to the surrounding communities or the environment occurred, responsible persons will be subject to disciplinary actions.

The Group monitors emissions of dust and smoke, sulphur dioxide, nitrogen oxides, volatile organic compounds ("VOCs"), benzene, toluene and xylene. Dusts are also filtered by filter bags and water-based paint are used to reduce VOCs emission. Smoke generated from welding is purified by appropriate ventilation and fume extractors. The Group also adopts advanced technologies to control emissions such as activated carbon adsorption, plasma adsorption and plasma-UV catalysis treatment. The collection and treatment facilities have efficiencies of 95% or above.

Apart from emission control, the Group centralises coordination of vehicle arrangement to ensure that vehicles are used in the most efficient way. The Group has established a management mechanism for sales teams' business trip and visiting, tracking business air travels and avoiding air travels whenever possible.

A1.6. Waste Reduction and Initiatives

The Group avoids and reduces paper use to promote a paperless office. When waste is inevitably generated, the Group recycles wastes to minimize adverse impact to the environment. It encourages double-sided printing and provides recycling collection trays to separately collect recyclable paper. Apart from saving paper, distribution of office resources (e.g. stationaries) is also strictly monitored through a registration system. When collecting, storing, transporting, using and treating solid wastes, the Group avoids air nuisance and leakage, and does not allow any unpermitted disposal of wastes.

With the Group's effort in paper recycling, a total of 4.78 tonnes of paper had been recycled during the reporting period.

A2. Use of Resources

To encourage utilization of resources, the Group formulated the management policy regarding energy and resources use, which manages consumption of natural gas, electricity, water, raw materials, packaging materials, office paper and other office necessities. Due to the enormous increase in production volume, the consumption of natural gas, petrol, diesel, electricity and water had been significantly increased during the reporting period.

A2.1. Energy Consumption

The energy use involved in the Group's operation includes the consumption of natural gas, LPG, petrol, diesel and electricity. The Group consumed a total of 66,574.01 MWh (energy intensity: 0.28 MWh/m^2) of energy in the reporting period.

Energy Consumption Sources	Direct Consumption	Consumption (in MWh)
Natural Gas	1,625,372.95 m^3	16,062.07
LPG	1,398,869.74 kg	19,498.30
Petrol	432,224 L	3,830.22
Diesel	714,279 L	7,141.60
Electricity	20,041,808 kWh	20,041.82

Natural gas was consumed for central air conditioning, canteen operation, heating and forging; LPG was used for canteen operation and production; petrol and diesel were used for drilling rig testing and Group-owned vehicles. To avoid leakage of natural gas, the Group regularly inspects and maintains transmission pipelines. The Group will repair the pipelines immediately once leakage is identified.

A2.2. Water Consumption

A total of 142,790 m^3 (water intensity: 0.59 m^3/m^2) of water was supplied by the municipal water suppliers and there was no issue in sourcing water that is fit for purpose during the reporting period.

Wastewater Treatment

A total of 102,460 m^3 of wastewater was generated during the reporting period. The Group keeps track of its discharges and holds valid discharge permit and discharge wastewater to third-party wastewater treatment facilities. It continuously improves its production process, upgrades equipment, adopts new technologies, reinforces existing on-site wastewater treatment facilities and reuses production water after sedimentation. Wastewater discharge was monitored and was in compliance with the Integrated Wastewater Discharge Standard (GB8978-1996) of the PRC.

A2.3. Energy Use Efficiency Initiatives

The Group keeps track of its monthly electricity consumption and controls consumption by:

- Developing electricity consumption systems to calculate, compare and analyse total electricity consumption;
- Adopting energy-saving lightings whenever possible;
- Controlling the temperature of air-conditioners at the range of 23–25°C;
- Educating employees to optimize productivity and reduce unnecessary electricity use; and
- Promoting electricity conservation behaviours among employees.

With the Group's effort in reducing energy consumption and enhancing energy efficiency, approximately 7,600 kWh of electricity had been saved during the reporting period.

A2.4. Water Use Efficiency Initiatives

The Group keeps track of its monthly water consumption and controls consumption by:

- Utilizing wastewater and reduce discharges;
- Reusing production water after treating by sedimentation;
- Maintaining taps, fire hydrants and pipe network to avoid wastage due to leakage; and
- Promoting water conservation behaviours among employees.

After implementing the abovementioned initiatives, approximately 3,000 m^3 of water had been saved during the reporting period.

A2.5. Packaging Materials

At product design stage, the Group reduces the use of raw materials whenever possible. Raw materials in stock shall be used before using new materials. The Group consumed mainly steel materials, steel plates, plywoods, wooden boxes, laminated lumber and PVC cloth during the reporting period. Packaging materials were mostly made up of recyclable materials. The Group repurposes waste packaging materials on site whenever possible. For example, waste wooden boxes were used for making brackets and scrap iron was used for making transferral trays.

Packaging Materials	Consumption
Steel materials	81,018.35 kg
Steel plates	2,961.60 kg
Plywoods	400 pieces
Wooden boxes	24 pieces
Laminated lumber	20 pieces
PVC cloth	4 pieces

A3. The Environment and Natural Resources

A3.1. Significant Impacts of Activities on the Environment

The Group's production generates exhaust gas, dust and smoke, wastewater and noise nuisance. The Group has therefore taken the following actions to minimize significant impact on the environment and natural resources:

- Treating exhaust gas by activated carbon and plasma purification;
- Treating dust and smoke by bag filters;
- Treating wastewater through sedimentation and discharging to qualified third-party wastewater treatment plants; and
- Reducing production noise level and vibration by sound insulation wall.

The abovementioned emissions, wastewater and noise level has been monitored and assessed annually. The Group will continue to minimize its adverse impact on the environment through regular monitoring, assessment and evaluation of performances.

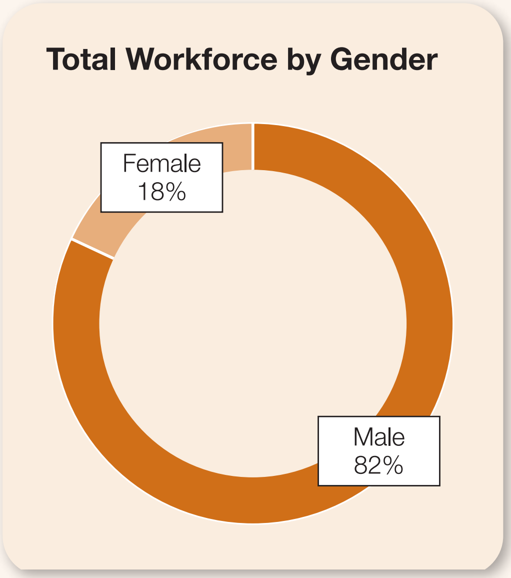
B. SOCIAL

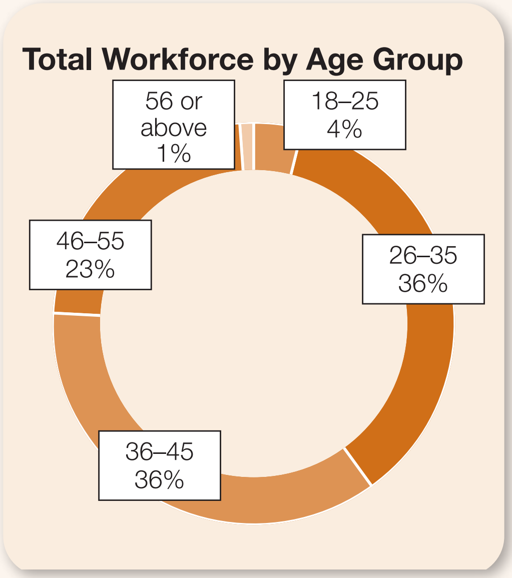
1. *Employment and Labour Practices*

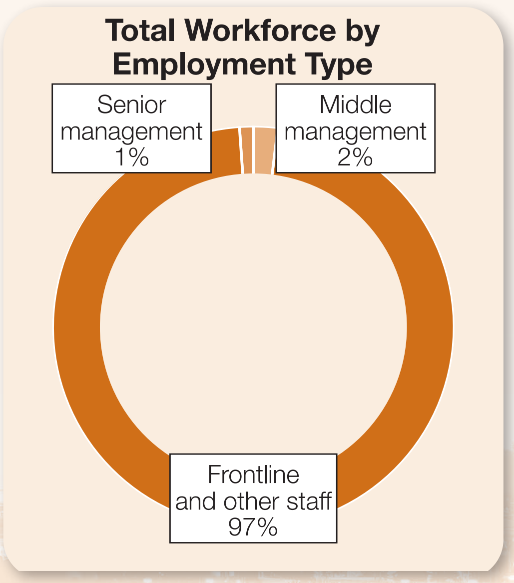
B1. Employment

Total Employees and Turnover

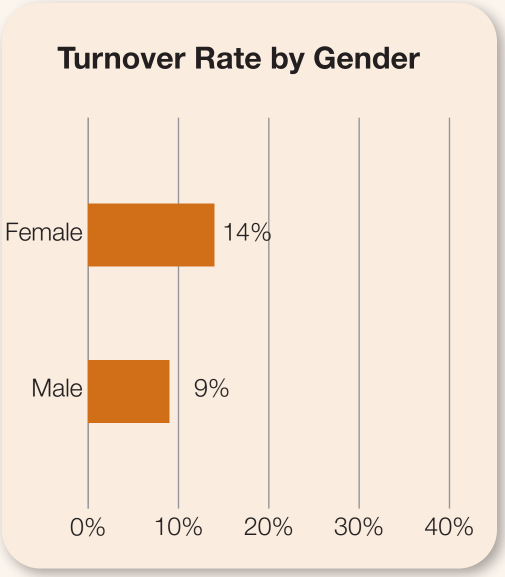
There were 2,127 employees as of 31 December 2018, in which all of them were full-time employees from the PRC.

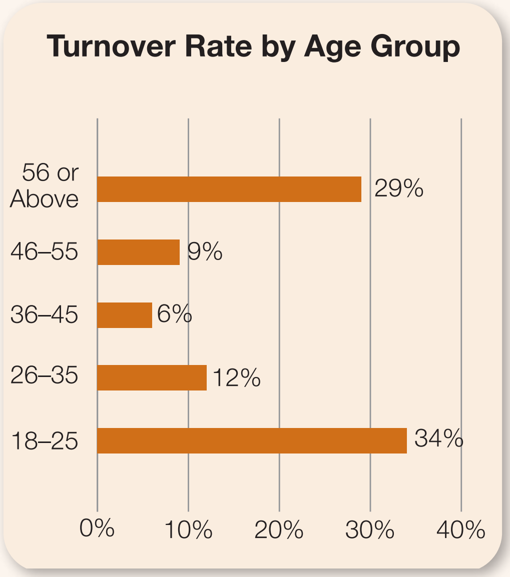


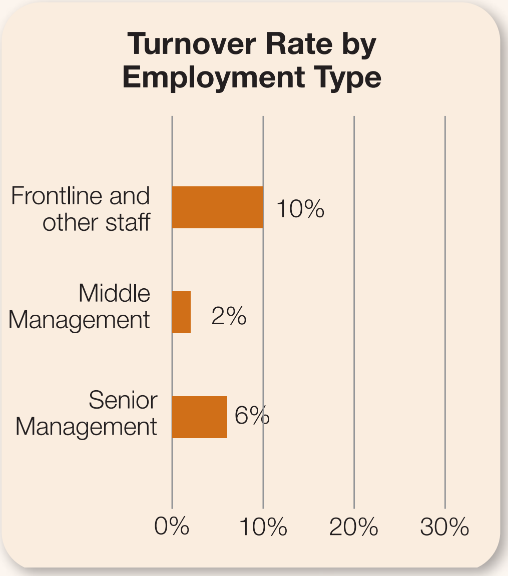




A total of 205 employees left the Group during the reporting period (turnover rate: 9.64%).







Employee Benefits and Welfare

The Group provided social insurances (including pension, medical, work-related injury, unemployment and maternity insurances), housing fund contributions and other welfare according to the statutory requirement. Major benefits provided by the Group cover all members of the Group and vary depending on job positions.

Remuneration and benefit packages include basic salary, overtime work compensation, allowances, awards and bonuses. Salary is reviewed every two years and adjusted in accordance with the overall cost of living, industrial salary trend, market trend, the Group's remuneration strategies and its performances.

- Insurance: mandatory social insurances, supplementary medical, employer's liability and accident insurance
- Allowances: service, night shift, health care, heatstroke prevention, food, consolation, lactation and training allowances
- Bonuses: performance and examination bonuses

There was no material non-compliance with laws and regulations relating to compensation and dismissal, recruitment and promotion, working hours, rest periods, and other benefits and welfare was recorded during reporting period.

Equal Opportunity

The Group treats employees equally regardless of their nationality, ethnicity, race, sex, religious belief and cultural background. There was no material non-compliance with laws and regulations relating to equal opportunity, diversity and anti-discrimination was recorded during reporting period.

Communication with Employees

The Group attaches great importance to employee health and satisfaction. It cares for the physical and mental health of employees and their families. During the reporting period, the Group organized a series of activities including site holiday home visits, oral health seminars, children's painting exhibition, wine tasting event, youth reading club and related sharing events, walking exercises and basketball competitions, etc. With the employee satisfaction rate of 95.32%, these engaging activities have effectively boosted employee contentment and fulfilment, at the same time promoting continuous improvement, diligence and team cooperation. They also ensure sharing of common values between employees and the Group and the creation of a motivating work environment.

B2. Employee Health and Safety

Occupational Health and Safety

Occupational health and safety issues are managed by the Group's HSE committee. Management on occupational health and safety have met the OHSAS 18001:2007 standard and the Group will migrate to the ISO 45001 standard in 2020. To pursue occupational health and production safety, the Group has separate policies on different aspects including safe production, occupational hazards, hazardous chemical, fire safety, accident prevention and emergency response plan. Employees' safety practices and performances are examined regularly to ensure competence for safe operation.

Before entering the production site, employees are required to put on personal protective equipment ("PPE") provided by the Group properly. If not put on properly, employees can be subject to disciplinary actions. The Group also provided allowance for distribution of heatstroke prevention products at high temperature conditions.

During the reporting period, the Group has developed plans for health and safety related training and introduced the Safety Month Program. The program included various activities that raise employee awareness regarding health and safety, such as knowledge competition, drills for emergency and other promotional events. The activities not only raised employee awareness on health and safety, but also enhanced employee emergency response. In addition, to remind employees to stay away from machines, the manufacturing plant has added warning tapes on the ground to separate machine areas and pavement.

In August 2018, exceedances of dust, xylene and noise level were found at individual measuring points during the occupational risk assessment conducted by third party. The Group had followed advice provided by the third-party assessment company to maintain ventilation facilities of workplace, implement safety measures to protect employees working under high temperature, and enhance promotion of occupational health and safety. Abiding by the *Law of the PRC on Prevention and Control of Occupational Diseases* and the *Law of the PRC on Work Safety*, there was no material non-compliance with laws and regulations relating to providing a safe working environment and protecting employees from occupational hazards during reporting period.

Occupational Health and Safety Data in 2018

Work related fatality	0
Work injury cases >3 days	6
Work injury cases <=3 days	1
Lost days due to work injury	589

Food Health and Safety

The Group has explicit contract terms with its contractors to ensure food safety. Food ingredients were tested before cooking. Samples of each dish are kept for record and testing if necessary. Food premises are sanitized regularly and inspected every day.

B3. Development and Training

During the reporting period, employees have participated in various types of training including induction, operational, safety, quality, and management training. To nurture talents, the Group has established online and offline training system and conducted skills evaluation for employees. Training sessions are also focused on employee needs to ensure that employee develop and improve according to their own needs. During the reporting period, employees of the Group had participated in a total of 7,269 hours of training, the average training hours per employee was 3.42 hours.

B4. Labour Standards

In pursuance of the Labour Law and the Labour Contract Law of the PRC, there were no child labour nor forced labour in the Group. All employees have signed the employment contract and agreed on the stipulated employment terms and conditions. The rights and interests of women and teen workers are protected under the Group's policies and all the applicable national regulations. There was no material non-compliance with laws and regulations in relation to prevention of child and forced labour during reporting period.

2. Operating Practices

B5. Supply Chain Management

According to the Group's scoring system, suppliers are assessed and scored with respect to their qualifications, productivity, technology, performances, quality management and control. The Group only selects qualified suppliers that have passed their supplier assessments. Selected suppliers are evaluated against different performance criteria monthly and annually. Major suppliers of the Group were from the United States, the PRC, Hong Kong, the United Arab Emirates, Dubai, Norway, Germany, Singapore, Britain, India, Sweden and Canada.

To manage environmental and social risks of the supply chain, the Group articulates its HSE policies to suppliers through the procurement agreement and has implemented measures to assess and monitor environmental and social performances of suppliers as shown in the table below.

Management of Supply Chain

Environmental Aspects	• Through procurement agreement or oral communication, the Group requires suppliers to use environmentally-friendly materials for packaging and minimise adverse impact to the environment if possible. • The Group assesses discharge permits of suppliers when applicable. Suppliers without valid discharge permits will not pass the Group's supplier assessment. • When assessing suppliers, the Group takes into account whether the suppliers have been certified to any environmental management system. Suppliers with certified environmental management system attain higher scores in the scoring system. • The Group requires selected suppliers to sign the Safety, Fire and Environmental Protection Agreement.
Social Aspects	• Suppliers supplying PPE shall possess valid LA certificates and fulfil qualification requirements set by the Group. Selected suppliers are evaluated by the safety management department and production department of the Group annually. • Before entering the manufacturing plants, suppliers must read and sign the Entry Terms or the Entry Safety Notice. They will be reminded to put on appropriate PPE and comply with the safety requirements set out by the Group. • Through agreement, the Group requires suppliers to safeguard their employees' health and safety.

B6. *Product Responsibility*

In order to provide quality products and services to customers, the Group established quality management system in compliance with the ISO 9000 standards and complies strictly with the API specification Q1. The department of quality management establishes, implements and maintains the quality management system to promote continuous improvement. There was no material non-compliance relating to health and safety, advertising, labelling and privacy matters regarding products and services provided and method of redress during the reporting period.

Product Assurance and Recall

Product quality is assured through compliance with international standards and the stringent inspection processes. Apart from meeting the ISO 9000 standards, main components of drilling rigs obtained the CE markings, fulfilled the state Gosstandart ("GOST") standards, API standards and all product requirements of the export markets where products are sold.

The Group manages its manufacturing process and its outsourced contractors' performances effectively. Defective incoming materials, semi-finished products and final products are eliminated from the production line immediately after noticed. Substandard products are analysed and handled with corrective or preventive measures according to the Group's policy. No product was recalled due to safety and health reasons and no material non-compliance with laws and regulations in relation to product health and safety was recorded during the reporting period.

Intellectual Property ("IP") Rights

The Group protects self-owned IP rights and make certain that its suppliers and other business partners respect IP rights of third parties. All drawings, ideas, manuals, designs, models, formulas provided by the Group to suppliers and other business partners shall not be copied or leaked to third parties without the Group's consent. The Group respects IP rights and prudently avoids infringement through research and analysis. Suppliers and other business partners shall not infringe copyrights, patent rights, trademarks and other IP rights in the process of research and development, design and manufacture. They can be held responsible for all costs if their infringement has caused loss to the Group.

Responsible team was set up for analysing Group-owned IP rights, identifying risks and dealing with infringement cases. After investigation and analysis by the responsible team and the legal department, the Group may take legal actions against infringers depending on the circumstances. No material non-compliance with laws and regulations in relation to IP rights was recorded during the reporting period.

Information Security Management

The Group has developed policies for information security management. To protect internal information and data, the Group adopted measures including:

— Control of authorities and accessibilities, USB ports and optical drive uses;

— Prohibition of the use of peer-to-peer file sharing services and installation of software at user level;

— Audit of internet access and activities; and

— Encryption of core data.

By signing the employment contract, employees also undertake not to disclose any confidential information (including customer information) and to protect IP rights. Customer information includes but is not limited to customers' ideas, inventions, data and models, content of documents and correspondences, financial information, marketing strategies and trade secrets. Employees in breach of the contract can be dismissed. No substantiated complaints concerning breaches of client privacy, identified leaks, thefts, or losses of customer information was received during the reporting period.

B7. Anti-corruption

The Group's anti-corruption policy promotes integrity and standardizes discipline of employees to protect legitimate rights of shareholders and investors. Any bribery, theft, fraud and misappropriation are prohibited. Improper benefits including banquets, entertainment, cash, stocks, equities, securities, valuables and properties, etc. shall not be accepted. This applies to any process of its business operation including procurement, manufacturing, marketing and communication.

Top management of the Group has assessed corruption risks and established respective monitoring procedures and system. Employees' awareness is raised through anti-corruption related talks, educational videos and promotion materials displayed in prominent areas. When there are alleged cases in violation of laws, regulations or the Group's policy, the Group will investigate and impose disciplinary actions (including warning, record of demerit, demotion and dismissal) upon offenders after verification. Whistle-blowers can report suspected cases to the auditing department through email (hhgp.jubao@hhcp.com.cn) or hotline (028-68176829).

During the reporting period, the Group's anti-corruption policy has been revised, implementing integrity and discipline related talks, correspondence communication methods, and inspection and supervision methods. The Group was in compliance with the Group's policy and all applicable laws on prohibiting corruption and bribery of the PRC. There was no concluded legal case regarding corrupt practices brought against the Group or its employees during the reporting period.

B8. Community Investment

The Group had no particular policy on community investment, but it actively supports poverty alleviation. During the reporting period, it has spent over RMB260,000 to purchase agricultural products produced from the state's poverty counties; its employees donated approximately RMB100,000 to the designated point of poverty alleviation in Yunnan Province of the PRC; and donated over RMB1,200,000 to Honghua Foreign Language School in Guanghan, Sichuan Province of the PRC.

REPORT OF THE DIRECTORS

The Board presents this annual report, together with the audited consolidated financial statements of the Group for the year ended 31 December 2018.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The Group principally engages in research, design, manufacture, setting and sale of land rigs and related parts and components, design and manufacture the offshore drilling module. Meanwhile it also provides clients with technical support services and drilling engineering services. During the Year, the nature of principal activities of the Group has no substantial change.

RESULTS AND DISTRIBUTION

The results of the Group for the year ended 31 December 2018 are set out in the consolidated financial statements on pages 89 to 239 of this annual report.

The Board did not recommend a final dividend for the year ended 31 December 2018.

CLOSURE OF REGISTER OF THE MEMBERS

The register of members of the Company will be closed from Thursday, 13 June 2019 to Wednesday, 19 June 2019, both days inclusive, for the purpose of ascertaining shareholders' entitlement to attend and vote at the Annual General Meeting. In order to be eligible to attend and vote at the Annual General Meeting, all transfer documents accompanied by the relevant share certificates must be lodged for registration with the Hong Kong branch share registrar and transfer office of the Company, Computershare Hong Kong Investor Services Limited, at Shops 1712–1716, 17th floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong for registration not later than 4:30 p.m. on Wednesday, 12 June 2019.

SHARE CAPITAL

Changes in the share capital of the Company during the Year are set out in note 21 to the consolidated financial statements.

PRE-EMPTIVE RIGHT

There is no provision of pre-emptive right under the Articles of Association and the laws of the Cayman Islands stipulating that the Company shall offer new Shares to existing Shareholders in proportion.

PURCHASE, SALE OR REPURCHASE OF THE LISTED SECURITIES OF THE COMPANY

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares during the year ended 31 December 2018.

RESERVES

As of 31 December 2018, the Group has a total of approximately RMB3,641 million worth of reserve. Details of movements in the reserves of the Group during the Year are set out in the consolidated statement of changes in equity in the consolidated financial statements.

SUBSIDIARIES

Details of the Company's principal subsidiaries as of 31 December 2018 are set out in note 11 to the consolidated financial statements.

DIRECTORS

The existing Directors of the Company during the Year and as of the date of this annual report are set out on page 2 the section "Corporate Information" of this annual report.

The status of all the Directors of the Company holding their offices during the year is set out in the section "Corporate Information".

In accordance with the Articles of Association, one third of the Directors (or closest to but not less than one third if the number is not three or a multiple of three) shall retire from office by rotation at each annual general meeting and each Director is required to retire at least once every three years and any Director appointed by the board shall hold office only until the next general meeting and shall then be eligible for re-election at the meeting. Mr. Jin Liliang, Mr. Han Guangrong, Mr. Chen Wenle and Ms. Su Mei will retire from office by rotation at the forthcoming annual general meeting and will be eligible for re-election.

According to the independent guidelines under the Listing Rules, the Company has received the annual confirmation of their independence from each Independent Non-executive Director, and the Company still considers such Independent Non-executive Directors as independent.

DIRECTORS' SERVICE CONTRACTS

Each of the Director of the Company is engaged on a service contract for a term of 3 years. The appointment may be terminated by not less than 3 months' written notice. The Directors shall retire by rotation and be eligible for re-election subject to the Articles of Association.

None of the Directors has a service contract with the Company which is not determinable within one year without payment of compensation, other than statutory compensation.

PERMITTED INDEMNITY

Pursuant to the Company's Articles of Association, subject to the Companies Law, every Director shall be indemnified out of the assets of the Company against all costs, charges, expenses, losses and liabilities which he/she may sustain or incur in the execution of his/her office or otherwise in relation thereto. The Company has taken out insurance against the liability and costs associated with defending any proceedings which may be brought against directors of the Group.

DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed under the following "Connected connected transactions", none of the Directors directly or indirectly had any material interest in the contracts of significance in relation to the Group's business to which the Company or its holding company or any of its subsidiaries was a party at the end of the Year or at any time during the Year.

REMUNERATION FOR DIRECTORS AND SENIOR MANAGEMENT

For the year ended 31 December 2018, details of remuneration for the Directors and Senior Management of the Company are set out in notes 32(f) and 36 to the consolidated financial statements.

The emoluments of the Executive Director and Senior Management by bands are as follows:

	2018 Number of individuals
RMB0 to RMB1,000,000	13
RMB1,000,001 to RMB2,000,000	6
RMB2,000,001 to RMB3,000,000	–
RMB3,000,001 to RMB4,000,000	–
RMB4,000,001 to RMB5,000,000	–
RMB5,000,001 to RMB6,000,000	–

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND/OR SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY OR ANY ASSOCIATED CORPORATION

At 31 December 2018, the interests and short positions of each Director and Chief Executive in the Shares , underlying Shares and debentures of the Company and its associated corporations (within the meaning of the SFO), as recorded in the register required to be kept by the Company under Section 352 of Part XV of the SFO or as notified to the Company and the Stock Exchange pursuant to the Model Code contained in Appendix 10 to the Listing Rules were as follows:

(A) ORDINARY SHARES OF HK$0.1 EACH OF THE COMPANY

	Long/Short position	Nature of interest	Number of shares held	% of the issued share capital of the Company
Mr. Zhang Mi	Long	Personal interest, corporate interest and settlor of a discretionary trust	1,083,554,363[1]	20.23%
Mr. Ren Jie	Long	Personal interest, corporate interest and settlor of a discretionary trust	33,776,200[2]	0.63%
Ms. Su Mei	Long	Personal interest	150,000[3]	0.002%

(1) Zhang Mi individually owns 3,050,000 Shares. Yi Langlin, spouse of Zhang Mi owns 2,156,000 Shares. Zhang Mi is the settlor of a discretionary trust, The ZYL Family Trust, whose trustee, through Wealth Afflux Limited, holds 36% of the issued share capital of Ally Giant Limited which holds 920,548,363 Shares. The Trustee of The ZYL Family Trust owns 157,800,000 Shares.

(2) Ren Jie individually owns 1,549,000 Shares. He is the settlor of a discretionary trust. The Trustee of The RJDJ Victory Trust owns 32,227,200 Shares.

(3) Su Mei individually owns 150,000 Shares.

(B) SHARE OPTIONS OF THE COMPANY

	Long/Short Position	Number of options held — Personal interest
Mr. Zhang Mi	Long	5,127,000
Mr. Ren Jie	Long	5,472,000
Mr. Qi Daqing (Resigned with effect from 1 January 2018)	Long	3,450,000
Mr. Liu Xiaofeng	Long	3,450,000
Mr. Chen Guoming	Long	2,550,000

Saved as disclosed above, at 31 December 2018, none of the Directors and Chief Executives (including their spouse and children under 18 years of age) had any interest in, or had been granted, or exercised, any rights to subscribe for Shares (or warrants or debentures, if applicable) of the Company and its associated corporations required to be disclosed pursuant to the SFO.

SUBSTANTIAL SHAREHOLDERS' INTERESTS OR/AND SHORT POSITIONS IN THE SHARES AND UNDERLYING SHARES OF THE COMPANY

The register of substantial shareholders required to be kept under section 336 of Part XV of the SFO shows that, at 31 December 2018, the Company had been notified of the following substantial shareholders' interests and short positions, being 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the Directors and Chief Executives of the Company.

		Number of shares held				
Name	Long/ Short Position	Personal interest Shares Interest	Corporate Interest	Corporate Interest and Settlor of a discretionary Trust	Total	% of the issued share capital of the Company
Ally Giant Limited	Long	920,548,363	–	–	920,548,363[1]	17.18%
Wealth Afflux Limited	Long	157,800,000	920,548,363	–	1,078,348,363[2]	20.13%
Equity Trustee Limited	Long	–	–	1,226,625,763	1,226,625,763[3]	22.90%
Yi Langlin	Long	2,156,000 1,086,525,363 (family interest)	–	–	1,088,681,363[4]	20.32%
Kehua Technology Co., Limited	Long	1,606,000,000	–	–	1,606,000,000[5]	29.98%
Shenzhen Aerospace Industry Technology Research Institute	Long	–	1,606,000,000	–	1,606,000,000[5]	29.98%
China Aerospace Science and Industry Corporation Limited	Long	—	1,606,000,000	–	1,606,000,000[5]	29.98%

Notes:

(1) Ally Giant Limited is owned by Wealth Afflux Limited and others 33 shareholders, holding 920,548,363 Shares in total.

(2) Wealth Afflux Limited is held by Equity Trustee Limited (as the trustee of The ZYL Family Trust). The ZYL Family Trust is a discretionary trust established by Zhang Mi (as the settlor),with Equity Trustee Limited (as the trustee). The beneficiaries under The ZYL Family Trust are Zhang Mi and his family members.

(3) Equity Trustee Limited, as the trustee of The ZYL Family Trust and the 8 other Trusts, holds 1, 226,625,763 Shares in total.

(4) Yi Langlin, spouse of Zhang Mi, is deemed to be interested in 1,088,681,363 Shares in which Zhang Mi holds 5,127,000 share options.

(5) Kehua Technology Co., Limited is owned 40% by Shenzhen Aerospace Industry Technology Research Institute and 60% by China Aerospace Science and Industry Corporation Limited and holds 1,606,000,000 Shares.

Save as disclosed above, to the best of the Directors and the Chief Executives of the Company's knowledge, as at 31 December 2018, none of the persons, other than the Directors or the Chief Executives of the Company, had interests or short positions in the Shares and underlying Shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or recorded in the register as required under Section 336 of the SFO.

SHARE OPTION SCHEME

(A) PRE-IPO SHARE OPTION SCHEME

The principal terms of Pre-IPO Share Option Scheme have been approved by resolutions in writing by all the Shareholders on 21 January 2008. A total of 270 eligible participants have been conditionally granted share options to subscribe for an aggregate of 60,000,000 Shares at an exercise price of offer price of HK$3.83 per Share. The vesting period of the Pre-IPO Share Option Scheme is ten years from the date of grant until 20 January 2018. As at 20 January 2018, none of the grantees has exercised the share options granted to him under the Pre-IPO Share Option Scheme, the total number of the share options granted have been cancelled or lapsed.

(B) SHARE OPTION SCHEME AFTER LISTING

Upon conditional approval by resolution in writing by all shareholders of the Company on 21 January 2008, the Company adopted a share option scheme (the "Share Option Scheme"). Details of the Share Option Scheme are as follows:

Purpose

The Company operates the Share Option Scheme for the purpose of providing incentive and rewards to participants who contribute to the success of the Group's operation and/or for the purpose that the Group may recruit or retain high calibre employees and attract people for the Group. The Share Option Scheme may provide the participants with opportunity of holding the Shares of the Company individually, and (a) facilitate the participants to use their best effort to improve their performance and effectiveness; and (b) attract and retain participants who are significant to long term development and profitability of the Group.

Participants

(a) any Executive Director, employee or proposed employee (whether full time or part time) of any member of the Group; (b) any Non-executive Director (including Independent Non-executive Director) of any member of the Group; (c) any supplier of goods or services to any member of the Group; (d) any customer of any member of the Group; (e) any advisor, consultant, any person or entity with professional or other services who provides research, development or other technical support to any member of the Group; (f) any shareholder of any member of the Group or any holder of any securities issued by any member of the Group; (g) any joint venture, business or strategic alliance partner of any member of the Group; (h) discretionary trust whose discretionary objects are as follows: any Executive Director, employee or prospective employee (whether full time or part time) and any Non-executive Director (including Independent Non-executive Director) of any member of the Group, any supplier of goods or services to any member of the Group, any customer of any member of the Group, any advisor, consultant, any person or entity with professional or other services who provides research, development or other technical support to any member of the Group, any shareholder of any member of the Group or any holder of any securities issued by any member of the Group and any joint venture, business or strategic alliance partner of any member of the Group.

Total number of Shares available for issue under the Share Option Scheme and % of issued share capital as at the date of this annual report

The total number of Shares available for issue under the Share Option Scheme upon exercise of all outstanding share options granted and yet to be exercised (excluding share options lapsed in accordance with the terms of the Share Option Scheme) was 113,209,936 Shares, representing approximately 2.11% of the issued share capital of the Company as at the date of this annual report.

Maximum entitlement of each participant

The maximum number of Shares issued and to be issued upon exercise of the share options (including those already exercised and outstanding share options) granted to each eligible participant under the Share Option Scheme in any 12-month period (until date of grant of share options) is limited to 1% of the Shares of the Company in issue. Any further grant of share options in excess of this limit is subject to Shareholders' approval in a general meeting but the participant and its associates must abstain from voting at the meeting. In this case, the Company must dispatch a circular to Shareholders, containing identity of the participant, number of share options to be granted to the participant (and share options previously granted to this participant) and related terms and all other data as required by the Listing Rules. The number and terms of the share options to be granted to this participant (including exercise price) must be determined before approval by the Shareholders. In calculating the subscription price, the date on which Board meeting is held for proposed further grant of share options is deemed as date of grant.

The period in which Shares must be taken up for under the Share Option Scheme

Share option may be exercised at any time during the period expiring tenth anniversary from the date of grant of share option as determined by the Board of Directors, but subject to early termination provisions of the terms of Share Option Scheme.

The minimum period, if any, for which a share option must be held before it can be exercised

Unless otherwise determined by the Board and stated in the offer of grant of share options to the grantee, there is no minimum period for which a share option must be held before it can be exercised.

Amounts to be paid on acceptance of share options

Grantee of share option must pay HK$1.00 to the Company upon acceptance of share option offer.

Basis of determining the exercise price

The subscription price of the share option granted under the Share Option Scheme is solely determined and notified to the participants by the Board of Directors, but not less than the highest of (i) the closing price of the Company's Shares as stated in the daily quotations sheet of the Stock Exchange on the date of the grant; (ii) the average closing price of the Company's Shares as stated in the Stock Exchange's daily quotations sheet for the five trading days immediately preceding the date of the grant; and (iii) the nominal value of the Company's Shares as at date of grant.

Condition and Termination of the share options

The Share Option Scheme is conditional on the Listing Committee of the Stock Exchange granting approval of the listing of, and permission to deal in, the Shares which may fall to be issued pursuant to the exercise of share options granted under the Share Option Scheme. The Company (by virtue of resolutions of general meeting) or the Board may at any time terminate the operation of the Share Option Scheme, under which circumstance, there will be no new share options to be granted, but the share options granted before the termination will continue to be valid and exercisable under the provisions of the Share Option Scheme.

The remaining life of the Share Option Scheme

Subject to early termination of the Share Option Scheme pursuant to the terms thereof, the Share Option Scheme shall remain valid and effective for 10 years commencing on the date of its adoption on 21 January 2008.

Details of the grant under the Share Option Scheme ended 31 December 2018 were as follows:

Date of grant	Number of grant (shares)	Exercise price per Share (HK$)	Exercise period of share options	Valid period of the share options
15 April 2009	60,000,000	1.27	up to 30% of the share options granted to each grantee from 1 December 2009 to 14 April 2010; up to 60% of the share options granted to each grantee on or before 14 April 2011; all the remaining share options granted to each grantee on or after 15 April 2011	up to 14 April 2019
11 October 2010	2,200,000	1.05	up to 40% of the share options granted to each grantee from 25 October 2010 to 10 October 2011; up to 70% of the share options granted to each grantee on or before 10 October 2012; all the remaining share options granted to each grantee on or after 11 October 2012	up to 10 October 2020
20 June 2011	7,600,000	0.83	up to 30% of the share options granted to each grantee from 19 July 2011 to 19 June 2012; up to 60% of the share options granted to each grantee on or before 19 June 2013; all the remaining share options granted to each grantee on or after 20 June 2013	up to 19 June 2021
5 April 2012	15,400,000	1.19	up to 30% of the share options granted to each grantee from 5 April 2013 to 4 April 2014; up to 60% of the share options granted to each grantee on or before 4 April 2015; all the remaining share options granted to each grantee on or after 5 April 2015	up to 4 April 2022

Date of grant	Number of grant (shares)	Exercise price per Share (HK$)	Exercise period of share options	Valid period of the share options
24 March 2014	3,200,000	2.024	up to 30% of the share options granted to each grantee from 24 April 2014 to 23 April 2015; up to 60% of the share options granted to each grantee on or before 23 April 2016; all the remaining share options granted to each grantee on or after 24 April 2016	up to 23 March 2024
2 July 2014	40,575,000	1.96	vesting of the share options is conditional upon the achievement of corporate goals of the Company and the individual performance of the respective Grantees. The share options or any portion thereof shall lapse if the relevant corporate goals cannot be achieved. Up to 30% of the share options granted to each grantee after April 2015; up to 60% of the share options granted to each grantee after April 2016; all the remaining share options granted to each grantee after April 2017	up to 1 July 2024
21 September 2016	41,350,000	0.44	up to 30% of the Share Options granted to each Grantee from 21 September 2017 to 20 September 2018 ;up to 60% of the Share Options granted to each Grantee on or before 20 September 2019 ;all the remaining Share Options granted to each Grantee on or after 21 September 2019	up to 20 September 2026

Particulars and movements of share options under the Share Option Scheme during the year ended 31 December 2018 were as follows:

	Number of share options									
Name or category of participant	**Outstanding as at 01/01/2018**	**Granted during the Year**	**Exercised during the Year**	**Lapsed during the Year**	**Cancelled during the Year**	**Outstanding as at 31/12/2018**	**Date of grant (DD/MM/YY)**	**Exercise period (DD/MM/YY)**	**Exercise price per Share HK$**	**Price immediately preceding the grant date of share options HK$**
Directors										
Mr. Zhang Mi	3,937,000	–	–	–	–	3,937,000	15/04/2009	01/12/2009–14/04/2019	1.27	1.29
	1,190,000	–	–	–	–	1,190,000	02/07/2014	02/07/2014–01/07/2024	1.96	1.92
Mr. Ren Jie	2,587,000	–	–	–	–	2,587,000	15/04/2009	01/12/2009–14/04/2019	1.27	1.29
	885,000	–	–	–	–	885,000	02/07/2014	02/07/2014–01/07/2024	1.96	1.92
	2,000,000	–	–	–	–	2,000,000	21/09/2016	21/09/2017–20/09/2026	0.44	0.435
Mr. Qi Daqing	1,000,000	–	–	–	–	1,000,000	15/04/2009	01/12/2009–14/04/2019	1.27	1.29
(Resigned with effect from	1,000,000	–	–	–	–	1,000,000	20/06/2011	19/07/2011–19/06/2021	0.83	0.79
1 January 2018)	750,000	–	–	–	–	750,000	24/03/2014	24/04/2014–23/03/2024	2.024	2.02
	700,000	–	–	–	–	700,000	21/09/2016	21/09/2017–20/09/2026	0.44	0.435
Mr. Chen Guoming	750,000	–	–	–	–	750,000	15/04/2009	01/12/2009–14/04/2019	1.27	1.29
	750,000	–	–	–	–	750,000	20/06/2011	19/07/2011–19/06/2021	0.83	0.79
	550,000	–	–	–	–	550,000	24/03/2014	24/04/2014–23/03/2024	2.024	2.02
	500,000	–	–	–	–	500,000	21/09/2016	21/09/2017–20/09/2026	0.44	0.435
Mr. Liu Xiaofeng	1,000,000	–	–	–	–	1,000,000	15/04/2009	01/12/2009–14/04/2019	1.27	1.29
	1,000,000	–	–	–	–	1,000,000	20/06/2011	19/07/2011–19/06/2021	0.83	0.79
	750,000	–	–	–	–	750,000	24/03/2014	24/04/2014–23/03/2024	2.024	2.02
	700,000	–	–	–	–	700,000	21/09/2016	21/09/2017–20/09/2026	0.44	0.435
Sub-total	20,049,000	–	–	–	–	20,049,000				
Other										
Employee	28,939,500	–	–	171,000	–	28,768,500	15/04/2009	01/12/2009–14/04/2019	1.27	1.29
Employee	4,543,000	–	–	–	–	4,543,000	20/06/2011	19/07/2011–19/06/2021	0.83	0.79
Employee	11,056,000	–	–	150,000	–	10,906,000	05/04/2012	05/04/2013–04/04/2022	1.19	1.20
Employee	1,150,000	–	–	–	–	1,150,000	24/03/2014	24/04/2014–23/03/2024	2.024	2.02
Employee	14,698,592	–	–	476,556	–	14,222,036	02/07/2014	02/07/2014–01/07/2024	1.96	1.92
Employee	35,551,000	–	384,000	1,025,000	–	34,142,000	21/09/2016	21/09/2017–20/09/2026	0.44	0.435
Sub-total	95,938,092	–	384,000	1,822,556	–	93,731,536				
Total	115,987,092	–	384,000	1,822,556	–	113,780,536				

(C) SHARE OPTION SCHEME OF 2017

The 2017 Share Option Scheme is conditionally adopted by the Shareholders at the annual general meeting proposed to be held on 14 June 2017. As at 31 December 2018, no options were granted under the 2017 Share Option Scheme.

RESTRICTED SHARE AWARD SCHEME

On 30 December 2011, the Board approved and adopted a restricted share award scheme in which Selected Participant(s) including any Employee or Director (including, without limitation, any Executive Directors, Non-executive Directors or Independent Non-executive Directors), any consultant or adviser (whether on any employment or contractual or honorary basis and whether paid or unpaid) of the Company or any member of the Group, who in the absolute opinion of the Board, have contributed to the Company or the Group. Pursuant to the Scheme Rules, existing Shares will be purchased by the Trustee from the market out of cash contributed by the Company and be held in trust for the relevant Selected Participant until such Shares are vested with the relevant Selected Participants in accordance with the Scheme Rules. The Scheme shall be effective for a term of 10 years commencing on the Adoption Date subject to any early termination as may be determined by the Board. The Board will implement the Scheme in accordance with the Scheme Rules including providing necessary funds to the Trustee to purchase for Shares up to 5% of the issued share capital of the Company from time to time. The Selected Participant is not entitled to receive any income or distribution, such as dividend derived from the Restricted Shares allocated to him, prior to the vesting of the Restricted Shares in the Selected Participants. As at 31 December 2018, the Trustee has purchased 97,817,000 of the Company's Shares, accounting for 1.82% of the issued share capital of the Company and total of 36,917,700 shares were granted to the Selected Participants and out of which 190,000 Shares were subsequently cancelled.

Particulars and movements of the Restricted Share Award Scheme during the year ended 31 December 2018 were as follows:

	Number of Shares					
	Outstanding during 01/01/2018	Purchased during the Year	Granted during the Year	Vested during the Year	Cancelled during the Year	Outstanding as at 31/12/2018
Total	61,089,300	–	–	–	–	61,089,300

CONNECTED TRANSACTIONS

During the Year, the Group has the following connected transactions which are required to be disclosed in this report in accordance with Chapter 14A of the Listing Rules. Certain related parties transactions disclosed in note 32 to the consolidated financial statements were not disclosed below as they fulfilled the exemption requirements in Chapter 14A of the Listing Rules.

PURCHASE FRAMEWORK AGREEMENT ENTERED INTO WITH HONTAI COMPANY

Guanghan Hongtai Business Trading Co., Ltd. ("Hongtai Company") is a party of which spouses of certain directors and managements have equity interests. Therefore Hongtai Company is a connected person of the Company according to Rules 14A.07 and 14A.12 of the Listing Rules.

Honghua Company and Hongtai Company entered into the New Purchase Framework Agreement on 30 December 2015 for a term of three years commencing from 1 January 2016 and ending on 31 December 2018. Pursuant to the New Purchase Framework Agreement, Honghua Company shall purchase from Hongtai Company low value consumables, auxiliary accessories, tools, welding materials and work-protation items. It is expected the annual caps payable from Honghua Company to Hongtai Company under the New Purchase Framework Agreement shall not exceed RMB26 million for each of the three years ending on 31 December 2018.

During the Year, the total purchases made by the Group from Hongtai Company amounted to approximately RMB7.398 million.

FRAMEWORK AGREEMENT FOR STRATEGIC COOPERATION BETWEEN ASIFL AND THE GROUP

On 1 June 2018, Honghua (China) Investment Co., Ltd. ("Honghua Investment"), Honghua Financial Leasing (Shenzhen) Co., Ltd. ("Honghua Shenzhen"), Honghua Financial Leasing (Shanghai) Co., Ltd. ("Honghua Shanghai") and Aerospace Science & Industry Financial Leasing Co., Ltd. ("ASIFL") entered into between the Lease Framework Agreement (2018 Revised edition) (the "Lease Framework Agreement"), to amend the relevant contents of the 2017 Framework Agreement and the supplemental agreement to the Framework Agreement. Term of the Lease Framework Agreement starts from the date of entering into the agreement ("1 June 2018") to 6 November 2020.

The annual cap for the sales transaction under the Finance Lease Transaction model was RMB400 million according to the Lease Framework Agreement, and the actual amount was RMB400 million during the Year. The maximum daily balance of the Leasing principal was RMB639.4 million for the Finance Lease Transactions according to the Lease Framework Agreement, and the actual largest outstanding amount was RMB557.28 million. The maximum one-off handling fee was RMB18 million, and the actual handling fee was RMB11.20 million during the year. The maximum outstanding interest for 2018 was RMB102.615 million according to the Lease Framework Agreement, and the actual outstanding interest fee was RMB74.07 million. The annual cap for the sales transaction under the Operating Lease Transaction model was RMB200 million according to the Lease Framework Agreement, and the actual amount was RMB200 million during the Year. The amount of rental to be paid for the Operating Lease Transaction was 29.812 million, and the actual amount was 0.

CASIC indirectly holds 29.98% of the shares in the Company and therefore is a substantial shareholder and connected person of the Company. CASIC and its subsidiaries together hold a 46.5% equity interest in ASIFL, thus ASIFL is an associate of CASIC and in turn a connected person of the Company. Therefore, these transactions constitute connected transactions.

FINANCIAL COOPERATION AGREEMENT BETWEEN AEROSPACE ASIFC AND THE GROUP

On 1 June 2018, the Company and Aerospace Science and Industry Financial Corporation ("ASIFC") entered into the Financial Cooperation Agreement. According to the Financial Cooperation Agreement, ASIFC will provide the Group with deposit and settlement services. Term of the Financial Cooperation Agreement was 3 years from the date of entering into the agreement ("1 June 2018").

During the year, the daily maximum balance of deposits (including accrued interests) under the Financial Cooperation Agreement was RMB1.5 billion, and the actual balance of deposits was RMB93.424 million.

CASIC indirectly holds 29.98% of the shares in the Company and therefore is a substantial shareholder and connected person of the Company. CASIC and its subsidiaries together hold a 100% equity interest in Aerospace Science and Industry Financial Corporation, thus Aerospace Science and Industry Financial Corporation is an associate of CASIC and in turn a connected person of the Company. Therefore, the deposit transactions under the Financial Cooperation Agreement constitute connected transactions.

LOAN AGREEMENT AND PROPERTY COLLATERAL AGREEMENT BETWEEN ASIFC AND THE GROUP

On 17 September 2018, Sichuan Honghua Electric Co., Ltd. ("Honghua Electric"), entered into the Loan Agreement and Property Collateral Agreement with ASIFC. According to the Agreement, ASIFC will provide a loan of RMB70 million to Honghua Electric for a term commencing on 17 September 2018 and expiring on 17 September 2019. Pursuant to the Property Collateral Agreement, the loan shall be secured by the property collateral provided by Honghua Electric in favour of ASIFC.

CASIC indirectly holds 29.98% of the shares in the Company and therefore is a substantial shareholder and connected person of the Company. CASIC and its subsidiaries together hold a 100% equity interest in Aerospace Science and Industry Financial Corporation, thus Aerospace Science and Industry Financial Corporation is an associate of CASIC and in turn a connected person of the Company. Therefore, the deposit transactions under the Financial Cooperation Agreement constitute connected transactions.

DISPOSAL OF EQUITY INTERESTS IN OFFSHORE SEGMENT, DEBT ARRANGEMENT FOR OFFSHORE SEGMENT AND SIIC GUARANTEE

On 28 October 2018, in respect of disposal of equity interests in Honghua Offshore Oil & Gas Equipment (Jiangsu) Co., Ltd. ("Jiangsu Offshore"), Shanghai Honghua Offshore Oil & Gas Equipment Co. ("Shanghai Offshore") and the equity interests in Prime FSP, LLC ("Prime"), FSP LNG B.V. ("FSP") and Hong Kong Tank Tek Limited ("Tank Tek"), the Group and Jiangsu Hongjieding Energy Technology Co., Ltd ("Jiangsu Hongjieding") entered into the following arrangements:

In relation to disposal of equity interests in Offshore Segment:

(1) Sichuan Honghua Petroleum Equipment Co., Ltd. ("Sichuan Honghua") entered into the Jiangsu Offshore Agreement with Jiangsu Hongjieding, pursuant to which Sichuan Honghua has agreed to sell and Jiangsu Hongjieding has agreed to acquire Sichuan Honghua's 51% equity interests in Jiangsu Offshore for a cash consideration of RMB1.

(2) Sichuan Honghua entered into the Shanghai Offshore Agreement with Jiangsu Hongjieding, pursuant to which Sichuan Honghua has agreed to sell and Jiangsu Hongjieding has agreed to acquire Sichuan Honghua's 51% equity interests in Shanghai Offshore for a cash consideration of RMB1.

(3) Honghua Holdings Limited ("Honghua Holdings") entered into the FSP and Tank Tek Agreement with Shanghai Offshore, pursuant to which Honghua Holdings has agreed to sell and Shanghai Offshore has agreed to acquire Honghua Holdings' 25% equity interests in FSP and 70% equity interests in Tank Tek, each for a cash consideration of USD1.

(4) Honghua (China) Investment Co., Ltd. ("Honghua Investment") entered into the Prime Agreement with Shanghai Offshore, pursuant to which Honghua Investment has agreed to sell and Shanghai Offshore has agreed to acquire Honghua Investment's 30% equity interests in Prime for a cash consideration of USD1.

In relation to the debt arrangement for the Offshore Segment:

(1) Honghua Investment entered into the Domestic Debt Repayment Agreement with Jiangsu Offshore and Shanghai Offshore, pursuant to which Jiangsu Offshore shall repay an existing debt of an aggregated amount of RMB1,989.5049 million, together with relevant interest to Honghua Investment after the completion of its equity transfer.

(2) Honghua Holdings entered into the Overseas Debt Repayment Agreement with Tank Tek, pursuant to which Tank Tek shall repay an existing debt of an aggregated amount of USD16.9291 million, together with relevant interest to Honghua Holdings after the completion of its equity transfer.

(3) On 5 August 2015, Honghua Investment issued an irrevocable guarantee in favor of SIIC Shanghai International Trade (Group) Co., Ltd. ("SIIC") for the debt owed by Jiangsu Offshore to SIIC ("SIIC Guarantee").

CASIC, through its wholly-owned subsidiary, namely Kehua, indirectly holds approximately 29.98% of the Shares in the Company, and therefore is a substantial shareholder and connected person of the Company. CASIC, through its subsidiary, controls the general partner of Nanjing Hangzhi, thus Nanjing Hangzhi is an associate of CASIC under the Listing Rules, and it holds 46.15% of equity interests in Jiangsu Hongjieding. In addition, Mr. Zhang Mi is an executive Director of the Company, holding 1,088,681,363 Shares or approximately 20.33% of the Shares in the Company. As at the date of this report, Mr. Zhang Mi, through his sole proprietorship, holds 53.85% of equity interests in Jiangsu Hongjieding. Therefore, Jiangsu Hongjieding and Shanghai Offshore (after the completion of its equity transfer) are connected persons of the Company under the Listing Rules. Therefore, the disposal of equity interests in Offshore Segment constitutes connected transaction for the Company under the Listing Rules.

Upon the completion of disposal of equity interests in Offshore Segment, Jiangsu Offshore, Shanghai Offshore and Tank Tek will cease to be subsidiaries of the Company and will become subsidiaries of Jiangsu Hongjieding. Therefore, the Domestic Debt and Overseas Debt will then constitute financial assistance provided by the Group to Jiangsu Offshore and Tank Tek, thus connected transactions for the Company. In addition, upon the completion of disposal of equity interests in Offshore Segment, Jiangsu Offshore will become a subsidiary of Jiangsu Hongjieding and therefore the SIIC Guarantee will constitute financial assistance provided by the Group to a connected person.

PROCESSING CONTRACT BETWEEN AEROSPACE INDUSTRIAL AND SICHUAN HONGHUA

On 16 November 2018, Sichuan Honghua and Guizhou Aerospace Industrial Co.,Ltd ("Aerospace Industrial") entered into the Processing Contract, pursuant to which Aerospace Industrial shall provide Sichuan Honghua with the processing and contracting services of solution tank (液缸) at a consideration of RMB2,256,000.

CASIC indirectly holds approximately 29.98% of the shares of the Company, and therefore is a substantial shareholder and a Connected Person of the Company. CASIC and its subsidiaries jointly hold 100% of equity interests in Aerospace Industrial. Therefore, Aerospace Industrial is the Associates of CASIC and thus the Connected Persons of the Company. Accordingly, the Transactions constitute connected transactions of the Company.

CONSTRUCTION CONTRACT BETWEEN INNOVATION CENTER AND SICHUAN HONGHUA

On 16 November 2018, Sichuan Honghua and Industrial Cloud Manufacturing (Sichuan) Innovation Center Co., Ltd. ("Innovation Center") entered into the Construction Contract, pursuant to which Innovation Center shall provide Sichuan Honghua with the hardware and software as well as labour, training and technical services for the intelligent centralized control system of power distribution (project) at a consideration of RMB1,472,000.

CASIC indirectly holds approximately 29.98% of the shares of the Company, and therefore is a substantial shareholder and a Connected Person of the Company. CASIC and its subsidiaries jointly hold 70% of equity interests in Innovation Center. Therefore, Innovation Center is the Associates of CASIC and thus the Connected Persons of the Company. Accordingly, the Transactions constitute connected transactions of the Company.

All the Independent Non-executive Directors have reviewed the above continuing connected transactions and confirmed that these transactions have been entered into are:

(1) in the ordinary and usual course of the business of the Group;

(2) either on normal commercial terms or on terms no less favourable to the Group than terms available to or from independent third parties; and

(3) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interest of the Shareholders as a whole.

In accordance with Rule 14A.56 of the Listing Rules, the Company is required to obtain a letter from its auditor to confirm that nothing has come to their attention that causes them to believe that these continuing connected transactions:

(1) have not been approved by the board of directors of the company;

(2) were not made in accordance with the pricing policy of the Company;

(3) were not conducted, in all material respects, in accordance with the relevant agreement governing those transactions;

(4) have exceeded the cap disclosed in previous announcements.

The Company's auditors were engaged to report on the Group's continuing connected transactions in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The auditors have issued to the Board an unqualified letter containing their findings and conclusions in respect of the continuing connected transactions disclosed by the Group in pages 222 to 227 of this annual report in accordance with Rule 14A.56 of Listing Rules. A copy of the auditor's letter has also been provided to the Stock Exchange.

BANK LOANS

Details of our bank loans and other borrowings are set out in note 25 to the consolidated financial statements.

FINANCIAL SUMMARY

Our financial summary for the past five years are set out in the section headed "Five-Year Financial Highlights" of this annual report.

STAFF RETIREMENT AND BENEFIT SCHEME

Details of the staff retirement and benefit scheme are set out in notes 9 and 32(f) to the consolidated financial statements.

FIXED ASSETS

Details of the changes of the fixed assets of the Group are set out in note 16 to the consolidated financial statements.

MAJOR CUSTOMERS AND SUPPLIERS

1. During the Year, the Group's five largest suppliers in total accounted for approximately 17.33% of total purchase, and the largest supplier accounted for approximately 4.62% of total purchase.

2. During the Year, the Group's five largest customers accounted for approximately 65.79% of total sales and the largest customer accounted for approximately 28.4% of revenue.

3. None of the Directors of the Company, their associates or any Shareholder (which to the knowledge of the Directors owns more than 5% of the Company's share capital) had an interest in the above suppliers or customers.

ENTRUST DEPOSITS AND ENTRUST LOANS

As at 31 December 2018, the Company has no entrust deposits or entrust loans being placed with commercial banks or non-commercial banks and other finance institutions.

TAXATION POLICY

The details of the Group's applicable income taxation policy and income tax rate are set out in note 13 to the consolidated financial statements.

SUFFICIENCY OF PUBLIC FLOAT

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

MANAGEMENT CONTRACTS

There was no contract concerning the management or administration of the whole or any substantial part of the business of the Company which was entered into or existed during the Year.

AUDITOR

The financial statements of the Group for the year ended 31 December 2018 have been audited by PricewaterhouseCoopers who will retire at the forthcoming annual general meeting and being eligible, offer themselves for re-appointment. A resolution to renew the appointment of PricewaterhouseCoopers as auditor of the Company will be proposed at the forthcoming annual general meeting of the Company.

By the order of the Board
Honghua Group Limited
Chairman
Jin Liliang

Hong Kong, 28 March 2019

pwc

羅兵咸永道

To the Shareholders of Honghua Group Limited
(incorporated in the Cayman Islands with limited liability)

OPINION

WHAT WE HAVE AUDITED

The consolidated financial statements of Honghua Group Limited (the "Company") and its subsidiaries (the "Group") set out on pages 89 to 239, which comprise:

- the consolidated balance sheet as at 31 December 2018;
- the consolidated statement of profit or loss for the year then ended;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

OUR OPINION

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 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs") 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 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 believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENCE

We are independent of the Group in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgment, 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.

Key audit matters identified in our audit are summarised as follows:

- Impairment of property, plant and equipment
- Valuation of inventory
- Valuation of trade receivables

Key Audit Matter	How our audit addressed the Key Audit Matter
Impairment of property, plant and equipment Refer to note 16 to the consolidated financial statements. As at 31 December 2018, the total balance of property, plant and equipment ("PP&E") is RMB1,518,266,000, including RMB403,218,000 relating to loss making subsidiaries of the Oil and gas engineering services segment. PP&E is carried at the lower of historical cost less accumulated depreciation and value in use based on discounted future cash flows of cash generating units ("CGU"). Significant judgements are required for determination of key assumptions, including discount rates, revenue growth rates and gross margins. As a result of management assessment, no additional provision for impairment was made in relation to the PP&E under the Oil and gas engineering services segment for the year ended 31 December 2018. We focused on this area because of the significance of PP&E and management judgements involved.	We evaluated the appropriateness of the discounted cash flow model adopted by management. We challenged the management's key assumptions by: • comparing the revenue growth rates with historical data, assessing future customer demand with reference to our knowledge of economic and industry trend; • comparing the gross margins with the historical data and considering the future product mix and production volume; • comparing the discount rates with the cost of capital for the CGUs. We tested the mathematical accuracy of the calculations of the discounted cash flows. We independently performed sensitivity analysis about the key drivers of growth, including revenue growth and expected changes in gross margins. We found that management's judgements in determining the value in use of PP&E are supported by the evidence we gathered.

Key Audit Matter	How our audit addressed the Key Audit Matter
Valuation of inventory Refer to note 19 to the consolidated financial statements. As at 31 December 2018, the Group had gross inventory balance of RMB1,737,487,000, against which a provision for inventory write-down of RMB172,690,000 was made. Inventories are carried at the lower of cost and net realisable value ("NRV"). NRV is determined based on the estimated selling price less the estimated costs to completion, if relevant, other costs necessary to make the sale and related taxes. We focused on this area because of the significance of inventory balance and management judgements involved in identifying inventories subject to write-down and determining the NRV.	We evaluated and tested management's controls over identifying inventories subject to write-down and determination of the estimated selling price. We evaluated and challenged the methodology adopted by management for identifying inventories subject to write-down based on our independent assessment of write-down indicators. We compared the estimated selling prices with the selling prices of the recent orders from customers. We challenged management's future sales projections for the prices and quantities by checking historical sales information and considering market trend. We independently evaluated the future market trend factors management considered in determining the estimated selling prices, including possible changes of customer demands and technology development, by corroborating with research information, checking subsequent outcomes of these factors and making reference to our industry knowledge. We assessed the reasonableness of the estimated costs to completion by comparing with the historical costs to completion of the similar inventories. We found that management's judgements in determining the NRV of inventory are supported by the evidence we gathered.

Key Audit Matter	How our audit addressed the Key Audit Matter
Valuation of trade receivables Refer to note 18 to the consolidated financial statements. The gross balance of trade receivables as at 31 December 2018 is RMB2,627,384,000 against which a provision for impairment of RMB169,007,000 was made. When assessing the impairment of trade receivables, judgement is required for determining the lifetime expected credit losses, taking into consideration the ageing of the trade receivables, their repayment history, current financial position as well as the expected operating results and ability to meet the obligation. We focused on this area because of the significance of trade receivables balance and management judgements involved in determining the collectability and impairment.	We evaluated and tested the controls over the collectability of the trade receivables, including the monthly review of ageing analysis, repayment and impairment assessment of trade receivables performed by management. We sent confirmations to customers on a sample basis, focusing on material balances. We obtained management's assessment on the recoverability of the trade receivables and performed our independent evaluation. We corroborated management's assessment by reviewing individual customer's credit profile and payment history on a sample basis. We evaluated whether the historical loss rates were appropriately adjusted for the forward-looking factors, such as the expected operating results of the trade receivables and their ability to meet the obligation. We found that management's judgements relating to the recoverability of trade receivable are supported by the evidence we gathered.

OTHER INFORMATION

The directors of the Company are responsible for the other information. The other information comprises all of 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 DIRECTORS AND AUDIT COMMITTEE FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRSs 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 Audit Committee are responsible 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. We report our opinion 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 to 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 Lee Chung Bor.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 28 March 2019

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

FOR THE YEAR ENDED 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

	Notes	Year ended 31 December 2018 RMB'000	2017 RMB'000
Continuing operations			
Revenue	5	**4,205,162**	2,175,856
Cost of sales	8	**(3,122,890)**	(1,540,763)
Gross profit		**1,082,272**	635,093
Distribution costs	8	**(313,211)**	(232,616)
Administrative expenses	8	**(469,484)**	(422,090)
Net impairment losses on financial and contract assets	3.1(b)	**(93,829)**	(133,094)
Other income	6	**90,678**	92,652
Other gains/(losses), net	7	**43,005**	(43,319)
Operating profit/(loss)		**339,431**	(103,374)
Finance income	10	**5,600**	25,370
Finance expenses	10	**(169,005)**	(239,573)
Finance expenses — net		**(163,405)**	(214,203)
Share of net losses of associates and joint ventures accounted for using the equity method	12	**(32,444)**	(28,968)
Profit/(loss) before income tax		**143,582**	(346,545)
Income tax expense	13	**(33,897)**	(48,651)
Profit/(loss) from continuing operations		**109,685**	(395,196)
Loss from discontinued operations	33	**(13,063)**	(834,386)
Profit/(loss) for the year		**96,622**	(1,229,582)

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

FOR THE YEAR ENDED 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

		Year ended 31 December	
	Notes	**2018 RMB'000**	2017 RMB'000
Profit/(loss) attributable to:			
— Owners of the Company		**82,287**	(1,239,368)
— Non-controlling interests		**14,335**	9,786
		96,622	(1,229,582)
Profit/(loss) attributable to owners of the Company arises from:			
— Continuing operations		**92,377**	(401,584)
— Discontinued operations		**(10,090)**	(837,784)
		82,287	(1,239,368)
Profit/(loss) per share from continuing and discontinued operations attributable to owners of the Company (expressed in RMB cents per share)			
Basic profit/(loss) per share			
From continuing operations	14	**1.74**	(8.59)
From discontinued operations	14	**(0.19)**	(17.91)
	14	**1.55**	(26.50)
Diluted profit/(loss) per share			
From continuing operations	14	**1.74**	(8.59)
From discontinued operations	14	**(0.19)**	(17.91)
	14	**1.55**	(26.50)

The notes on pages 99 to 239 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Profit/(loss) for the year	**96,622**	(1,229,582)
Other comprehensive income		
Items that may be reclassified to profit or loss		
Change in value of available-for-sale financial assets, net of tax	**–**	1,423
Currency translation differences	**25,164**	(86,371)
Items that will not be reclassified to profit or loss		
Change in the fair value of equity investments at fair value through other comprehensive income	**(717)**	–
Income tax relating to this item	**179**	–
Other comprehensive income for the year, net of tax	**24,626**	(84,948)
Total comprehensive income for the year	**121,248**	(1,314,530)
Total comprehensive income attributable to:		
— Owners of the Company	**106,091**	(1,329,508)
— Non-controlling interests	**15,157**	14,978
	121,248	(1,314,530)
Total comprehensive income attributable to owners of the Company arises from:		
— Continuing operations	**118,082**	(493,333)
— Discontinued operations	**(11,991)**	(836,175)
	106,091	(1,329,508)

The notes on pages 99 to 239 form an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

		As at 31 December	
	Note	**2018 RMB'000**	2017 RMB'000
ASSETS			
Non-current assets			
Lease prepayments	15	**192,242**	218,742
Property, plant and equipment	16	**1,518,266**	1,516,225
Payment for acquisition of leasehold prepayment		**10,000**	37,510
Intangible assets	17	**161,186**	146,906
Investments in associates	12	**–**	37,169
Investments in joint ventures	12	**35,135**	40,389
Deferred income tax assets	26	**261,632**	232,057
Financial assets at fair value through other comprehensive income	3.3(c)	**74,053**	–
Available-for-sale financial assets	3.3(c)	**–**	90,192
Trade and other receivables	18	**907,304**	6,186
Loan to an associate and other related party	3.1(b)	**1,584,192**	–
Other non-current assets		**28,165**	8,719
Total non-current assets		**4,772,175**	2,334,095
Current assets			
Inventories	19	**1,564,797**	1,816,083
Contract assets	5	**42,758**	–
Trade and other receivables	18	**2,939,969**	2,559,988
Loan to an associate and other related party	3.1(b)	**79,982**	–
Current tax recoverable		**46**	6,595
Assets classified as held for sale		**684**	–
Financial assets at fair value through other comprehensive income	3.3(c)	**93,884**	–
Pledged bank deposits	20	**137,302**	191,140
Cash and cash equivalents	20	**685,500**	1,100,292
		5,544,922	5,674,098
Assets of disposal group classified as held for sale	33	**–**	2,058,351
Total current assets		**5,544,922**	7,732,449
Total assets		**10,317,097**	10,066,544

AS AT 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

	Note	As at 31 December 2018 RMB'000	As at 31 December 2017 RMB'000
EQUITY			
Equity attributable to owners of the Company			
Share capital	21	**488,015**	487,983
Other reserves	23	**4,223,911**	4,180,608
Accumulated losses		**(583,183)**	(657,876)
		4,128,743	4,010,715
Non-controlling interests		**190,168**	166,935
Total equity		**4,318,911**	4,177,650
LIABILITIES			
Non-current liabilities			
Deferred income	28	**49,086**	68,624
Borrowings	25	**575,000**	1,881,691
Total non-current liabilities		**624,086**	1,950,315

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

		As at 31 December	
	Note	**2018 RMB'000**	2017 RMB'000
Current liabilities			
Contract liabilities	5	**241,082**	–
Deferred income	28	**45,450**	41,268
Trade and other payables	24	**2,340,886**	1,760,966
Current income tax liabilities		**56,041**	67,175
Borrowings	25	**2,545,450**	1,434,325
Provisions for other liabilities and charges	27	**145,191**	115,671
		5,374,100	3,419,405
Liabilities of disposal group classified as held for sale	33	**–**	519,174
Total current liabilities		**5,374,100**	3,938,579
Total liabilities		**5,998,186**	5,888,894
Total equity and liabilities		**10,317,097**	10,066,544

The notes on pages 99 to 239 form an integral part of these consolidated financial statements.

The consolidated financial statements on pages 89 to 98 were approved by the Board of Directors on 28 March 2019 and were signed on its behalf.

Zhang Mi
Director

Ren Jie
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

		Attributable to owners of the Company											
	Note	Share capital RMB'000 (Note 21)	Share premium RMB'000 (Note 23)	Other reserve RMB'000 (Note 23)	Capital reserve RMB'000 (Note 23)	Surplus reserve RMB'000 (Note 23)	Exchange reserve RMB'000 (Note 23)	Fair value reserve RMB'000 (Note 23)	Shares held for share award scheme RMB'000 (Note 22)	Retained earnings/ (Accumulated losses) RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total Equity RMB'000
Balance at 1 January 2017		300,983	2,349,292	47,075	533,067	418,281	(216,034)	–	(124,618)	590,864	3,898,910	184,542	4,083,452
(Loss)/profit for the year		–	–	–	–	–	–	–	–	(1,239,368)	(1,239,368)	9,786	(1,229,582)
Other comprehensive income		–	–	–	–	–	(91,563)	1,423	–	–	(90,140)	5,192	(84,948)
Total comprehensive income		–	–	–	–	–	(91,563)	1,423	–	(1,239,368)	(1,329,508)	14,978	(1,314,530)
Transactions with owners													
Issue of new ordinary shares	21	186,961	1,247,436	–	–	–	–	–	–	–	1,434,397	–	1,434,397
Equity-settled share-based transactions		–	–	–	3,293	–	–	–	–	–	3,293	–	3,293
Shares issued under share option scheme		39	199	–	(65)	–	–	–	–	–	173	–	173
Options lapsed under share option schemes		–	–	–	(2,044)	–	–	–	–	2,044	–	–	–
Acquisition of non-controlling interests		–	–	3,450	–	–	–	–	–	–	3,450	(32,585)	(29,135)
Appropriation to surplus reserve		–	–	–	–	11,416	–	–	–	(11,416)	–	–	–
Total transactions with owners, recognised directly in equity		187,000	1,247,635	3,450	1,184	11,416	–	–	–	(9,372)	1,441,313	(32,585)	1,408,728
Balance at 31 December 2017		487,983	3,596,927	50,525	534,251	429,697	(307,597)	1,423	(124,618)	(657,876)	4,010,715	166,935	4,177,650

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

		Attributable to owners of the Company											
	Note	Share capital RMB'000 (Note 21)	Share premium RMB'000 (Note 23)	Other reserve RMB'000 (Note 23)	Capital reserve RMB'000 (Note 23)	Surplus reserve RMB'000 (Note 23)	Exchange reserve RMB'000 (Note 23)	Fair value reserve RMB'000 (Note 23)	Shares held for share award scheme RMB'000 (Note 22)	Accumulated losses RMB'000	Total RMB'000	Non-controlling interests RMB'000	Total Equity RMB'000
Balance at 1 January 2018		487,983	3,596,927	50,525	534,251	429,697	(307,597)	1,423	(124,618)	(657,876)	4,010,715	166,935	4,177,650
Profit for the year		–	–	–	–	–	–	–	–	82,287	82,287	14,335	96,622
Other comprehensive income		–	–	–	–	–	24,342	(538)	–	–	23,804	822	24,626
Total comprehensive income		–	–	–	–	–	24,342	(538)	–	82,287	106,091	15,157	121,248
Transactions with owners													
Equity-settled share-based transactions		–	–	–	1,726	–	–	–	–	–	1,726	–	1,726
Disposal of subsidiaries		–	–	–	–	–	–	–	–	–	–	8,076	8,076
Contribution from shareholders		–	–	10,063	–	–	–	–	–	–	10,063	–	10,063
Shares issued under share option scheme		32	169	–	(53)	–	–	–	–	–	148	–	148
Options lapsed under share option schemes		–	–	–	(364)	–	–	–	–	364	–	–	–
Appropriation to surplus reserve		–	–	–	–	7,958	–	–	–	(7,958)	–	–	–
Total transactions with owners, recognised directly in equity		32	169	10,063	1,309	7,958	–	–	–	(7,594)	11,937	8,076	20,013
Balance at 31 December 2018		488,015	3,597,096	60,588	535,560	437,655	(283,255)	885	(124,618)	(583,183)	4,128,743	190,168	4,318,911

The notes on pages 99 to 239 form an integral part of these consolidated financial statements.

THE CONSOLIDATED FINANCIAL STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

		Year ended 31 December	
		2018	2017
	Note	**RMB'000**	RMB'000
Cash flows from operating activities			
Cash generated from operations	30	**524,885**	437,388
Income tax paid		**(61,939)**	(10,191)
Net cash generated from operating activities		**462,946**	427,197
Cash flows from investing activities			
Payment for additions of property, plant and equipment and construction in progress		**(352,896)**	(93,214)
Proceeds from disposal of property, plant and equipment	30	**37,867**	6,345
Purchase of available-for-sale financial assets		**–**	(1,451,191)
Proceeds from disposal of available-for-sale financial assets		**–**	1,467,760
Net loans granted to related companies		**(4,910)**	(17,516)
Proceeds from government grants related to assets		**32,340**	14,475
Net cash outflow on disposal of subsidiaries	30	**(97,197)**	–
Interest received		**5,443**	10,458
Expenditure on development project and other intangible assets		**(52,010)**	(55,327)
Net cash used in investing activities		**(431,363)**	(118,210)

THE CONSOLIDATED FINANCIAL STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

	Note	2018 RMB'000	2017 RMB'000
		Year ended 31 December	
Cash flows from financing activities			
Issue of ordinary shares		–	1,434,397
Proceeds from borrowings		1,553,589	1,656,936
Repayments of borrowings		(1,948,514)	(3,024,410)
Interest and charges paid		(207,310)	(219,439)
Net loans from related companies		120,000	480,000
Payment for acquisition of non-controlling interests		–	(29,135)
Proceeds from share issued under share option scheme		148	173
Net cash (used in)/generated from financing activities		(482,087)	298,522
Net (decrease)/increase in cash and cash equivalents		(450,504)	607,509
Cash and cash equivalents at the beginning of year		1,124,806	544,360
Exchange gains/(losses) on cash and cash equivalents		11,198	(27,063)
Cash and cash equivalents at end of the year		685,500	1,124,806

The notes on pages 99 to 239 form an integral part of these consolidated financial statements.

1 GENERAL INFORMATION

Honghua Group Limited ("the Company") and its subsidiaries (together "the Group") are principally engaged in manufacturing of drilling rigs, offshore engineering, and oil and gas exploitation equipment and providing drilling services.

The Company was incorporated in the Cayman Islands on 15 June 2007 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 address of its registered office is Clifton House, 75 Fort Street, PO Box 1350, Grand Cayman, KY1-1108, Cayman Islands.

The Company was listed on the Main Board of the Stock Exchange of Hong Kong Limited on 7 March 2008.

These financial statements are presented in Chinese Renminbi ("RMB"), unless otherwise stated, and were approved for issue by the Board of Directors of the Company on 28 March 2019.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set our below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 BASIS OF PREPARATION

The consolidated financial statements of the Group have been prepared in accordance with all applicable International Financial Reporting Standards ("IFRS") and requirements of the Hong Kong Companies Ordinance. The consolidated financial statements have been prepared under the historical cost convention, except that financial assets at fair value through other comprehensive income are carried at fair value, and certain financial assets and liabilities are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 BASIS OF PREPARATION (continued)

2.1.1 New and amended standards adopted by the Group

The Group has applied the following standards and amendments for the first time for their annual reporting period commencing 1 January 2018:

- IFRS 9 Financial Instruments;
- IFRS 15 Revenue from Contracts with Customers;
- Classification and Measurement of Share-based Payment Transactions — Amendments to IFRS 2;
- Annual Improvements 2014-2016 cycle;
- Transfers to Investment Property — Amendments to IAS 40; and
- Interpretation 22 Foreign Currency Transactions and Advance Consideration.

The Group had to change its accounting policies following the adoption of IFRS 9 and IFRS 15. There is no retrospective adjustment recognised in prior periods. The impacts of adopting the following standards are disclosed in Note 2.2.

- IFRS 9 Financial Instruments; and
- IFRS 15 Revenue from Contracts with Customers.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 BASIS OF PREPARATION (continued)

2.1.2 New standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2018 reporting periods and have not been early adopted by the Group. The Group's assessment of the impact of these new standards and interpretations is set out below.

IFRS 16 Leases

Nature of change

IFRS 16 was issued in January 2016. It will result in almost all leases being recognised on the balance sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exceptions are short-term and low-value leases.

Impact

The Group has reviewed all of the Group's leasing arrangements over the last year in light of the new lease accounting rules in IFRS 16. The standard will affect primarily the accounting for the Group's operating leases. The Group mainly has leasing arrangements with short-term and low-value leases, and there is no significant impact on the financial statements.

Date of adoption by Group

The Group will apply the standard from its mandatory adoption date of 1 January 2019. The Group intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. Right-of-use assets for property leases will be measured on transition as if the new rules had always been applied. All other right-of-use assets will be measured at the amount of the lease liability on adoption (adjusted for any prepaid or accrued lease expenses).

There are no other standards that are not yet effective and that would be expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES

This note explains the impact of the adoption of IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers on the Group's consolidated financial statements.

(a) Impact on the consolidated financial statements

IFRS 9 was generally adopted without restating comparative information and IFRS 15 was adopted using the modified retrospective transition method. The reclassifications and the adjustments arising from the new impairment rules are therefore not reflected in the consolidated balance sheet as at 31 December 2017.

The following tables show the adjustments recognised for each individual line item. Line items that were not affected by the changes have not been included. As a result, the sub-totals and totals disclosed cannot be recalculated from the numbers provided. There was no significant impact on retained earnings at 1 January 2018. The adjustments are explained in more detail by standard below.

Consolidated Balance Sheet (extract)	**31 December 2017 As originally presented** RMB'000	**IFRS 9** RMB'000	**IFRS 15** RMB'000	**1 January 2018 Restated** RMB'000
Non-current assets				
Financial assets at fair value through other comprehensive income (FVOCI)	–	90,912	–	90,912
Available-for-sale financial assets	90,912	(90,912)	–	–
Current assets				
Financial assets at fair value through other comprehensive income (FVOCI)	–	21,337	–	21,337
Contract assets	–	67,840	–	67,840
Trade and other receivables	2,559,988	(89,177)	–	2,470,811
Total assets	2,650,900	–	–	2,650,900
Current liabilities				
Trade and other payables	1,760,966	–	(218,821)	1,542,145
Contract liabilities	–	–	218,821	218,821
Net assets	889,934	–	–	889,934

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES (continued)

(b) IFRS 9 Financial Instruments

(i) Classification and measurement

On 1 January 2018 (the date of initial application of IFRS 9), the Group's management has assessed which business models apply to the financial assets held by the Group and has classified its financial instruments into the appropriate IFRS 9 categories. The main effects resulting from this reclassification are as follows:

Financial assets — 1 January 2018	Notes	FVOCI RMB'000	FVOCI (Available-for-sale 2017) RMB'000	Amortised cost (Receivables 2017) RMB'000
Closing balance 31 December 2017 — IAS 39	(a)	–	90,192	2,559,988
Reclassify bank acceptance bill receivables from receivables to FVOCI to be settled within 12 months	(b)	21,337	–	(21,337)
Opening balance 1 January 2018 — IFRS 9		21,337	90,192	2,538,651

The impact of these changes on the Group's equity is as follows:

	Notes	Effect on AFS reserve RMB'000	Effect on FVOCI reserve RMB'000
Opening balance — IAS 39		1,423	–
Reclassify investment in unlisted companies from available–for-sale ("AFS") to FVOCI	(a)	(1,423)	1,423
Opening balance — IFRS 9		–	1,423

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES (continued)

(b) *IFRS 9 Financial Instruments* (continued)

(i) *Classification and measurement* (continued)

Equity investments previously classified as available-for-sale

The Group elected to present in OCI changes in the fair value of all its equity investments previously classified as available-for-sale, because these investments are held as long-term strategic investments that are not expected to be sold in the short to medium term. As a result, assets with a fair value of RMB90,192,000 were reclassified from available-for-sale financial assets to financial assets at FVOCI and fair value gains of RMB1,423,000 were reclassified from the available-for-sale financial assets reserve to the FVOCI reserve on 1 January 2018.

Reclassification from amortised cost to FVOCI

Bank acceptance bill receivables were reclassified from receivables at amortised cost to FVOCI, as the Group's business model is achieved both by collecting contractual cash flows and selling of these assets. The contractual cash flows of these investments are solely principal and interest. As a result, bank acceptance bill receivables with a fair value of RMB21,337,000 were reclassified from receivables at amortised cost to FVOCI. As these assets are expected to be settled within 12 months, they are reclassified as current assets.

Reclassifications of financial instruments on adoption of IFRS 9

On the date of initial application, 1 January 2018, the financial instruments of the Group were as follows, with any reclassifications noted:

	Measurement category		Carrying amount		
	Original (IAS 39)	New (IFRS 9)	Original RMB'000	New RMB'000	Difference RMB'000
Non-current financial assets					
Investment in unlisted companies	Available for sale	FVOCI	90,912	90,912	–
Current financial assets					
Bank acceptance bill receivables	Amortised cost	FVOCI	21,337	21,337	–

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES (continued)

(b) IFRS 9 Financial Instruments (continued)

(ii) Impairment of financial assets

The Group has the following types of financial assets that are subject to IFRS 9's new expected credit loss model:

- trade receivables for sale of inventory and from the provision of service
- contract assets
- loan to an associate and other related party carried at amortised cost
- bank acceptance bill receivables at FVOCI
- finance lease receivables
- other financial assets at amortised cost
- pledged bank deposits, and
- cash and cash equivalents

The Group was required to revise its impairment methodology under IFRS 9 for each of these classes of assets.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES (continued)

(b) *IFRS 9 Financial Instruments* (continued)

(ii) *Impairment of financial assets* (continued)

Trade receivables, contract assets and finance lease receivables

The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables, contract assets and finance lease receivables.

To measure the expected credit losses, trade receivables, contract assets and finance lease receivables have been grouped based on shared credit risk characteristics and the days past due. The contract assets relate to unbilled work in progress and have substantially the same risk characteristics as the trade receivables for the same types of contracts. The Group has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets.

Based on the assessments undertaken, the Group does not identify material change to the loss allowance for trade receivables, contract assets and finance lease receivables.

Trade receivables, contract assets and finance lease receivables are written off when there is no reasonable expectation of recovery.

Loan to an associate and other related party carried at amortised cost

Loan to an associate and other related party is considered credit-impairment on origination and no loss allowance is recognised on initial recognition. For such assets, impairment is determined based on full lifetime expected credit loss on initial recognition. However, lifetime expected credit losses are included in the estimated cash flows when calculating the effective interest rate on initial recognition. The effective interest rate for interest recognition throughout the life of the asset is a credit-adjusted effective interest rate. As a result, no loss allowance is recognised on initial recognition.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES (continued)

(b) ***IFRS 9 Financial Instruments*** (continued)

(ii) *Impairment of financial assets* (continued)

Bank acceptance bill receivables at FVOCI

Bank acceptance bill receivables carried at FVOCI are considered to have low credit risk, and the loss allowance recognised during the period was therefore limited to 12 months expected losses. Management considers 'low credit risk' for the instruments as the issuers have strong capacity to meet its contractual cash flow obligations in the near term.

Other financial assets at amortised cost

The Group applies either 12-month expected credit losses or lifetime expected credit losses for other financial assets at amortised cost, depending on whether there has been a significant increase in credit risk since initial recognition. There is no significant impact on the Group's retained earnings and equity at 1 January 2018.

While pledged bank deposits and cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 CHANGES IN ACCOUNTING POLICY AND DISCLOSURES (continued)

(c) *IFRS 15 Revenue from Contracts with Customers*

The Group has adopted IFRS 15 Revenue from Contracts with Customers from 1 January 2018 which resulted in changes in accounting policies and adjustments to the amounts recognised in the consolidated financial statements. In accordance with the transition provisions in IFRS 15, the Group uses the modified retrospective approach, under which the cumulative impact of the adoption (if any) was recognised in retained earnings as of 1 January 2018 and no comparative figures were restated.

The Group has assessed the effects of the adoption of IFRS 15 to the retained earnings of 1 January 2018, there is no significant impact on the retained earnings. In summary, the following adjustments were made to the amounts recognised in the balance sheet at the date of initial application (1 January 2018):

		IAS 18 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 15 carrying amount 1 January 2018
		RMB'000	RMB'000	RMB'000	RMB'000
Contract assets	(i)	–	67,840	–	67,840
Trade and other receivables	(i)	2,559,988	(67,840)	–	2,492,148
Contract liabilities	(ii)	–	218,821	–	218,821
Trade and other payables	(ii)	1,760,966	(218,821)	–	1,542,145

(i) Contract assets

Contract assets recognised in relation to oil and gas engineering services contracts were previously presented as part of trade receivables.

(ii) Contract liabilities

Advance from customers have been presented as trade and other payables originally are now presented as contract liabilities. With the adoption of IFRS 15, a contract liability is recognised if the entity receives consideration (or if it has the unconditional right to receive consideration) in advance of performance. Contract liabilities are expected to be settled within 12 months after the end of the period are presented as current liabilities in the balance sheet, otherwise are presented as other non-current liabilities.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 SUBSIDIARIES

2.3.1 Consolidation

A subsidiary is an entities (including a structured entity) over which the Group has control. The Group controls an entity when the Group is exposed to, 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. Subsidiaries are consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

(a) Business combinations

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

The Group recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis. Non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation are measured at either fair value or the present ownership interests' proportionate share in the recognised amounts of the acquiree's identifiable net assets. All other components of non-controlling interests are measured at their acquisition date fair value, unless another measurement basis is required by IFRS.

Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date carrying value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date. Any gains or losses arising from such remeasurement are recognised in profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 SUBSIDIARIES (continued)

2.3.1 Consolidation (continued)

(a) *Business combinations* (continued)

Any contingent consideration to be transferred by the Group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in profit or loss. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If the total of consideration transferred, non-controlling interest recognised and previously held interest measured is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

Intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the transferred asset. When necessary, amounts reported by subsidiaries have been adjusted to conform with the Group's accounting policies.

(b) *Changes in ownership interests in subsidiaries without change of control*

Transactions with non-controlling interests that do not result in a loss of control are accounted for as equity transactions — that is, as transactions with the owners of the subsidiary in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying amount of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 SUBSIDIARIES (continued)

2.3.1 Consolidation (continued)

(c) Disposal of subsidiaries

When the Group ceases to have control, any retained interest in the entity is re-measured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. It means the amounts previously recognised in other comprehensive income are reclassified to profit or loss or transferred to another category of equity as specified/permitted by applicable IFRSs.

2.3.2 Separate financial statements

Investments in subsidiaries are accounted for at cost less impairment. Cost includes direct attributable costs of investment. The results of subsidiaries are accounted for by the company on the basis of dividend received and receivable.

Impairment testing of the investments in subsidiaries is required upon receiving a dividend from these investments if the dividend exceeds the total comprehensive income of the subsidiary in the period the dividend is declared or if the carrying amount of the investment in the separate financial statements exceeds the carrying amount in the consolidated financial statements of the investee's net assets including goodwill.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 ASSOCIATES

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The Group's investments in associates include goodwill identified on acquisition. Upon the acquisition of the ownership interest in an associate, any difference between the cost of the associate and the Group's share of the net fair value of the associate's identifiable assets and liabilities is accounted for as goodwill.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income is reclassified to profit or loss where appropriate.

The Group's share of post-acquisition profit or loss is recognised in profit or loss, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to 'share of profits of associates' in profit or loss.

Profits and losses resulting from upstream and downstream transactions between the Group and its associate are recognised in the Group's financial statements only to the extent of unrelated investor's interests in the associates. Unrealised losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

Gains or losses on dilution of equity interest in associates are recognised in profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 JOINT ARRANGEMENTS

The Group has applied IFRS 11 to all joint arrangements. Under IFRS 11 investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor. The Group has assessed the nature of its joint arrangements and determined them to be joint ventures. Joint ventures are accounted for using the equity method.

Under the equity method of accounting, interests in joint ventures are initially recognised at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses and movements in other comprehensive income. The Group's investments in joint ventures include goodwill identified on acquisition. Upon the acquisition of the ownership interest in a joint venture, any difference between the cost of the joint venture and the Group's share of the net fair value of the joint ventures' identifiable assets and liabilities is accounted for as goodwill. When the Group's share of losses in a joint venture equals or exceeds its interests in the joint ventures, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the joint ventures.

Unrealised gains on transactions between the Group and its joint ventures are eliminated to the extent of the Group's interest in the joint ventures. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of the joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

2.6 SEGMENT REPORTING

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the senior executive management that makes strategic decisions.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.7 FOREIGN CURRENCY TRANSLATION

(a) *Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Renminbi ("RMB"), which is the Group's and Company's presentation currency. The Company's functional currency is Hong Kong Dollar ("HKD").

(b) *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are generally recognised in profit or loss, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the statement of profit or loss within 'finance income or expenses'. All other foreign exchange gains and losses are presented in the statement of profit or loss within 'other gains/(losses) — net'.

Changes in the fair value of debt securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortised cost are recognised in profit or loss, and other changes in carrying amount are recognised in other comprehensive income.

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available for sale, are included in other comprehensive income.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.7 FOREIGN CURRENCY TRANSLATION (continued)

(c) Group companies

The results and financial position of the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each statement of profit or loss are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions), and

(iii) all resulting currency translation differences are recognised in other comprehensive income.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate. Currency translation differences arising are recognised in other comprehensive income.

(d) Disposal of foreign operation and partial disposal

On the disposal of a foreign operation (that is, a disposal of the Group's entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation, a disposal involving loss of joint control over a joint venture that includes a foreign operation, or a disposal involving loss of significant influence over an associate that includes a foreign operation), all of the currency translation differences accumulated in equity in respect of that operation attributable to the owners of the company are reclassified to profit or loss.

In the case of a partial disposal that does not result in the Group losing control over a subsidiary that includes a foreign operation, the proportionate share of accumulated currency translation differences are re-attributed to non-controlling interests and are not recognised in profit or loss. For all other partial disposals (that is, reductions in the Group's ownership interest in associates or joint ventures that do not result in the Group losing significant influence or joint control), the proportionate share of the accumulated exchange difference is reclassified to profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.8 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the statement of profit or loss during the financial period in which they are incurred.

For the drilling rigs used for oil and gas engineering services included in Plant and machinery, the depreciation is calculated using units-of-production method. For each day a rig is operating, it is depreciated over an approximate of 5,000~6,000-day period, after provision for residual values.

Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

• Freehold land	Not depreciation
• Buildings held for own use	20–35 years
• Plant and machinery	5–10 years
• Fixtures, fittings and equipment	5–10 years
• Motor vehicles	5–6 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.11).

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised within 'Other gains/(losses) — net' in profit or loss.

Construction-in-progress ("CIP") represents buildings under construction and plant and equipment pending for installation, and are stated at cost. Costs include construction and acquisition costs. No provision for depreciation is made on CIP until such time as the relevant assets are completed and ready for intended use. When the assets concerned are brought into use, the costs are transferred to property, plant and equipment and depreciated in accordance with the policy as stated above.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.9 LEASE PREPAYMENTS

Lease prepayments represent upfront prepayments made for the land use rights. Lease prepayments are stated at costs and are amortised on a straight-line basis over the remaining period of the land use rights, net of any impairment losses.

2.10 INTANGIBLE ASSETS

(a) Goodwill

Goodwill arises on the acquisition of subsidiaries represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identified net assets acquired.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash-generating units ("CGUs"), or groups of CGUs, that is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes. Goodwill is monitored at the operating segment level.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of the CGU containing the goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs of disposal. Any impairment is recognised immediately as an expense and is not subsequently reversed.

(b) Technical know-how

Separately acquired technical know-how is shown at historical cost. Technical know-how acquired in a business combination is recognised at fair value at the acquisition date. Technical know-how has a finite useful life and is carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of technical know-how over its estimated useful life of 10 years.

(c) Capitalised development costs

Capitalised development costs that are directly attributable to the design and testing of new or improved products when meet relevant criteria. Amortisation is calculated using the straight-line method over its estimated useful life of 10 years (Note 2.34).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.11 IMPAIRMENT OF NON-FINANCIAL ASSETS

Intangible assets that have an indefinite useful life or intangible assets not ready to use are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting date.

2.12 NON-CURRENT ASSETS (OR DISPOSAL GROUPS) HELD FOR SALE AND DISCONTINUED OPERATIONS

Non-current assets (or disposal groups) are classified as held for sale when their carrying amount will be recovered principally through a sale transaction and a sale is considered highly probable. The non-current assets (except for certain assets as explained below), (or disposal groups), are stated at the lower of carrying amount and fair value less costs to sell. Deferred tax assets, assets arising from employee benefits, financial assets (other than investments in subsidiaries and associates) and investment properties, which are classified as held for sale, would continue to be measured in accordance with the policies set out elsewhere in Note 2.

A discontinued operation is a component of the Group's business, the operations and cash flows of which can be clearly distinguished from the rest of the Group and which represents a separate major line of business or geographic area of operations, or is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or is a subsidiary acquired exclusively with a view to resale. The results of discontinued operations are presented separately in the statement of profit or loss.

An impairment loss is recognised for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell. A gain is recognised for any subsequent increases in fair value less costs to sell of an asset (or disposal group), but not in excess of any cumulative impairment loss previously recognised. A gain or loss not previously recognised by the date of the sale of the non-current asset (or disposal group) is recognised at the date of derecognition.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.12 NON-CURRENT ASSETS (OR DISPOSAL GROUPS) HELD FOR SALE AND DISCONTINUED OPERATIONS (continued)

Non-current assets (including those that are part of a disposal group) are not depreciated or amortised while they are classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale continue to be recognised.

Non-current assets classified as held for sale and the assets of a disposal group classified as held for sale are presented separately from the other assets in the balance sheet. The liabilities of a disposal group classified as held for sale are presented separately from other liabilities in the balance sheet.

2.13 FINANCIAL ASSETS

2.13.1 Classification

From 1 January 2018, the Group classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value through OCI, and
- those to be measured at amortised cost.

The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or OCI. For investments in equity instruments that are not held for trading, this will depend on whether the Group has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income (FVOCI).

The Group reclassifies debt investments when and only when its business model for managing those assets changes.

2.13.2 Recognition and derecognition

Regular way purchases and sales of financial assets are recognised on trade-date, the date on which the Group commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.13 FINANCIAL ASSETS (Continued)

2.13.3 *Measurement*

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss (FVPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

Debt instruments

Subsequent measurement of debt instruments depends on the Group's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the Group classifies its debt instruments:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss and presented in other gains/(losses) together with foreign exchange gains and losses. Impairment losses are presented as separate line item in the statement of profit or loss.

- FVOCI: Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in other gains/(losses). Interest income from these financial assets is included in finance income using the effective interest rate method. Foreign exchange gains and losses are presented in other gains/(losses) and impairment expenses are presented as separate line item in the statement of profit or loss.

- FVPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL. A gain or loss on a debt investment that is subsequently measured at FVPL is recognised in profit or loss and presented net within other gains/(losses) in the period in which it arises.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.13 FINANCIAL ASSETS (continued)

2.13.3 *Measurement* (continued)

Equity instruments

The Group subsequently measures all equity investments at fair value. Where the Group's management has elected to present fair value gains and losses on equity investments in OCI, there is no subsequent reclassification of fair value gains and losses to profit or loss following the derecognition of the investment. Dividends from such investments continue to be recognised in profit or loss as other income when the Group's right to receive payments is established.

Changes in the fair value of financial assets at FVPL are recognised in other gains/(losses) in the statement of profit or loss as applicable. Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI are not reported separately from other changes in fair value.

2.13.4 *Impairment*

From 1 January 2018, the Group assesses on a forward looking basis the expected credit losses associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

For trade receivables, the Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables, see Note 3.1(b) for further details.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.13 FINANCIAL ASSETS (continued)

2.13.5 *Accounting policies applied until 31 December 2017*

The Group has applied IFRS 9 retrospectively, but has elected not to restate comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the Group's previous accounting policy.

Until 31 December 2017 the Group classifies its financial assets in the following categories:

- financial assets at fair value through profit or loss,
- loans and receivables, and
- available-for-sale financial assets.

The classification determined on the purpose for which the investments were acquired. Management determined the classification of its investments at initial recognition and, in the case of assets classified as held-to-maturity, re-evaluated this designation at the end of each reporting period.

(a) Reclassification

The Group could choose to reclassify a non-derivative trading financial asset out of the held for trading category if the financial asset was no longer held for the purpose of selling it in the near term. Financial assets other than loans and receivables were permitted to be reclassified out of the held for trading category only in rare circumstances arising from a single event that was unusual and highly unlikely to recur in the near term. In addition, the Group could choose to reclassify financial assets that would meet the definition of loans and receivables out of the held for trading or available-for-sale categories if the Group had the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

Reclassifications were made at fair value as of the reclassification date. Fair value became the new cost or amortised cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date were subsequently made. Effective interest rates for financial assets reclassified to loans and receivables and held-to-maturity categories were determined at the reclassification date. Further increases in estimates of cash flows adjusted effective interest rates prospectively.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.13 FINANCIAL ASSETS (continued)

2.13.5 *Accounting policies applied until 31 December 2017* (continued)

(b) Subsequent measurement

The measurement at initial recognition did not change an adoption of IFRS 9, see description above.

Subsequent to the initial, recognition loans and receivables and held-to-maturity investments were subsequently carried at amortised cost using the effective interest method.

Available-for-sale financial assets and financial assets at FVPL were subsequently carried at fair value. Gains or losses arising from changes in the fair value are recognised as follows:

- for 'financial assets at FVPL' — in profit or loss within other gains/(loss)
- for available-for-sale financial assets that are monetary securities denominated in a foreign currency — translation differences related to changes in the amortised cost of the security were recognised in profit or loss and other changes in the carrying amount were recognised in other comprehensive income
- for other monetary and non-monetary securities classified as available-for-sale — in other comprehensive income.

Details on how the fair value of financial instruments is determined are disclosed in Note 3.3(a).

When securities classified as available-for-sale were sold, the accumulated fair value adjustments recognised in other comprehensive income were reclassified to profit or loss as gains and other losses from investment securities.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.13 FINANCIAL ASSETS (continued)

2.13.5 *Accounting policies applied until 31 December 2017* (continued)

(c) *Impairment*

The Group assessed at the end of each reporting period whether there was objective evidence that a financial asset or group of financial assets was impaired. A financial asset or a group of financial assets was impaired and impairment losses were incurred only if there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost was considered an indicator that the assets are impaired.

Assets carried at amortised cost

For loans and receivables, the amount of the loss was measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that had not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset was reduced and the amount of the loss was recognised in profit or loss. If a loan or held-to-maturity investment had a variable interest rate, the discount rate for measuring any impairment loss was the current effective interest rate determined under the contract. As a practical expedient, the Group could measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreased and the decrease could be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss was recognised in profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.13 FINANCIAL ASSETS (continued)

2.13.5 *Accounting policies applied until 31 December 2017* (continued)

(c) *Impairment* (continued)

Assets classified as available-for-sale

If there was objective evidence of impairment for available-for-sale financial assets, the cumulative loss — measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss — was removed from equity and recognised in profit or loss.

Impairment losses on equity instruments that were recognised in profit or were not reversed through profit or loss in a subsequent period.

If the fair value of a debt instrument classified as available-for-sale increased in a subsequent period and the increase could be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss was reversed through profit or loss.

2.14 OFFSETTING FINANCIAL INSTRUMENTS

Financial assets and liabilities are offset and the net amount reported in the balance sheet where there is a legally enforceable right to offset the recognised amounts, and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the company or the counterparty.

2.15 DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group does not have any derivative instruments that qualifying for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.16 INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.17 TRADE AND OTHER RECEIVABLES

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection of trade and other receivables is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade and other receivables are recognised initially at the amount of consideration that is unconditional unless they contain significant financing components, when they are recognised at fair value. The Group holds the trade receivables with the objective to collect the contractual cash flows and therefore measures them subsequently at amortised cost using the effective interest method. See Note 18 for further information about the Group's accounting for trade receivables and Note 3.1(b) for a description of the Group's impairment policies.

2.18 CASH AND CASH EQUIVALENTS

In the consolidated statement of cash flows, cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts.

2.19 SHARE CAPITAL

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.20 TRADE AND OTHER PAYABLES

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.21 BORROWINGS

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in profit or loss over the period of the borrowings using the effective interest method.

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalised as a prepayment for liquidity services and amortised over the period of the facility to which it relates.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

An initial recognition the derivative component of senior notes under borrowings is measured at fair value and presented as part of derivative financial instruments. Any excess of proceeds over the amount initially recognised as the derivative component is recognised as the liability component. Transaction costs that relate to issue of the senior note are allocated to the liability and derivative components in proportion to the allocation of proceeds. The portion of the transaction costs relating to the liability component is recognised initially as part of the liability. The portion relating to derivative component is recognised immediately in profit or loss.

The derivative component is subsequently remeasured in accordance with Note 2.15. The liability component is subsequently carried at amortised cost. The interest expense recognised in profit or loss on the liability component is calculated using the effective interest method.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.22 BORROWING COSTS

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

Borrowing costs include interest expense, finance charges in respect of finance lease and exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. The exchange gains and losses that are an adjustment to interest costs include the interest rate differential between borrowing costs that would be incurred if the entity had borrowed funds in its functional currency, and the borrowing costs actually incurred on foreign currency borrowings. Such amounts are estimated based on interest rates on similar borrowings in the entity's functional currency.

When the construction of the qualifying assets takes more than one accounting period, the amount of foreign exchange differences eligible for capitalisation is determined for each annual period and are limited to the difference between the hypothetical interest amount for the functional currency borrowings and the actual interest incurred for foreign currency borrowings. Foreign exchange differences that did not meet the criteria for capitalisation in previous years should not be capitalised in subsequent years.

2.23 CURRENT AND DEFERRED INCOME TAX

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.23 CURRENT AND DEFERRED INCOME TAX (continued)

(a) Current income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company and its subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

(b) Deferred income tax

Inside basis differences

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.23 CURRENT AND DEFERRED INCOME TAX (continued)

(b) ***Deferred income tax*** (continued)

Outside basis differences

Deferred income tax liabilities are provided on taxable temporary differences arising from investments in subsidiaries, associates and joint arrangements, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future. Generally the Group is unable to control the reversal of the temporary difference for associates. Only when there is an agreement in place that gives the Group the ability to control the reversal of the temporary difference in the foreseeable future, deferred tax liability in relation to taxable temporary differences arising from the associate's undistributed profits is not recognised.

Deferred income tax assets are recognised on deductible temporary differences arising from investments in subsidiaries, associates and joint arrangements only to the extent that it is probable the temporary difference will reverse in the future and there is sufficient taxable profit available against which the temporary difference can be utilised.

(c) ***Offsetting***

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.24 EMPLOYEE BENEFITS

(a) *Pension obligations*

Pursuant to the relevant labour rules and regulations in the People's Republic of China (the "PRC"), the PRC subsidiaries of the Group participates in defined contribution retirement benefit schemes (the "Schemes") organised by the PRC municipal government authorities whereby the Group is required to make contributions to the Schemes at the rate of 20% to 22% (2017: 20% to 22%) of the standard wages determined by the relevant authorities in the PRC for the year ended 31 December 2018. The local government authority is responsible for the entire pension obligations payable to retired employees. The contributions to the schemes are charged to profit or loss as and when incurred.

(b) *Housing fund and other benefits*

All full-time employees of the Group's subsidiaries in the PRC are entitled to participate in various government-sponsored housing and other benefits funds. The Group contributes on a monthly basis to these funds based on certain percentages of the salaries of the employees. The Group's liability in respect of these funds is limited to the contributions payable in each period.

2.25 SHARE-BASED PAYMENTS

(a) *Equity-settled share-based payment transactions*

The Group operates an equity-settled, share-based compensation plan, under which the entity receives services from employees as consideration for equity instruments (options) of the Group. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted:

- including any market performance conditions (for example, an entity's share price);
- excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period); and
- including the impact of any non-vesting conditions (for example, the requirement for employees to save or holding shares for a specified period of time).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.25 SHARE-BASED PAYMENTS (continued)

(a) *Equity-settled share-based payment transactions* (continued)

At the end of each reporting period, the Group revises its estimates of the number of options that are expected to vest based on the non-marketing performance and service conditions. It recognises the impact of the revision to original estimates, if any, in profit or loss, with a corresponding adjustment to equity.

In addition, in some circumstances employees may provide services in advance of the grant date and therefore the grant date fair value is estimated for the purposes of recognising the expense during the period between service commencement period and grant date.

When the options are exercised, the Company issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital (and share premium).

(b) *Share-based payment transactions among group entities*

The grant by the Company of options over its equity instruments to the employees of subsidiary undertakings in the Group is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity in the parent entity accounts.

2.26 PROVISIONS

Provisions for warranties costs and legal claims are recognised when: the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 REVENUE RECOGNITION

(a) *Sale of goods*

The Group manufactures and sells land drillings rigs, parts and components to the ultimate customers or dealers. Sales are recognised when control of the products has transferred, being when the customer has the ability to direct the use of and obtain substantially all of the remaining benefits from the products. The control of products is transferred when products have been shipped to the specified location, being when customer has accepted the products and collectability of the related parted receivables is reasonably assured.

The sales commission is the incremental cost of obtaining a contract and the Group expenses these costs as incurred where the expected amortisation period is one year or less.

The Group's obligation to repair or replace faulty products under the standard warranty terms is recognised as a provision, see Note 27.

Instalment sales, under which the consideration is receivable in instalments. The certain contracts where the period between the transfer of the promised goods or services to the customer and payment by the customer exceeds one year shall be considered any financing components. As a consequence, the Group adjusts the transaction prices for the time value of money.

As receivable is recognised when the goods are delivered as this is the point in time that the consideration is unconditional because only the passage of time is required before the payment is due.

(b) *Sale of services*

For sales of services, revenue is recognised in the accounting period in which the services are rendered, by reference to stage of completion of the specific transaction and assessed on the basis of actual services provided as a proportion of the total service to be provided because the customer receives and uses the benefits simultaneously.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 REVENUE RECOGNITION (continued)

(c) *Interest income*

Except interest income from financial lease service is recorded as revenue; all other kinds of interest income are recorded as finance income. At the financial leasing commencement date, the minimum lease payments from the lessee is recognized as finance lease receivable and unguaranteed residual value is recognised at the same time. The difference between the sum of minimum lease payments and unguaranteed residual value and its present value is accounted for as unearned finance income charge.

The unearned finance income is amortized using the effective interest method over the period of the lease.

(d) *Accounting policies applied before 1 January 2018*

Revenue was measured at the fair value of the consideration received or receivable, and represented amounts receivable for goods supplied, stated net of discounts returns and value added taxes. The Group recognised revenue when the amount of revenue can be reliably measured; when it was probable that future economic benefits would flow to the entity; and when specific criteria had been met for each of the Group's activities, as described below. The Group based its estimates of return on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

(i) Sale of goods

Revenue from the sales of goods is recognised when significant risks and rewards of ownership of the goods are transferred to the ultimate customers or dealers, as appropriate (normally in the form of delivery of goods to ultimate customers, dealers or parties designated by the dealers), and the ultimate customers, dealers or parties designated by the dealers have accepted the products and collectability of the related receivables is reasonably assured.

Instalment sales, under which the consideration is receivable in instalments. Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sales price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, using the effective interest method.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 REVENUE RECOGNITION (continued)

(d) *Accounting policies applied before 1 January 2018* (continued)

(ii) Sale of services

For sales of services, revenue is recognised in the accounting period in which the services are rendered, by reference to stage of completion of the specific transaction and assessed on the basis of actual services provided as a proportion of the total service to be provided.

(iii) Revenue from construction contracts

A construction contract is defined by IAS 11, 'Construction contracts', as a contract specifically negotiated for the construction of an asset.

When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract by reference to the stage of completion. Contract costs are recognised as expenses by reference to the stage of completion of the contract activity at the end of the reporting period. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable.

Variations in contract work, claims and incentive payments are included in contract revenue to the extent that may have been agreed with the customer and are capable of being reliably measured.

The Group uses the 'percentage-of-completion' method to determine the appropriate amount to recognise in a given period. The stage of completion is measured by reference to the contract costs incurred up to the end of the reporting period as a percentage of total estimated costs for each contract. Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion.

On the balance sheet, the Group reports the net contract position for each contract as either an asset or a liability. A contract represents an asset where costs incurred plus recognised profits (less recognised losses) exceed progress billings; a contract represents a liability where the opposite is the case.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.27 REVENUE RECOGNITION (continued)

(d) *Accounting policies applied before 1 January 2018* (continued)

(iv) *Interest income*

Except interest income from financial lease service is recorded as revenue; all other kinds of interest income are recorded as finance income. At the financial leasing commencement date, the minimum lease payments from the lessee is recognized as finance lease receivable and unguaranteed residual value is recognised at the same time. The difference between the sum of minimum lease payments and unguaranteed residual value and its present value is accounted for as unearned finance income charge.

The unearned finance income is amortized using the effective interest method over the period of the lease.

2.28 EARNINGS PER SHARE

(a) *Basic earnings per share*

Basic earnings per share is calculated by dividing:

- the profit attributable to owners of the company, excluding any costs of servicing equity other than ordinary shares

by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year and excluding treasury shares.

(b) *Diluted earnings per share*

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account:

- the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares, and

- the weighted average number of additional ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.29 DIVIDEND INCOME

Dividends are received from financial assets measured at fair value through profit or loss (FVPL) and at fair value through other comprehensive income (FVOCI) (2017 — from financial assets at FVPL and available-for-sale financial assets). Dividends are recognised as other income in profit or loss when the right to receive payment is established. This applies even if they are paid out of pre-acquisition profits, unless the dividend clearly represents a recovery of part of the cost of an investment. In this case, the dividend is recognised in OCI if it relates to an investment measured at FVOCI. However, the investment may need to be tested for impairment as a consequence.

2.30 LEASES

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of profit or loss on a straight-line basis over the period of the lease.

The Group leases certain property, plant and equipment. Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is charged to the statement of profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the useful life of the asset and the lease term.

A finance lease of an asset by a manufacturer gives rise to two types of income: finance income over the lease term; and a profit or loss equivalent to that arising on an outright sale. Where a manufacturer enters into a finance lease with a customer, the manufacturer should recognise selling profit or loss in income for the period in accordance with the policy followed by the entity for outright sales. This is because the asset's risks and rewards of ownership have passed to the customer. The sales revenue recorded by a manufacturer is the lower of the asset's fair value or the present value of the minimum lease payments computed at a market rate of interest.

When assets are leased out under a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.30 LEASES (continued)

The method for allocating gross earnings to accounting periods is referred to a as the 'actuarial method'. The actuarial method allocates rentals between finance income and repayment of capital in each accounting period in such a way that finance income will emerge as a constant rate of return on the lessor's net investment in the lease.

When assets are leased out under an operating lease, the asset is included in the balance sheet based on the nature of the asset.

Lease income on operating leases is recognised over the term of the lease on a straight-line basis.

2.31 DIVIDEND DISTRIBUTION

Provision is made for the amount of any dividend declared, being appropriately authorised and no longer at the discretion of the entity, on or before the end of the reporting period but not distributed at the end of the reporting period.

2.32 GOVERNMENT GRANTS

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the profit or loss over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred income and are credited to profit or loss on a straight-line basis over the expected lives of the related assets.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.33 INTEREST INCOME

Interest income from financial assets at FVPL is included in the net fair value gains/(losses) on these assets.

Interest income on financial assets at amortised cost and financial assets at FVOCI (2017 — available-for-sale securities and loans and receivables) calculated using the effective interest method is recognised in the statement of profit or loss as part of other income.

Interest income is presented as finance income where it is earned from financial assets that are held for cash management purposes, see Note 10 below. Any other interest income is included in other income.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for financial assets that subsequently become credit-impaired. For credit-impaired financial assets the effective interest rate is applied to the net carrying amount of the financial asset (after deduction of the loss allowance).

2.34 RESEARCH AND DEVELOPMENT

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when the following criteria are fulfilled:

(a) it is technically feasible to complete the intangible asset so that it will be available for use or sale;

(b) management intends to complete the intangible asset and use or sell it;

(c) there is an ability to use or sell the intangible asset;

(d) it can be demonstrated how the intangible asset will generate probable future economic benefits;

(e) adequate technical, financial and other resources to complete the development and to use or sell the intangible asset are available; and

(f) the expenditure attributable to the intangible asset during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over its useful life.

3 FINANCIAL RISK MANAGEMENT

3.1 FINANCIAL RISK FACTORS

The Group's activities expose to a variety of financial risks: market risk (including foreign exchange risk, cash flow and fair value interest rate risk), credit risk and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by the senior executive management of the Group. The senior executive management of the Group identifies, evaluates and hedges financial risks in close co-operation with the Group's operating units. The board provides principles for overall risk management, as well as policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

(a) Market risk

(i) Foreign exchange risk

The Group is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar ("USD"), Euros ("EUR") and RMB. Foreign exchange risk arises when future commercial transactions or recognised assets or liabilities are denominated in a currency that is not the entity's functional currency. Management has set up a policy to require the Group companies to manage their foreign exchange risk against their functional currency.

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 currencies. The exchange rate adopted for the foreign exchange transactions are the rates of exchange quoted by the commercial banks that are based on the middle price quoted by People's Bank of China and determined largely by supply and demand.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(a) *Market risk* (continued)

(i) *Foreign exchange risk* (continued)

The following table details the Group's exposure at 31 December 2018 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 31 December 2018.

	Exposure to foreign currency		
	USD items (RMB'000)	EUR items (RMB'000)	RMB items (RMB'000)
At 31 December 2018			
Cash and cash equivalents	**130,917**	**431**	**538**
Trade and other receivables	**1,374,704**	**265**	**–**
Borrowings	**(429,293)**	**–**	**–**
Trade and other payables	**(180,980)**	**–**	**(1,034)**
Overall net exposure	**895,348**	**696**	**(496)**

	Exposure to foreign currency		
	USD items (RMB'000)	EUR items (RMB'000)	RMB items (RMB'000)
At 31 December 2017			
Cash and cash equivalents	159,093	240	387
Trade and other receivables	1,006,595	536	–
Borrowings	(42,702)	–	–
Trade and other payables	(203,378)	–	(1,969)
Overall net exposure	919,608	776	(1,582)

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(a) *Market risk* (continued)

(i) Foreign exchange risk (continued)

As at 31 December 2018 and 2017, the Group did not have any forward exchange contracts to hedge its exposure to foreign exchange risk.

As at 31 December 2018, if RMB had weakened/strengthened by 5% (2017: 5%) against the USD with all other variables held constant, the Group's post-tax profit for the year then ended would have been approximately RMB36,987,000 higher/lower (2017: RMB39,183,000 higher/lower), mainly as a result of foreign exchange gains/losses on translation of USD-denominated cash and cash equivalents, trade and other receivables, borrowings and trade and other payables.

The sensitivity analysis above represents an aggregation of the instantaneous effects on each of the group entities' profit or loss after tax measured in the respective functional currencies, translated into RMB at the exchange rate ruling at the end of the reporting period for presentation purposes.

(ii) Cash flow and fair value interest rate risk

The Group's interest rate risk arises primarily from borrowings. Borrowings obtained at variable rates expose the Group to cash flow interest rate risk which is partially offset by cash held at variable rates. All borrowings including senior notes obtained at fixed rates expose the Group to fair value interest rate risk. The Group's policy is to manage its interest rate risk to ensure there are no undue exposures to significant interest rate movements. The Group does not use derivative financial instruments to hedge its fixed and variable rate debt obligations.

As at 31 December 2018, it is estimated that a general increase/decrease of 50 basis points in interest rates, with all other variables held constant, would have decreased/increased the Group's profit after tax by approximately RMB3,692,000 (2017: RMB4,352,000).

The sensitivity analysis above indicates the instantaneous change in the Group's profit after tax that would arise assuming that the change in interest rates had occurred as at 31 December 2018 and 2017, the impact on the Group's profit after tax is estimated as annualised impact on interest expense of such a change in interest rates. The analysis is performed on the same basis for 2017.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) Credit risk

Credit risk arises from cash and cash equivalents, contractual cash flows of debt instruments carried at amortised cost and at fair value through comprehensive income FVOCI, and deposits with banks, as well as credit exposures to customers, including outstanding receivables.

(i) Risk management

Credit risk is managed on a group basis. Management has a credit policy in place and the exposures to these credit risks are monitored on an on-going basis.

Risk control assesses the credit quality of the customer, taking into account its financial position, past experience and other factors. Individual risk limits are set based on internal or external ratings in accordance with limits set by the management. The compliance with credit limits by customers is regularly monitored by line management.

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer and the industry in which the customers operate. Significant concentration of credit risk primarily arises when the Group has significant exposure to individual customers. As at 31 December 2018, 13% (2017: 7%) and 34% (2017: 24%) of the total trade receivables was due from the Group's largest customer and the five largest customers respectively. The Group also has significant concentration of credit risk on customers in the oil drilling industry and the volatility in global oil prices may affect the financial results and ability of customers to make payments.

The Group provides guarantees which expose the Group to credit risk (Note 34).

The credit risk on cash at bank and pledged bank deposits is limited as the counterparties are banks with sound credit standing. Majority of the Group's cash and cash equivalents at bank and pledged bank deposits were deposited at the state-owned commercial banks in the PRC.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) *Credit risk* (continued)

(ii) *Impairment of financial assets*

The Group has the following types of financial assets that are subject to the expected credit loss model:

- trade receivables for sales of inventory and from the provision of services
- contract assets
- loan to an associate and other related party carried at amortised cost
- bank acceptance bill receivables carried at FVOCI
- finance lease receivables
- other financial assets at amortised cost
- pledged bank deposits, and
- cash and cash equivalents

While pledged bank deposits and cash and cash equivalents are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial.

Trade receivables and contract assets

The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) ***Credit risk*** (continued)

(ii) *Impairment of financial assets* (continued)

Trade receivables and contract assets (continued)

To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due. The contract assets relate to unbilled work in progress and have substantially the same risk characteristics as the trade receivables for the same types of contracts. The Group has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets.

The expected loss rates are based on the payment profiles of sales over a period of 24 month before 31 December 2018 or 1 January 2018 respectively and the corresponding historical credit losses experienced within this period. The historical loss rates are adjusted to reflect current and forward-looking information on macroeconomic factors affecting the ability of the customers to settle the receivables. The Group has identified the GDP and the unemployment rate of the countries in which it sells its goods and services to be the most relevant factors, and accordingly adjusts the historical loss rates based on expected changes in these factors.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) *Credit risk* (continued)

(ii) *Impairment of financial assets* (continued)

Trade receivables and contract assets (continued)

On that basis, the loss allowance as at 31 December 2018 and 1 January 2018 (on adoption of IFRS 9) was determined as follows for both trade receivables and contract assets:

i) As at 31 December 2018, receivables with amounts are subject to separate assessment for impairment as below:

31 December 2018	Current	1-30 days past due	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total
Expected loss rate	–	–	–	–	48.15%	–
Gross carrying amount – trade receivables	–	–	–	–	217,322	217,322
Loss allowance	–	–	–	–	(104,650)	(104,650)

As the above debtors suffered in several lawsuits or operation difficulty, the Group cannot be able to collect the amount under the original terms, provisions for impairment on those receivables were made.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) ***Credit risk*** (continued)

(ii) *Impairment of financial assets* (continued)

Trade receivables and contract assets (continued)

ii) As at 31 December 2018, trade receivables have been grouped on the basis of shared credit risk characteristics and the days past due for the measurement of expected credit losses:

- bank acceptance bill receivables group

  As at 31 December 2018, the total amount of bank acceptance bills was RMB1,133,000, these bills will be accepted by large state-owned banks or national commercial banks. The Group believes that there is no significant credit losses due to the bank default.

- revenue of land drilling rigs group

At 31 December 2018	Current	1-30 days past due	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total
Expected loss rate	0.33%	0.00%	0.00%	0.00%	0.90%	–
Gross carrying amount –						
trade receivables	1,100,695	–	–	–	246,063	1,346,758
Loss allowance	(3,619)	–	–	–	(2,215)	(5,834)

- revenue of fracture pumps group

At 31 December 2018	Current	1-30 days past due	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total
Expected loss rate	0.32%	0.00%	0.00%	0.00%	0.00%	–
Gross carrying amount –						
trade receivables	345,082	–	–	–	–	345,082
Loss allowance	(1,089)	–	–	–	–	(1,089)

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) *Credit risk* (continued)

(ii) Impairment of financial assets (continued)

Trade receivables and contract assets (continued)

ii) As at 31 December 2018, trade receivables have been grouped on the basis of shared credit risk characteristics and the days past due for the measurement of expected credit losses: (continued)

- revenue of parts and components and others group

At 31 December 2018	Current	1-30 days past due	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total
Expected loss rate	3.11%	6.32%	7.65%	10.81%	11.23%	–
Gross carrying amount – trade receivables	487,984	26,264	26,816	45,827	244,437	831,328
Gross carrying amount – contract assets	12,560	–	–	–	–	12,560
Loss allowance	(15,564)	(1,660)	(2,051)	(4,953)	(27,457)	(51,685)

- revenue of oil and gas engineering services group

At 31 December 2018	Current	1-30 days past due	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total
Expected loss rate	0.06%	0.00%	0.00%	0.00%	6.95%	–
Gross carrying amount – trade receivables	205,923	–	–	–	63,345	269,268
Gross carrying amount – contract assets	10,942	–	–	–	19,385	30,327
Loss allowance	(129)	–	–	–	(5,749)	(5,878)

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) *Credit risk* (continued)

(ii) *Impairment of financial assets* (continued)

Trade receivables and contract assets (continued)

For the opening loss allowances for trade receivables as at 1 January 2018, the restatement on transaction as a result of applying the expected credit risk model was not material. The closing loss allowances for trade receivables and contract assets as at 31 December 2018 reconcile to the opening loss allowances as follows:

	Contract assets		Trade receivables	
	2018	2017	**2018**	2017
31 December — calculated under IAS 39	**–**	–	**(265,086)**	(297,241)
Amounts restated through opening retained earnings	**–**	–	**–**	–
Opening loss allowance as at 1 January 2018 calculated under IFRS 9	**–**	–	**(265,086)**	(297,241)
Increase in loss allowance recognised in profit or loss during the year	**(129)**	–	**(54,098)**	(111,222)
Receivables written off during the year as uncollectible	**–**	–	**18**	82,692
Disposal of subsidiaries	**–**	–	**151,304**	–
Exchange rate changes	**–**	–	**(1,145)**	–
Transferred to disposal group classified as held for sale (Note 33)	**–**	–	**–**	60,685
	(129)	–	**(169,007)**	(265,086)

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) ***Credit risk*** (continued)

(ii) *Impairment of financial assets* (continued)

Trade receivables and contract assets (continued)

Trade receivables and contract assets are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan with the Group, and a failure to make contractual payments.

Impairment losses on trade receivables and contract assets are presented as net impairment losses within operating profit. Subsequent recoveries of amounts previously written off are credited against the same line item.

Previous accounting policy for impairment of trade receivables

In the prior year, the impairment of trade receivables was assessed based on the incurred loss model. Individual receivables which were known to be uncollectible were written off by reducing the carrying amount directly. The other receivables were assessed collectively to determine whether there was objective evidence that an impairment had been incurred but not yet been identified. For these receivables the estimated impairment losses were recognised in a separate provision for impairment. The Group considered that there was evidence of impairment if any of the following indicators were present:

- significant financial difficulties of the debtor
- probability that the debtor will enter bankruptcy or financial reorganisation, and
- default or late payments (more than 30 days overdue).

Receivables for which an impairment provision was recognised were written off against the provision when there was no expectation of recovering additional cash.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) ***Credit risk*** (continued)

(ii) *Impairment of financial assets* (continued)

Loan to an associate and other related party

Loan to an associate and other related party is considered credit-impairment on origination and no loss allowance is recognised on initial recognition. For such assets, impairment is determined based on full lifetime expected credit loss on initial recognition. However, lifetime expected credit losses are included in the estimated cash flows when calculating the effective interest rate on initial recognition. The effective interest rate for interest recognition throughout the life of the asset is a credit-adjusted effective interest rate. As a result, no loss allowance is recognised on initial recognition. As at 31 December 2018, the balance of current loan to an associate and other related party was RMB79,982,000 and the balance of non-current loan to an associate and other related party was RMB1,584,192,000 (Note 32).

Any subsequent changes in lifetime expected credit losses, both positive and negative, will be recognised immediately in profit or loss.

Financial assets at fair value through other comprehensive income

Bank acceptance bill receivables carried at FVOCI are considered to have low credit risk, and the loss allowance recognised during the period was therefore limited to 12 months expected losses. Management considers 'low credit risk' for the instruments as the issuers have strong capacity to meet its contractual cash flow obligations in the near term.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) ***Credit risk*** (continued)

(ii) *Impairment of financial assets* (continued)

Finance lease receivables

The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for finance lease receivables.

To measure the expected credit losses, finance lease receivables have been grouped based on shared credit risk characteristics and the days past due.

The expected loss rates are based on the payment profiles of revenue over a period of 24 month before 31 December 2018 or 1 January 2018 respectively and the corresponding historical credit losses experienced within this period. The historical loss rates are adjusted to reflect current and forward-looking information on macroeconomic factors affecting the ability of the customers to settle the receivables. The Group has identified the GDP and the unemployment rate of the countries in which it rents its inventory out through financing lease to be the most relevant factors, and accordingly adjusts the historical loss rates based on expected changes in these factors.

On that basis, the loss allowance as at 31 December 2018 and 1 January 2018 (on adoption of IFRS 9) was determined as follows for finance lease receivables:

(i) As at 31 December 2018, receivables with amounts are subject to separate assessment for impairment as below:

At 31 December 2018	Current	1-30 days past due	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total
Expected loss rate	–	–	–	–	46.54%	–
Gross carrying amount – finance lease receivables	–	–	–	–	140,633	140,633
Loss allowance	–	–	–	–	(65,449)	(65,449)

As the above debtors suffered in several lawsuits or operation difficulty, the Group cannot be able to collect the amount under the original terms, provisions for impairment on those receivables were made.

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) ***Credit risk*** (continued)

(ii) *Impairment of financial assets* (continued)

Finance lease receivables (continued)

(ii) As at 31 December 2018, trade receivables have been grouped on the basis of shared credit risk characteristics and the days past due for the measurement of expected credit losses:

Receivables within due date group

At 31 December 2018	Current	1-30 days past due	More than 30 days past due	More than 60 days past due	More than 90 days past due	Total
Expected loss rate	0.32%	–	–	–	–	–
Gross carrying amount – finance lease receivables	114,199	–	–	–	–	114,199
Loss allowance	(367)	–	–	–	–	(367)

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) *Credit risk* (continued)

(ii) *Impairment of financial assets* (continued)

Other financial assets at amortised cost

Other financial assets at amortised cost include bank interest receivables and other receivables. For the opening loss allowances for other financial assets as at 1 January 2018, the restatement on transaction as a result of applying the expected credit risk model was not material. The closing loss allowances for other financial assets as at 31 December 2018 reconcile to the opening loss allowances as follows:

	1-30 days past due: expected credit losses in the next 12 months RMB'000	More than 90 days past due: expected credit losses throughout lifetime RMB'000	Total RMB'000
Closing loss allowance as at 31 December 2017 (calculated under IAS 39)	–	(92,552)	(92,552)
Amounts restated through opening retained earnings	–	–	–
Opening loss allowance as at 1 January 2018 (calculated under IFRS 9)	–	(92,552)	(92,552)
Increase in the allowance recognised in profit or loss during the year	(614)	(21,463)	(22,077)
Exchange rate changes	–	(2,673)	(2,673)
Closing loss allowance as at 31 December 2018	(614)	(116,688)	(117,302)

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(b) ***Credit risk*** (continued)

(ii) *Impairment of financial assets* (continued)

Other financial assets at amortised cost (continued)

All the bank interest receivables are considered as low credit risk financial instruments without significant credit risk because the banks have strong capacity to meet its contractual cash flow obligations in the near term.

Net impairment losses on financial and contract assets recognised in profit or loss

During the year, the following losses were recognised in profit or loss in relation to impaired financial assets:

	2018 RMB'000	2017 RMB'000
Impairment losses		
Impairment losses on trade receivables and contract assets	(54,227)	(96,418)
Impairment losses on finance lease receivables	(17,525)	(17,359)
Impairment losses on other financial assets at amortised cost	(22,077)	(19,317)
Net impairment losses on financial and contract assets	(93,829)	(133,094)

3 FINANCIAL RISK MANAGEMENT (continued)

3.1 FINANCIAL RISK FACTORS (continued)

(c) Liquidity risk

Individual operating entities within the Group are responsible for their own cash management, including the short term investment of cash surpluses and the raising of loans to cover expected cash demands, subject to approval by the Company's management when the borrowings exceed certain predetermined levels of authority.

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 adequate committed lines of funding from major financial institutes to meet its liquidity requirements in the short and long term.

The Group has significant concentration of credit risk on customers in the oil and gas industry. The volatility in global oil prices may affect the ability of customers to make payments and demand of the Group's goods and services and hence may affect the liquidity of the Group.

The table below analyses the Group's non-derivative financial liabilities into relevant maturity groupings based on the remaining period the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

	Less than 1 year RMB'000	Between 1 and 2 years RMB'000	Between 2 and 5 years RMB'000	Over 5 years RMB'000	Total contractual cash flows RMB'000
At 31 December 2018					
Trade and other payables (i)	2,340,314	–	–	–	2,340,314
Senior notes	869,831	–	–	–	869,831
Borrowings (excluding senior notes)	1,766,926	504,180	47,940	51,297	2,370,343
Total financial liabilities	4,977,071	504,180	47,940	51,297	5,580,488
At 31 December 2017					
Trade and other payables (i)	1,542,145	–	–	–	1,542,145
Senior notes	97,360	1,404,200	–	–	1,501,560
Borrowings (excluding senior notes)	1,494,096	56,659	579,540	–	2,130,295
Total financial liabilities	3,133,601	1,460,859	579,540	–	5,174,000

(i) Trade and other payables include trade payables, bills payable, amounts due to related companies and other payables.

3 FINANCIAL RISK MANAGEMENT (continued)

3.2 CAPITAL MANAGEMENT

The Group's primary objectives when managing capital are to safeguard the Group's ability to continue as ageing concern, so that it can continue to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital.

The Group's capital structure is regularly reviewed and managed in accordance with the capital management practices of the Group and in light of changes in economic conditions affecting the Group, to the extent that these do not conflict with the directors' fiduciary duties towards the Group.

Consistent with others in the industry, the Group monitors capital risk on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including "current and non-current borrowings" as shown in the consolidated balance sheet) less cash and cash equivalents. Total capital is calculated as "equity" as shown in the consolidated balance sheet plus net debt. The Group aims to maintain the gearing ratio at a reasonable level.

For the year ended 31 December 2018, the Group's strategy, which was unchanged from 2017, was to maintain sufficient capital to cover any net debt position by adjusting the amount of dividends paid to shareholders or issue new shares. The gearing ratios as at 31 December 2018 and 2017 were as follows:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Total borrowings (Note 25)	**3,120,450**	3,316,016
Less: cash and cash equivalents (Note 20)	**(685,500)**	(1,100,292)
Net debt	**2,434,950**	2,215,724
Total equity	**4,318,911**	4,177,650
Total capital	**6,753,861**	6,393,374
Gearing ratio	**36%**	35%

3 FINANCIAL RISK MANAGEMENT (continued)

3.3 FAIR VALUE ESTIMATION

(a) *Fair value hierarchy*

This section explains the judgements and estimates made in determining the fair values of the financial instruments that are recognised and measured at fair value in the financial statements. To provide an indication about the reliability of the inputs used in determining fair value, the Group has classified its financial instruments into the three levels prescribed under the accounting standards. An explanation of each level follows underneath the table.

The Group has an established control framework with respect to the measurement of fair values. Management of the Group has overall responsibility for overseeing all significant fair value measurements, including level 3 fair values and reports directly to the management.

Management of the Group regularly reviews significant unobservable inputs and valuation adjustments. If third-party information is used to measure fair values, then management of the Group assesses the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

The following table presents the Group's financial assets that are measured at fair value at 31 December 2018.

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
Assets				
Financial asset at fair value through other comprehensive income				
— investment in unlisted companies	–	–	89,475	89,475
— Bank acceptance bill receivables	–	–	78,462	78,462
Total assets	–	–	167,937	167,937

3 FINANCIAL RISK MANAGEMENT (continued)

3.3 FAIR VALUE ESTIMATION (continued)

(a) *Fair value hierarchy* (continued)

The following table presents the Group's financial assets that are measured at fair value at 31 December 2017.

	Level 1 RMB'000	Level 2 RMB'000	Level 3 RMB'000	Total RMB'000
Assets				
Available-for-sale financial assets				
— investment in unlisted companies	–	–	90,192	90,192
Total assets	–	–	90,192	90,192

There were no transfers among levels 1, 2 and 3 during 2018 and 2017. There were no other changes in valuation techniques during 2018 and 2017.

The Group's policy is to recognise transfers into and transfers out of fair value hierarchy levels as at the end of the reporting period.

Level 1: The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Level 2: The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is 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. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Level 3: If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3. This is the case for unlisted equity securities.

3 FINANCIAL RISK MANAGEMENT (continued)

3.3 FAIR VALUE ESTIMATION (continued)

(b) Valuation techniques used to determine fair values

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

(c) Fair value measurements using significant unobservable inputs (level 3)

	Financial assets at FVOCI— investment in unlisted companies (Available-for-sale 2017) RMB'000	Financial assets at FVOCI— Bank acceptance bill receivables (Receivables 2017) RMB'000	Total RMB'000
Opening balance 1 January 2017	88,294	–	88,294
Changes in fair value	1,898	–	1,898
Closing balance 31 December 2017	90,192	–	90,192
Opening balance 1 January 2018	**90,192**	**30,839**	**121,031**
Acquisitions	**–**	**635,435**	**635,435**
Disposals	**–**	**(587,812)**	**(587,812)**
Changes in fair value	**(717)**	**–**	**(717)**
Closing balance 31 December 2018	**89,475**	**78,462**	**167,937**

3 FINANCIAL RISK MANAGEMENT (continued)

3.3 FAIR VALUE ESTIMATION (continued)

(c) *Fair value measurements using significant unobservable inputs (level 3)* (continued)

There is no unrealised gains or losses recognised in profit or loss attributable to balances held at the end of the reporting period. The gains or losses arising from the holding of the financial assets measured at fair value during the financial period are recognised in other income/(expense)—net.

The carrying amounts of the Group's financial assets and liabilities including cash and cash equivalents, pledged bank deposits, trade and other receivables, trade and other payables and current borrowings, approximate their fair values due to their short maturities. The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments. The fair value of the non-current borrowings is disclosed in Note 25.

(d) *Valuation inputs and relationships to fair value*

The following table summarises the quantitative information about the significant unobservable inputs used in level 3 fair value measurements. See (b) above for the valuation techniques adopted.

Description	Fair value at 31 December 2018 RMB'000	Fair value at 31 December 2017 RMB'000	Unobservable inputs	Range of inputs (probability-weighted average) 2018	Range of inputs (probability-weighted average) 2017	Relationship of unobservable inputs to fair value
Unlisted companies – current (2017: non-current)	15,422	16,139	Discount rate on book value	21%	21%	negative
Unlisted companies – non-current	74,053	74,053	Discount rate	11%	11%	negative
Bank acceptance bill receivables	78,462	–	Discount rate	3.85%–6.76%	–	negative

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

4.1 CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Measurement of expected credit loss

The Group calculates expected credit losses according to the default risk exposure and expected credit loss rate, and determines the expected credit loss rate based on default probability and default loss rate. In determining the expected credit loss rate, the Group uses data such as internal historical credit loss experience, etc., and adjusts historical data based on current conditions and forward-looking information. When considering forward-looking information, the indicators used by the Group include the risk of economic downturn, the expected increase in unemployment rate, the external market environment, the technological environment and changes in customer conditions. The Group regularly monitors and reviews assumptions related to the calculation of expected credit losses. In 2018, there was no significant change in the above estimation techniques and key assumptions.

(b) Impairment of non-financial assets

If circumstances indicate that the carrying value of non-financial assets may not be recoverable, these assets may be considered impaired, and an impairment loss may be recognised in accordance with IAS 36, Impairment of assets. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. The recoverable amount is the greater of the fair value less costs to sell and the value in use. In determining that value in use, expected cash flows generated by the assets are discounted to their present value, which requires significant judgement relating to revenue, gross margin and pre-tax discount rate. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of revenue and amount of operating costs.

(c) Write down of inventories

The Group estimates the write down for obsolescence of inventories with reference to aged inventories analyses, projections of expected future saleability of goods and management experience and judgement. Based on this review, write down of inventories will be made when the carrying amounts of inventories decline below their estimated net realisable value. Due to changes in market conditions, actual saleability of goods may be different from estimation and profit or loss could be affected by differences in this estimation.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

4.1 CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS (continued)

(d) Income taxes

The Group is subject to various taxes in the places which the Group has operations. Significant judgement is required in determining the provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred income tax assets relating to certain temporary differences and tax losses are recognised as management considers it is probable that future taxable profit will be available against which the temporary differences or tax losses can be utilised. Where the expectation is different from the original estimate, such differences will impact the recognition of deferred income tax assets and income tax expense in the period in which such estimate is changed.

Deferred tax liabilities are generally recognised for all taxable temporary differences, except that the temporary differences arise from the initial recognition of goodwill, or arise from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss.

5 SEGMENT INFORMATION

The senior executive management is the Group's chief operating decision-maker. Management has determined the operating segments based on the information reviewed by the senior executive management for the purposes of allocating resources and assessing performance.

The Group manages its businesses by divisions, which are organised by business lines (land drilling rigs, offshore drilling rigs, parts and components and others, oil and gas engineering services) and geographically. In a manner consistent with the way in which information is reported internally to the Group's chief operating decision maker for the purposes of resource allocation and performance assessment, the Group has identified four reportable segments. No operating segments have been aggregated to form the following reportable segments.

The Group disposed its equity interests in the major entities of the offshore drilling rigs segment in 2018, and the results of those major entities of this segment have been presented as discontinued operations (Note 33).

The senior executive management assesses the performance of the operating segments based on a measure of segment profit or loss. This measurement basis excludes the share of profit or loss of joint ventures and associates, other gains/(losses), net and other income. Finance income and expenses are not allocated to segments, as this type of activity is driven by the central treasury function, which manages the cash position of the Group. Other information provided, except as noted below, to the senior executive management is measured in a manner consistent with that in the consolidated financial statements.

Sales between segments are carried out in the ordinary course of business and in accordance with the terms of the underlying agreements. The revenue from external parties reported to the senior executive management is measured in a manner consistent with that in profit or loss.

5 SEGMENT INFORMATION (continued)

The following table presents revenue and profit information regarding the Group's operating segments for the years ended 31 December 2018 and 2017 respectively. The segment information below includes the discontinued operations as disclosed in Note 33. The Group derives revenue from the transfer of good and services over time and at a point in the following operating segments.

	Land drilling rigs Year ended 31 December		Parts and components and others Year ended 31 December		Oil and gas engineering services Year ended 31 December		Offshore drilling rigs Year ended 31 December		Total Year ended 31 December	
	2018 RMB'000	2017 RMB'000	2018 RMB'000	2017 RMB'000	2018 RMB'000	2017 RMB'000	2018 RMB'000	2017 RMB'000	2018 RMB'000	2017 RMB'000
Segment revenue	2,326,526	418,553	1,691,014	1,791,617	319,265	170,809	16,544	172,876	4,353,349	2,553,855
Inter-segment revenue	–	–	(131,643)	(212,435)	–	(2,844)	(11,545)	(12,916)	(143,188)	(228,195)
Revenue from external customers	2,326,526	418,553	1,559,371	1,579,182	319,265	167,965	4,999	159,960	4,210,161	2,325,660
Timing of revenue recognition										
At a point in time	2,326,526	418,553	1,691,014	1,791,617	–	–	16,544	–	4,034,084	2,210,170
Over time	–	–	–	–	319,265	170,809	–	172,876	319,265	343,685
Reportable segment profit/(loss)	228,870	57,142	197,533	(37,698)	11,310	(61,466)	(46,225)	(609,048)	391,488	(651,070)
Depreciation and amortisation for the year	58,768	28,490	87,303	112,879	40,027	41,826	53,212	78,873	239,310	262,068
Impairment on trade and other receivables	20,877	19,993	73,913	89,124	3,631	615	(10,073)	62,547	88,348	172,279
Write-down of inventories	24,888	6,550	21,091	28,611	9,088	–	4,795	123,611	59,862	158,772
Impairment provision of property, plant and equipment	576	–	315	–	–	–	–	300,100	891	300,100
Impairment provision of intangible assets	–	–	–	–	–	–	–	9,062	–	9,062

Given the manufacturing processes of the Group's business are in a form of vertical integration, the Group's chief operating decision maker considered segment assets and liabilities information was not relevant in assessing performance of and allocating resources to the operations segments. During the year ended 31 December 2018, such information was not reviewed by the Group's chief operating decision maker. Accordingly, no segment assets and liabilities are presented.

5 SEGMENT INFORMATION (continued)

A reconciliation of segment profit/(loss) to profit/(loss) before income tax is provided as follows:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Segment profit/(loss)		
— for reportable segments	**391,488**	(651,070)
Elimination of inter-segment profit/(loss)	**13,587**	(46,290)
Segment profit/(loss) derived from Group's external customers	**405,075**	(697,360)
Share of loss of joint ventures	**(28,169)**	(4,362)
Share of loss of associates	**(4,275)**	(24,606)
Other income and other gains, net	**159,715**	23,542
Finance income	**6,641**	25,486
Finance expenses	**(174,040)**	(262,715)
Unallocated head office and corporate expenses	**(245,251)**	(116,523)
Profit/(loss) before income tax	**119,696**	(1,056,538)

The following table sets out revenue from external customers by geographical location, based on the destination of the customer:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
PRC (country of domicile)	**1,101,255**	966,557
Americas	**304,220**	327,268
Middle East	**1,358,710**	363,834
Europe and Central Asia	**1,121,046**	521,340
South Asia and South East	**283,848**	116,544
Africa	**41,082**	30,117
	4,210,161	2,325,660

5 SEGMENT INFORMATION (continued)

The following table sets out non-current assets, other than financial instruments and deferred income tax assets, by geographical location:

	As at 31 December	
	2018 RMB'000	2017 RMB'000
PRC (country of domicile)	**1,501,686**	2,935,946
Americas	**174,377**	43,165
Middle East	**171,398**	192,811
Europe and Central Asia	**62,398**	94,698
Africa	**35,135**	38,720
	1,944,994	3,305,340

For the year ended 31 December 2018, revenues of approximately RMB940,703,000, RMB863,879,000 and RMB517,241,000 were derived from three external customers respectively. These revenues were attributed to the sales of land drilling rigs in Middle East, the sales of land drilling rigs in Europe and Central Asia and the sales of parts and components in PRC (country of domicile), respectively.

For the year ended 31 December 2017, revenues of approximately RMB255,744,000 was derived from one external customers. These revenues were attributed to the sales of parts and components in the PRC.

ASSETS AND LIABILITIES RELATED TO REVENUE

The Group has recognised the following assets and liabilities related to revenue:

	As at 31 December	
	2018 RMB'000	2017 RMB'000
Current contract assets (i)	**42,887**	–
Less: loss allowance	**(129)**	–
Total contract assets	**42,758**	–
Current contract liabilities (ii)	**241,082**	–

(i) Contract assets recognised in relation to oil and gas engineering service were previously presented as part of trade receivables (RMB67,840,000 as at 1 January 2018).

(ii) Contract liabilities in relation to sale of goods were previously included in trade and other payables (RMB218,821,000 as at 1 January 2018).

6 OTHER INCOME

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Government grants	**23,799**	42,641
Repair services income	**16,540**	23,067
Rental income (Note 16)	**43,291**	20,448
Sales of scrap materials	**6,173**	3,035
Others	**875**	3,461
	90,678	92,652

7 OTHER GAINS/(LOSSES), NET

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Insurance compensation	**41,930**	43,754
Recognition of deferred income	**20,858**	17,998
Gains/(loss) on disposals of property, plant and equipment	**1,505**	(5,842)
Legal claims with former shareholders	**(10,063)**	–
Other penalty losses	**(7,083)**	(19,532)
Net losses on disposals and dissolution of subsidiaries and a joint venture (i)	**(7,355)**	–
Legal claims of sales agency (Note 27)	**–**	(48,725)
Other legal claims	**–**	(29,824)
Donations	**–**	(228)
Others	**3,213**	(920)
	43,005	(43,319)

(i) In 2018, the Group disposed and dissolved several subsidiaries (Note 11) and a joint venture (Note 12). The amount does not include the gain on sale of offshore drilling rigs segment (Note 33).

8 EXPENSES BY NATURE

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Raw materials and consumables used	**2,308,923**	967,080
Employee benefit expenses	**433,648**	463,766
Service fee	**221,281**	58,595
Amortisation and depreciation		
— Property, plant and equipment	**149,661**	136,038
— Intangible assets	**31,882**	43,182
— Lease prepayment	**4,604**	4,658
Transportation	**157,664**	51,844
Changes in inventories of finished goods and work in progress	**95,229**	99,061
Provision for inventory write-down	**87,693**	35,332
Research and development costs (i)	**133,031**	42,200
Less: amount capitalised into intangible assets	**(51,388)**	(26,382)
Utilities	**77,095**	49,004
Operating lease charges	**69,396**	43,343
Travelling expenses	**48,654**	31,687
Provision of prepayments	**27,169**	1,122
Repairs and maintenance expenditure on property, plant and equipment	**17,456**	8,556
Business and other taxes	**17,124**	19,275
Provision for warranty	**10,263**	10,853
Commission	**5,542**	46,406
Auditors' remuneration		
— Audit services	**5,110**	4,910
— Other services	**80**	900
Impairment provision of property, plant and equipment	**891**	–
Other expenses	**54,577**	104,039
Total cost of sales, distribution costs and administrative expenses	**3,905,585**	2,195,469

(i) The amount does not include staff costs of the research and development department of approximately RMB32,984,000 (2017: RMB30,337,000) and relevant amortisation and depreciation of approximately RMB33,736,000 (2017: RMB26,255,000), which are included in the total staff costs as disclosed in Note 9 and total amortisation and depreciation in Note 16 and Note 17 respectively.

9 EMPLOYEE BENEFIT EXPENSES

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Contributions to defined contribution retirement schemes	**35,281**	34,031
Equity-settled share-based payment expenses (Note 22)	**1,726**	3,293
Salaries, wages and other benefits	**396,641**	426,442
	433,648	463,766

(A) FIVE HIGHEST PAID INDIVIDUALS

The five individuals whose emoluments were highest in the Group for the year ended 31 December 2018 included two (2017: one) directors. Their emoluments are reflected in the analysis disclosed as Note 36. The emoluments payable to the remaining three (2017: four) individuals for the years ended 31 December 2018 and 2017 are as follows:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Basic salaries, allowances and other benefits in kind	**1,410**	2,981
Discretionary bonuses	**2,104**	1,655
Contributions to defined contribution retirement schemes	**125**	225
Share-based payments	**–**	138
	3,639	4,999

The emoluments of the above individual fell within the following bands:

	Number of individuals Year ended 31 December	
	2018	2017
HKD1,000,001 to HKD1,500,000	**3**	4

10 FINANCE EXPENSES — NET

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Finance expenses		
Interest on borrowings wholly repayable within five years	**161,785**	230,133
Net foreign exchange loss	**7,394**	10,841
Others	**541**	895
Less: interest expense capitalised into assets under construction (Note 16)	**(715)**	(2,296)
	169,005	239,573
Finance income		
Interest income on bank deposits	**(5,100)**	(20,682)
Interest income from long-term receivables	**(500)**	(3,119)
Gain on settlement of available-for-sale financial assets	**–**	(1,569)
	(5,600)	(25,370)
	163,405	214,203

11 SUBSIDIARIES

The following is a list of the principal subsidiaries as at 31 December 2018:

Name of company	Place of incorporation	Particulars of issued and paid-up capital	Attributable equity interest		Principal activities
			Direct	Indirect	
Honghua Holdings Limited ("Honghua Holdings")	Hong Kong	1 ordinary share	100%	–	Investment holding
Sichuan Honghua Petroleum Equipment Co., Ltd. ("Honghua Company") ((i) and (iii))	The PRC	Registered capital RMB1,600,000,000	–	100%	Manufacturing of petroleum equipment
Sichuan Honghua Electric Co., Ltd. ("Honghua Electric") ((i) and (iii))	The PRC	Registered capital RMB100,000,000	–	84%	Manufacturing of panel of drilling rigs
Honghua International Co., Ltd. ("Honghua International") ((i) and (iii))	The PRC	Registered capital RMB51,200,000	–	90%	Trading of drilling rigs and related parts
Honghua (China) Investment Co., Ltd. ("Honghua China") ((i), (ii) and (iii))	The PRC	Registered capital USD320,000,000	–	100%	Investment holding
Newco (H.K.) Limited	Hong Kong	1,000 ordinary shares	–	100%	Trading of drilling rigs and related parts
Honghua America, LLC	United States of America	Registered capital USD3,414,407	–	100%	Trading of drilling rigs and related parts
Gansu Hongteng Oil & Gas Equipment Co., Ltd. ("Gansu Hongteng") ((i) and (iii))	The PRC	Registered capital RMB120,000,000	–	70%	Manufacturing of related parts of drilling rigs
Russia Touhey Motor Drilling Service Limited ("TNG")	Russia Federation	Registered capital RUB489,297,344	–	51%	Oil and gas drilling service

11 SUBSIDIARIES (continued)

(i) These entities are domestic limited liability companies established in the PRC.

(ii) The entity is a wholly-owned foreign invested enterprise established in the PRC.

(iii) The official names of these companies are in Chinese. The English translation of the company name is for reference only.

(iv) In June 2018, the Group sold 100% equity interest in Russia Honghua Co., Ltd, which was a wholly owned subsidiary of the Group, at the consideration of Ruble 10,000. This disposal of the equity interest did not have any gain or loss.

(v) The Group dissolved several insignificant subsidiaries and incurred a total loss of RMB7,165,000 in 2018 (Note 7).

MATERIAL NON-CONTROLLING INTERESTS

The total non-controlling interests as at 31 December 2018 was approximately RMB190,168,000 (2017: RMB166,935,000), of which approximately RMB135,571,000 (2017: RMB115,780,000) is attributed to Honghua Electric, approximately RMB30,445,000 (2017: RMB29,285,000) is attributed to Honghua International, approximately RMB9,927,000 (2017: RMB9,927,000) is attributed to Gansu Hongteng, and approximately RMB(2,166,000) (2017: RMB11,943,000) is attributed to TNG. The non-controlling interests in respect of other subsidiaries are not material. The amounts disclosed for each subsidiary are before inter-company eliminations.

SUMMARISED FINANCIAL INFORMATION ON SUBSIDIARIES WITH MATERIAL NON-CONTROLLING INTERESTS

Set out below are the summarised financial information for each subsidiary that has non-controlling interests that are material to the Group.

11 SUBSIDIARIES (continued)

SUMMARISED FINANCIAL INFORMATION ON SUBSIDIARIES WITH MATERIAL NON-CONTROLLING INTERESTS (continued)

Summarised balance sheet

	Honghua Electric As at 31 December		Honghua International As at 31 December		Gansu Hongteng As at 31 December		TNG As at 31 December	
	2018 RMB'000	2017 RMB'000	**2018 RMB'000**	2017 RMB'000	**2018 RMB'000**	2017 RMB'000	**2018 RMB'000**	2017 RMB'000
Current								
Assets	**1,616,764**	1,307,694	**1,526,373**	1,535,913	**111,221**	104,683	**81,121**	138,689
Liabilities	**(904,212)**	(711,799)	**(1,190,212)**	(1,205,182)	**(144,577)**	(144,559)	**(147,320)**	(100,264)
Total current net assets/(liabilities)	**712,552**	595,895	**336,161**	330,731	**(33,356)**	(39,876)	**(66,199)**	38,425
Non-current								
Assets	**268,071**	266,692	**19,795**	13,057	**68,794**	75,313	**61,992**	78,434
Liabilities	**(18,416)**	(22,098)	**–**	–	**–**	–	**(213)**	(88,248)
Total non-current net assets/(liabilities)	**249,655**	244,594	**19,795**	13,057	**68,794**	75,313	**61,779**	(9,814)
Net assets	**962,207**	840,489	**355,956**	343,788	**35,438**	35,437	**(4,420)**	28,611

11 SUBSIDIARIES (continued)

SUMMARISED FINANCIAL INFORMATION ON SUBSIDIARIES WITH MATERIAL NON-CONTROLLING INTERESTS (continued)

Summarised statement of profit or loss and other comprehensive income

	Honghua Electric Year ended 31 December		Honghua International Year ended 31 December		Gansu Hongteng Year ended 31 December		TNG Year ended 31 December	
	2018 RMB'000	2017 RMB'000	**2018 RMB'000**	2017 RMB'000	**2018 RMB'000**	2017 RMB'000	**2018 RMB'000**	2017 RMB'000
Revenue	**955,649**	453,234	**878,348**	424,552	**64,434**	36,851	**–**	10,831
Profit/(loss) before income tax	**142,999**	134,129	**16,325**	49,332	**36**	1,083	**(31,335)**	(13,015)
Income tax expense	**(21,281)**	(18,019)	**(4,157)**	(15,577)	**(35)**	(220)	**(18)**	150
Profit/(loss) for the year	**121,718**	116,110	**12,168**	33,755	**1**	863	**(31,353)**	(12,865)
Other comprehensive income for the year	**–**	–	**–**	–	**–**	–	**(1,678)**	–
Total comprehensive income	**121,718**	116,110	**12,168**	33,755	**1**	863	**(33,031)**	(12,865)
Total comprehensive income allocated to non-controlling interests	**19,791**	18,879	**1,160**	3,217	**–**	259	**(16,185)**	(6,304)

11 SUBSIDIARIES (continued)

SUMMARISED FINANCIAL INFORMATION ON SUBSIDIARIES WITH MATERIAL NON-CONTROLLING INTERESTS (continued)

Summarised cash flows

	Honghua Electric Year ended 31 December		Honghua International Year ended 31 December		Gansu Hongteng Year ended 31 December		TNG Year ended 31 December	
	2018 RMB'000	2017 RMB'000	**2018 RMB'000**	2017 RMB'000	**2018 RMB'000**	2017 RMB'000	**2018 RMB'000**	2017 RMB'000
Cash flows from operating activities								
Cash (used in)/generated from operations	**(83,916)**	(93,003)	**133,854**	344,812	**4,781**	(112,309)	**9,745**	2,865
Interest paid	**–**	(4,543)	**–**	(16,520)	**(3,384)**	(2,711)	**–**	–
Income tax paid	**(16,843)**	(10)	**(13,512)**	(1,288)	**(8)**	(9)	**(1,869)**	(5,057)
Net cash (used in)/generated from operating activities	**(100,759)**	(97,556)	**120,342**	327,004	**1,389**	(115,029)	**7,876**	(2,192)
Net cash generated from/(used in) from investing activities	**311,218**	152,924	**(107,452)**	20,249	**(339)**	115,529	**(8,217)**	2,478
Net cash (used in)/generated from financing activities	**(218,415)**	(50,000)	**(130,000)**	(348,880)	**–**	–	**–**	–
Net (decrease)/increase in cash and cash equivalents	**(7,956)**	5,368	**(117,110)**	(1,627)	**1,050**	500	**(341)**	286
Cash and cash equivalents at beginning of year	**38,047**	32,679	**214,415**	216,042	**1,896**	1,396	**341**	55
Cash and cash equivalents at end of year	**30,091**	38,047	**97,305**	214,415	**2,946**	1,896	**–**	341

The information above is the amount before inter-company eliminations.

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

The amounts recognised in the consolidated balance sheet are as follows:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Investment in associates and joint ventures	**35,135**	77,558

The amounts recognised in profit or loss are as follows:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Investment in associates and joint ventures	**(32,444)**	(28,968)

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
At 1 January	**77,558**	106,525
Share of loss	**(32,444)**	(28,968)
Decreases in ownership interest	**(9,151)**	–
Currency translation differences	**(828)**	1
At 31 December	**35,135**	77,558

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

INVESTMENT IN ASSOCIATES

Set out below are the associates of the Group as at 31 December 2018, which are held directly by the Group.

Nature of investment in associates as at 31 December 2018 and 2017.

Name of company	Place of establishment	% of ownership interest	Nature of the relationship	Measurement method
Honghua Offshore Oil and Gas Equipment (Jiangsu) Co., Ltd. ("Honghua (Jiangsu)")	The PRC	49%	(i)	Equity
Shanghai Honghua Offshore Oil & Gas Equipment Co., Ltd. ("Honghua (Shanghai)")	The PRC	49%	(i)	Equity
Prime FSP, LLC ("Prime FSP", formerly known as Tank Tek, LLC)	United States of America	2018:0%; 2017:30%	(i)	Equity
Hongdaojianyuan Marine Science and Technology Co., (Sansha) Ltd. ("Sansha Hongdao")	The PRC	2018:0%; 2017:30%	(ii)	Equity

(i) In 2018, the Group disposed 51% equity interests in Honghua (Jiangsu) and Honghua (Shanghai), respectively and these two companies have become associates of the Group. The Group also disposed 30% equity interests in Prime FSP at the same time. The key transaction terms have been disclosed in Note 33.

(ii) Sansha Hongdao was incorporated in 2013 and mainly engages in the designing and manufacturing of offshore equipment. Sansha Hongdao was dissolved in 2018.

The associates are unlisted companies and there is no quoted market price available for its equity.

There are no contingent liabilities relating to the Group's interest in the associates.

Honghua (Jiangsu) and Honghua (Shanghai) are associates of the Group as at 31 December 2018, which, in the opinion of the directors, are material to the Group. The summarised financial information for these two associates has been included in Note 33.

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

INVESTMENT IN JOINT VENTURES

Set out below are the joint ventures of the Group as at 31 December 2018, which are held directly by the Group.

Nature of investment in joint ventures as at 31 December 2018 and 2017

Name of company	Place of establishment	% of ownership interest	Nature of the relationship	Measurement method
Egyptian Petroleum HH Rigs Manufacturing Co. S.A.E. ("HH Egyptian Company")	Egypt	50%	(i)	Equity
Honghua Oil Equipment Trading Co., Ltd ("Honghua Oil Equipment")	Hong Kong	2018: 0% 2017: 50%	(ii)	Equity
Honghua Financial Leasing (Shenzhen) Co., Ltd. ("Honghua (Shenzhen)")	The PRC	51%	(iii)	Equity

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

INVESTMENT IN JOINT VENTURES (continued)

(i) HH Egyptian Company mainly engages in the manufacturing and sale of drilling rigs, parts and components.

(ii) Honghua Oil Equipment mainly engages in the trading of drilling rigs, parts and components. Honghua Oil Equipment was dissolved and incurred a loss of RMB190,000 (Note 7) in 2018.

(iii) Honghua (Shenzhen) was incorporated in 2014 and mainly engages in providing leasing services. The Group's voting rights in the board of directors of Honghua (Shenzhen) has increased from 40% to 50%, and Honghua (Shenzhen) is accounted as a joint venture.

The joint ventures are unlisted companies and there is no quoted market price available for its equity.

There are no contingent liabilities relating to the Group's interest in the joint ventures.

Honghua (Shenzhen) and HH Egyptian Company are joint ventures of the Group as at 31 December 2018, which, in the opinion of the directors, is material to the Group.

Set out below are the summarised financial information for Honghua (Shenzhen) and HH Egyptian Company which are accounted for using the equity method. The information disclosed reflects the amounts presented in the financial statements of the joint ventures and not the Group's share of those amounts. They have been amended to reflect adjustments made by the entity when using the equity method, including fair value adjustments and modifications for differences in accounting policy.

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

INVESTMENT IN JOINT VENTURES (continued)

Honghua (Shenzhen)

Summarised balance sheet

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Current assets		
Cash and cash equivalents	**1,594**	11,609
Other current assets	**102,467**	127,195
Total current assets	**104,061**	138,804
Non-current assets	**1,001,718**	205,599
Current liabilities		
Financial liabilities (excluding trade payables)	**–**	–
Other current liabilities	**(199,999)**	(76,827)
Total current liabilities	**(199,999)**	(76,827)
Non-current liabilities		
Financial liabilities (excluding trade payables)	**–**	–
Other current liabilities	**(857,508)**	(212,462)
Total non-current liabilities	**(857,508)**	(212,462)
Net assets	**48,272**	55,114

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

INVESTMENT IN JOINT VENTURES (continued)

Honghua (Shenzhen) (continued)

Summarised statement of comprehensive income

	Year ended 31 December	
	2018 RMB'000	2017 RMB'000
Revenue	**83,654**	5,645
Interest income	**43**	24
Depreciation and amortisation	**(52,422)**	(5,972)
Interest expense	**(526)**	(1,343)
Income tax expense	**2,852**	(1,297)
Loss from continuing operations	**(6,841)**	(47,791)
Loss from discontinued operations	**–**	–
Loss for the period	**(6,841)**	(47,791)
Other comprehensive income	**–**	–
Total comprehensive income	**(6,841)**	(47,791)

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

INVESTMENT IN JOINT VENTURES (continued)

Honghua (Shenzhen) (continued)

Reconciliation of summarised financial information

Reconciliation of the summarised financial information presented to the carrying amount of its interest in the joint venture.

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Opening net assets 1 January	**55,114**	102,905
Loss for the year	**(6,841)**	(47,791)
Closing net assets	**48,273**	55,114
Interest in joint venture (51.11%)	**24,672**	28,169
Adjustment (i)	**(24,672)**	–
Carrying value	**–**	28,169

(i) The adjustment is made because of the internal transaction elimination between the Group and Honghua (Shenzhen). The elimination amount is higher than the net assets calculated by the percentage held by the Group, thus the carrying amount of investment in Honghua (Shenzhen) is deducted to 0.

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

INVESTMENT IN JOINT VENTURES (continued)

HH Egyptian Company

Summarised balance sheet

	As at 31 December	
	2018	2017
	RMB '000	RMB '000
Current assets		
Cash and cash equivalent	**2,139**	2,036
Other current assets	**43,063**	40,999
Total current assets	**45,202**	43,035
Non-current assets	**88,908**	93,975
Current liabilities		
Financial liabilities (excluding trade payables)	**–**	–
Other current liabilities	**(63,841)**	(60,781)
Total current liabilities	**(63,841)**	(60,781)
Non-current liabilities		
Financial liabilities (excluding trade payables)	**–**	–
Other non-current liabilities	**–**	–
Total non-current liabilities	**–**	–
Net assets	**70,269**	76,229

12 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD (continued)

INVESTMENT IN JOINT VENTURES (continued)

HH Egyptian Company (continued)

Summarised statement of comprehensive income

	Year ended 31 December	
	2018 RMB '000	2017 RMB '000
Revenue	**6,276**	6,402
Interest income	**–**	–
Depreciation and amortisation	**–**	–
Interest expense	**(19)**	(20)
Income tax expense	**–**	–
Loss from continuing operations	**(8,550)**	(8,723)
Loss for the period	**(8,550)**	(8,723)
Other comprehensive income	**2,590**	–
Total comprehensive income	**(5,960)**	(8,723)

The information above reflects the amounts presented in the financial statements of the joint venture, adjusted for differences in accounting policies between the Group and the joint venture, and not the Group's share of those amounts.

Reconciliation of summarised financial information

Reconciliation of the summarised financial information presented to the carrying amount of its interest in the joint venture.

	Year ended 31 December	
	2018 RMB '000	2017 RMB '000
Opening net assets 1 January	**76,229**	78,717
Post-tax loss for the year	**(8,550)**	(8,723)
Currency translation differences	**2,590**	6,235
Closing net assets	**70,269**	76,229
Interest in joint venture (50%)	**35,135**	38,115
Carrying value	**35,135**	38,115

13 INCOME TAX EXPENSE

Taxation in the consolidated statement of profit or loss represents:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Current income tax — Hong Kong Profits Tax (i)		
Provision for the year	**2,922**	2,081
Under provision in respect of prior years	**(304)**	2,191
	2,618	4,272
Current income tax — PRC (ii)		
Provision for the year	**48,627**	10,131
Under provision in respect of prior years	**3,944**	571
	52,571	10,702
Current income tax — Other jurisdictions (iii)		
Provision for the year	**7,987**	6,700
Under provision in respect of prior years	**(16)**	–
	7,971	6,700
Total current income tax	**63,160**	21,674
Deferred income tax (Note 26)	**(29,263)**	26,977
Income tax expense	**33,897**	48,651

13 INCOME TAX EXPENSE (continued)

(i) Hong Kong

The provision for Hong Kong Profits Tax is calculated at 16.5% of the estimated assessable profits of the subsidiaries of the Group incorporated in Hong Kong for the years ended 31 December 2018 and 2017.

(ii) PRC

Pursuant to the income tax rules and regulations of the PRC, the subsidiaries of the Group in the PRC are subject to PRC enterprise income tax at a rate of 25% for the years ended 31 December 2018 and 2017, except for the following companies:

(a) Honghua Company

Corporate income tax ("CIT") of Honghua Company is accrued at a tax rate of 15% applicable for Hi-tech enterprises pursuant to the relevant PRC tax rules and regulations for the years ended 31 December 2018 and 2017.

(b) Honghua Electric

On 6 April 2012, State Taxation Administration issued Notice 12(2012) ("the Notice") in respect of favourable CIT policy applicable to qualified enterprises located in western China. Honghua Electric applied and obtained an approval from in-charge tax authority under the policy for the 15% preferential CIT rate and is qualified for the 15% preferential CIT rate from 2012 to 2020.

(iii) Others

Taxation for other entities is charged at their respective applicable tax rates ruling in the relevant jurisdictions.

(iv) Withholding tax

Under the PRC tax law and its implementation rules, dividends receivable by non-PRC resident enterprises from PRC enterprises are subject to withholding tax at a rate of 10%, unless reduced by tax treaties or arrangements, for profits earned since 1 January 2008. Pursuant to a tax arrangement between the PRC and Hong Kong, a qualified Hong Kong tax resident will be liable for withholding tax at a reduced rate of 5% for dividend income derived from the PRC.

The Company's directors revisited the dividend policy of the Group in 2018 and 2017. In order to retain the fundings for operations and future development, it was resolved that the Group's PRC subsidiaries will not distribute dividend to the offshore holding companies in the foreseeable future. Any dividends to be declared by the Company will be distributed from the share premium account.

13 INCOME TAX EXPENSE (continued)

(v) The tax on the Group's profit/(loss) before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to the consolidated entities as follows:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Profit/(loss) before income tax	**143,582**	(346,545)
Tax calculated at statutory tax rates applicable to each group entities	**11,562**	(15,425)
Tax effect of non-deductible expenses	**9,406**	9,713
Tax effect of non-taxable income	**(3,413)**	(4,454)
Tax losses for which no deferred income tax asset was recognised	**–**	14,669
Deductible temporary differences for which no deferred income tax asset was recognised	**1,262**	20,562
Recognise deductible temporary differences for which no deferred income tax asset was recognised in prior years	**(54,754)**	–
Reversal of previously recognised deductible temporary differences	**–**	20,726
Write off of previously recognised tax losses	**66,699**	292
Under provision in respect of prior years	**3,624**	2,762
Use of tax losses which unrecognised in prior years	**(489)**	(194)
Income tax expense	**33,897**	48,651

(vi) Amounts recognised directly in other comprehensive income

Aggregate current and deferred tax arising in the reporting period and not recognised in net profit or loss but charged to other comprehensive income:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Deferred tax: Changes in fair value of available-for-sale financial assets	**–**	475
Deferred tax: Changes in the fair value of equity investments at fair value other comprehensive income	**(179)**	–
	(179)	475

14 EARNINGS/(LOSS) PER SHARE

(a) BASIC EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings/(loss) per share is based on the profit/(loss) attributable to owners of the Company by the weighted average number of ordinary shares in issue during the year.

	Year ended 31 December	
	2018	2017
Profit/(loss) attributable to owners of the Company (RMB'000)	**82,287**	(1,239,368)
From continuing operations	**92,377**	(401,584)
From discontinued operations	**(10,090)**	(837,784)
Weighted average number of ordinary shares in issue (thousands)	**5,355,521**	4,739,009
Effect of the share award scheme (thousands)	**(62,089)**	(62,089)
Effect of share options exercised (thousands)	**213**	94
Adjusted weighted average number of ordinary shares in issue (thousands)	**5,293,645**	4,677,014
Basic earnings/(loss) per share (RMB cents per share)	**1.55**	(26.50)
From continuing operations (RMB cents per share)	**1.74**	(8.59)
From discontinued operations (RMB cents per share)	**(0.19)**	(17.91)

14 EARNINGS/(LOSS) PER SHARE (continued)

(b) DILUTED EARNINGS/(LOSS) PER SHARE

The calculation of diluted earnings/(loss) per share is based on adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Company has one category of dilutive potential ordinary shares: share options. For the share options, a calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	Year ended 31 December	
	2018	2017
Profit/(loss) attributable to owners of the Company (RMB'000)	**82,287**	(1,239,368)
From continuing operations	**92,377**	(401,584)
From discontinued operations	**(10,090)**	(837,784)
Weighted average number of ordinary shares in issue (thousands)	**5,293,645**	4,677,014
Effect of deemed issue of shares under the share option scheme (thousands)	**–**	–
Adjusted weighted average number of ordinary shares (diluted) in issue (thousands)	**5,293,645**	4,677,014
Diluted earnings/(loss) per share (RMB cents per share)	**1.55**	(26.50)
From continuing operations (RMB cents per share)	**1.74**	(8.59)
From discontinued operations (RMB cents per share)	**(0.19)**	(17.91)

15 LEASE PREPAYMENTS

The Group's interests in land use rights represent prepaid operating lease payments for land located in the PRC, the net book values of which are analysed as follows:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
At 1 January	**218,742**	379,582
Additions	**110**	45
Transfers	**(2,123)**	
Disposal of subsidiaries	**(19,883)**	–
Transferred to disposal group classified as held for sale (Note 33)	**–**	(152,842)
Amortisation	**(4,604)**	(8,043)
At 31 December	**192,242**	218,742

(a) All the amortisation of the Group's land use rights was charged to administrative expenses. The amount related to disposal group classified as held for sale were transferred to "Loss for the year from discontinued operations".

(b) Bank borrowings are secured on land use rights for the carrying amount of approximately RMB25,371,000 (2017: RMB26,043,000) (Note 25).

16 PROPERTY, PLANT AND EQUIPMENT

	Freehold land RMB'000	Buildings held for own use RMB'000	Plant and machinery RMB'000	Furniture, fittings and equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
At 1 January 2017							
Cost	5,897	1,684,683	1,590,212	408,754	82,031	347,691	4,119,268
Accumulated depreciation and impairment	–	(298,933)	(685,042)	(281,103)	(60,136)	–	(1,325,214)
Net book amount	5,897	1,385,750	905,170	127,651	21,895	347,691	2,794,054
Year ended 31 December 2017							
Opening net book amount	5,897	1,385,750	905,170	127,651	21,895	347,691	2,794,054
Additions	–	6,554	55,838	35,295	618	32,375	130,680
Transfer from construction in progress	–	80,156	2,293	4,204	–	(86,653)	–
Transfer from inventories	–	–	41,048	–	–	–	41,048
Transfer to inventories	–	–	(103,716)	–	–	–	(103,716)
Disposals (Note 30)	–	(4,196)	(1,536)	(6,146)	(225)	–	(12,103)
Transferred to disposal group classified as held for sale (Note 33)	–	(656,639)	(76,857)	(643)	(399)	(73,603)	(808,141)
Depreciation charge	–	(79,208)	(90,522)	(37,115)	(3,933)	–	(210,778)
Currency translation difference	(342)	(3,126)	(9,056)	(2,085)	(110)	–	(14,719)
Impairment provision of fixed assets	–	(243,517)	(26,550)	(3,792)	(173)	(26,068)	(300,100)
Closing net amount	5,555	485,774	696,112	117,369	17,673	193,742	1,516,225
At 31 December 2017							
Cost	5,555	1,764,071	1,575,083	440,022	82,314	293,413	4,160,458
Transferred to disposal group classified as held for sale	–	(656,639)	(76,857)	(643)	(399)	(73,603)	(808,141)
Accumulated depreciation and impairment	–	(621,658)	(802,114)	(322,010)	(64,242)	(26,068)	(1,836,092)
Net book amount	5,555	485,774	696,112	117,369	17,673	193,742	1,516,225
Year ended 31 December 2018							
Opening net book amount	5,555	485,774	696,112	117,369	17,673	193,742	1,516,225
Additions	–	2,029	180,556	70,019	32,689	9,744	295,037
Transfer from construction in progress	–	4,632	2,846	2,891	–	(10,369)	–
Transfer from inventories	–	–	24,596	–	–	–	24,596
Transfer to investment properties	–	(3,465)	–	–	–	–	(3,465)
Disposals (Note 30)	–	(684)	(33,149)	(2,497)	(32)	–	(36,362)
Disposal of subsidiaries	–	(12,899)	(10,966)	(1,386)	(608)	(101,804)	(127,663)
Depreciation charge	–	(32,961)	(76,042)	(38,840)	(2,228)	–	(150,071)
Currency translation difference	280	1,068	(641)	254	(101)	–	860
Impairment provision of fixed assets	–	–	–	–	–	(891)	(891)
Closing net amount	5,835	443,494	783,312	147,810	47,393	90,422	1,518,266
At 31 December 2018							
Cost	5,835	695,026	1,550,078	490,067	107,022	193,117	3,041,145
Disposal of subsidiaries	–	(12,899)	(10,966)	(1,386)	(608)	(101,804)	(127,663)
Accumulated depreciation and impairment	–	(238,633)	(755,800)	(340,871)	(59,021)	(891)	(1,395,216)
Net book amount	5,835	443,494	783,312	147,810	47,393	90,422	1,518,266

16 PROPERTY, PLANT AND EQUIPMENT (continued)

(a) Depreciation expense of approximately RMB109,994,000 (2017: RMB170,228,000) has been charged in cost of sales, RMB6,697,000 (2017: RMB4,133,000) in distribution expenses, RMB32,970,000 (2017: RMB36,417,000) in administrative expenses and RMB410,000 (2017: RMB0) in development cost. The amount related to disposal group classified as held for sale was transferred to "Loss for the year from discontinued operations".

(b) As at 31 December 2018, the Group was in the process of obtaining the legal title of buildings with carrying amount of approximately RMB205,601,000 (2017: RMB165,264,000).

(c) Bank borrowings were secured by certain buildings and machinery of the Group with a net book value of approximately RMB29,747,000 as at 31 December 2018 (2017: RMB12,630,000) (Note 25).

(d) The Group has capitalised borrowing costs amounting to approximately RMB715,000 (2017: RMB2,296,000) on qualifying assets. Borrowing costs were capitalised at the weighted average rate of its general borrowings at 4.15% (2017: 4.27%).

(e) Net rental income amounting to approximately RMB46,848,000 (2017: RMB21,611,000) relating to the lease of plant and machinery are included in profit or loss (Note 6). The amount related to disposal group classified as held for sale was transferred to "Loss for the year from discontinued operations".

(f) The impairment charge of approximately RMB300,100,000 for the year ended 31 December 2017 relates to the impairment of the offshore drilling rigs cash generating unit, which operates in the offshore drilling rigs segment. This impairment was recognised in profit or loss within "Loss for the year from discontinued operations".

The recoverable amount is determined based on value-in-use calculations for the year ended 31 December 2017. These calculations use cash flow projections based on financial budgets approved by management covering a seventeen-year period, cash flows beyond the five-year period are calculated based on a forecasted growth rate according to historical industry cycle. The discount rate applied to the cash flow projections primarily ranging from 11.0% to 11.9%, which represents the weighted-average cost of capital for the industry. The impairment charge has been recognised against property, plant and equipment of RMB300,100,000.

16 PROPERTY, PLANT AND EQUIPMENT (continued)

(g) For the years ended 31 December 2018 and 2017, inventories were transferred to property, plant and equipment for the research purposes of landing drilling products, and property, plant and equipment was transferred out to inventories for rebuild and future sale.

(h) The category of plant and machinery leased by the Group to third parties under operating leases with the following carrying amounts:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Cost	**87,129**	53,236
Accumulated depreciation at 1 January	**(31,766)**	(25,985)
Additions	**193,517**	48,814
Deduction	**–**	(14,921)
Depreciation charge for the year	**(21,562)**	(5,781)
Net book amount	**227,318**	55,363

17 INTANGIBLE ASSETS

	Goodwill RMB'000	Technical know-how RMB'000	Development Cost and others RMB'000	Total RMB'000
At 1 January 2017				
Cost	13,484	362,634	190,676	566,794
Accumulated amortisation and impairment	–	(289,122)	(21,069)	(310,191)
Disposal of subsidiaries	(13,484)	(11,219)	(987)	(25,690)
Net book amount	–	62,293	168,620	230,913
Year ended 31 December 2017				
Opening net book amount	–	62,293	168,620	230,913
Additions	–	–	64,389	64,389
Amortisation charge	–	(36,198)	(7,049)	(43,247)
Transferred to disposal group classified as held for sale (Note 33)	–	–	(90,807)	(90,807)
Impairment provision of development cost (i)	–	–	(9,062)	(9,062)
Currency translation difference	–	(2,811)	(2,469)	(5,280)
Closing net amount	–	23,284	123,622	146,906
At 31 December 2017				
Cost	–	348,604	251,609	600,213
Transferred to disposal group classified as held for sale	–	–	(90,807)	(90,807)
Accumulated amortisation and impairment	–	(325,320)	(37,180)	(362,500)
Net book amount	–	23,284	123,622	146,906

17 INTANGIBLE ASSETS (continued)

	Goodwill RMB'000	Technical know-how RMB'000	Development Cost and others RMB'000	Total RMB'000
Year ended 31 December 2018				
Opening net book amount	–	23,284	123,622	146,906
Additions	–	–	52,010	52,010
Amortisation charge	–	(23,519)	(8,363)	(31,882)
Disposal of subsidiaries	–	–	(6,210)	(6,210)
Currency translation difference	–	235	127	362
Closing net amount	–	–	161,186	161,186
At 31 December 2018				
Cost	–	348,839	203,876	552,715
Disposal of subsidiaries	–	–	(6,210)	(6,210)
Accumulated amortisation and impairment	–	(348,839)	(36,480)	(385,319)
Net book amount	–	–	161,186	161,186

(i) The carrying amount of the intangible assets has been reduced to its recoverable amount through recognition of an impairment loss against development cost included in the offshore drilling rigs segment. This loss was recognised in profit or loss within "Loss for the year from discontinued operations".

All the amortisation of the Group's intangible assets was charged to administrative expenses. The amount related to disposal group classified as held for sale was transferred to "Loss for the year from discontinued operations".

18 TRADE AND OTHER RECEIVABLES

	As at 31 December	
	2018 RMB'000	2017 RMB'000
Trade receivables (a)	2,627,384	2,145,069
Bills receivable	33,637	32,187
Less: provision for impairment of trade receivables	(169,007)	(265,086)
	2,492,014	1,912,170
Amount due from related parties (Note 32(b))		
— Trade	349,870	74,072
— Non-trade	122,858	37,248
Finance lease receivable	254,832	157,113
Less: provision for impairment of finance lease receivable	(65,816)	(48,291)
Value-added tax recoverable	123,623	222,503
Prepayments	374,168	203,899
Less: provision for prepayments	(28,291)	(1,122)
Other receivables (b)	341,317	101,134
Less: provision for impairment of other receivables	(117,302)	(92,552)
	3,847,273	2,566,174
Representing:		
Current portion (c)	2,939,969	2,559,988
Non-current portion (d)	907,304	6,186
Total	3,847,273	2,566,174

18 TRADE AND OTHER RECEIVABLES (continued)

(a) As at 31 December 2018 and 2017, the ageing analysis of the net amount of trade receivables and bills receivable (including amounts due from related parties of trading in nature), based on the invoice date is as follows:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Within 3 months	**2,028,514**	937,417
3 to 12 months	**102,487**	352,453
Over 1 year	**710,883**	696,372
	2,841,884	1,986,242

The Group maintains different billing policies for different customers based on the negotiated terms with each of the customers. The Group issues progress billing at different stages such as upon the signing of contracts and upon the delivery of products. The exact percentage of each part of payment varies from contract to contract. Trade receivables are generally due for payment within 90 days from the date of billing.

(b) Included in other receivables of the Group as at 31 December 2018 is an amount of approximately RMB42,380,000 (2017: RMB32,317,000) to be indemnified by some beneficiary owners of the Company in relation to a legal claim (Note 27).

(c) Except for the non-current trade and other receivables, all of the other trade and other receivables are expected to be recovered within one year.

(d) Non-current trade and other receivables as at 31 December 2018 included (1) finance lease receivables of approximately RMB76,759,000 (2017: RMB6,186,000); (2) receivables of approximately RMB830,345,000 (2017: RMB0) arising from instalment sales which are due for payment 1 year after the end of the reporting period and are discounted at market interest rate as at 31 December 2018; and (3) prepayment for acquisition of property, plant and equipment of approximately RMB200,000 (2017: RMB0).

(e) As at 31 December 2018 and 2017, the Group's maximum exposure to credit risk was the carrying value of each class of receivables mentioned above.

(f) The carrying amounts of the current portion of trade and other receivables approximate their fair value.

(g) As at 31 December 2017, Group's bills receivables of approximately RMB10,000,000 were secured for the Group's borrowings (Note 25).

18 TRADE AND OTHER RECEIVABLES (continued)

(h) The creation and release of provision for prepayments has been included in "Administrative expenses" and provision for impaired receivables has been included in "Net impairment losses on financial and contract assets" in profit or loss respectively.

(i) As at 31 December 2018 and 2017, the Group had receivables under finance lease as follows:

	2018 RMB'000	2017 RMB'000
Non-current receivables		
Finance leases — gross receivables	80,373	6,337
Unearned finance income	(3,614)	(151)
	76,759	6,186
Current receivables		
Finance leases — gross receivables	182,599	152,044
Unearned finance income	(4,526)	(1,117)
	178,073	150,927
Gross receivables from finance leases:		
— No later than 1 year	182,599	152,044
— Later than 1 year and no later than 5 years	80,373	6,337
	262,972	158,381
Unearned future finance income on finance leases	(8,140)	(1,268)
Net investment in finance leases	254,832	157,113
The net investment in finance leases is analysed as follows:		
No later than 1 year	178,073	150,927
Later than 1 year and no later than 5 years	76,759	6,186
Total	254,832	157,113

18 TRADE AND OTHER RECEIVABLES (continued)

(j) IMPAIRMENT AND RISK EXPOSURE

The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. Note 3.1(b) provides for details about the calculation of the allowance.

19 INVENTORIES

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Raw materials	**527,939**	615,515
Work in progress	**522,983**	695,262
Finished goods	**513,300**	504,769
Goods in transit	**575**	537
	1,564,797	1,816,083

For the year ended 31 December 2018, the cost of inventories recognised as the Group's expense and included in 'cost of sales' amounted to approximately RMB2,404,152,000 (2017: RMB1,066,141,000).

(a) Movement on the provision for inventory is as follows:

	Years ended 31 December	
	2018	2017
	RMB'000	RMB'000
At 1 January	**91,488**	103,011
Provision	**114,146**	221,876
Write off	**(5,246)**	(14,230)
Reversal	**(26,453)**	(63,104)
Disposal of subsidiaries	**(1,245)**	–
Transferred to disposal group classified as held for sale (Note 33)	**–**	(156,065)
At 31 December	**172,690**	91,488

20 CASH AND CASH EQUIVALENTS

(a) CASH AND CASH EQUIVALENTS

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Cash on hand	**5,278**	1,350
Cash at bank	**680,222**	1,098,942
Cash and cash equivalents	**685,500**	1,100,292

(b) RECONCILIATION TO CASH FLOW STATEMENT

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Cash and cash equivalents from continuing operations	**685,500**	1,100,292
Cash and cash equivalents from discontinuing operations	**–**	24,514
Balances per statement of cash flows	**685,500**	1,124,806

(c) PLEDGED BANK DEPOSITS

As at 31 December 2018 and 2017, the deposits are pledged to banks as security for bills payable (Note 24).

21 SHARE CAPITAL

Ordinary shares, issued and fully paid:

	Number of shares (thousands)	Amount RMB'000
At 1 January 2017	3,241,057	300,983
Proceeds from shares issued (i)	2,114,000	186,961
Shares issued under share option scheme	464	39
At 31 December 2017	5,355,521	487,983
At 1 January 2018	**5,355,521**	**487,983**
Shares issued under share option scheme (Note 22(b)(ii))	**384**	**32**
At 31 December 2018	**5,355,905**	**488,015**

(i) According to the subscription agreement dated 19 December 2016 entered into between the Company as the issuer and China Aerospace Science and Industry Corporation ("CASIC") as the subscriber, the Company conditionally agreed to allot and issue an aggregate of 1,606,000,000 new shares of the Company to CASIC at a subscription price of HKD0.77 per share.

On 11 April 2017, the Company entered into a placing agreement which the Company agreed to allot and issue an aggregate of 508,000,000 new shares of the Company to investors at a subscription price of HKD0.77 per share.

Both the CASIC subscription agreement and the placing agreement were fully completed in May 2017. After the transactions, CASIC holds approximately 29.99% of the total number of issued shares as enlarged.

The total authorised number of ordinary shares is 10,000,000,000 shares (2017: 10,000,000,000 shares) with a par value of HKD0.1 per share (2017: HKD0.1 per share).

22 SHARE-BASED PAYMENTS

(a) PRE-IPO SHARE OPTION SCHEME

(i) The Company adopted a pre-IPO share option scheme ("the Pre-IPO Option Scheme") on 21 January 2008 whereby employees of the Group were given the options to subscribe for shares of the Company. 60,000,000 options were granted on 21 January 2008.

(ii) Each 20% of options granted under the Pre-IPO Option Scheme will vest each year commencing from the listing date and the options are exercisable for a period of ten years. The Group has no legal or constructive obligation to repurchase or settle the options in cash. Any vested option will be lapsed if not exercised by the employees in one month after they left the Group.

(iii) The number and weighted average exercise prices of share options granted under the Pre-IPO Option Scheme are as follows:

	Year ended 31 December			
	2018		2017	
	Average exercise price in HKD per share option	**Number of share options (thousands)**	Average exercise price in HKD per share option	Number of share options (thousands)
At 1 January	**HKD3.83**	**52,056**	HKD3.83	53,356
Granted	**–**	**–**	–	–
Exercised	**–**	**–**	–	–
Forfeited	**–**	**–**	–	–
Lapsed	**HKD3.83**	**(52,056)**	HKD3.83	(1,300)
At 31 December	**–**	**–**	HKD3.83	52,056

22 SHARE-BASED PAYMENTS (continued)

(b) SHARE OPTION SCHEME

(i) The Company also adopted a share option scheme ("the Share Option Scheme") on 21 January 2008 for any eligible employees of the entities within the Group. The terms and conditions of the grants that existed during the year are as follows, whereby all options are settled by physical delivery of shares:

	Number of share options (thousands)		Vesting conditions	Contractual life of options
Options granted:				
– on 15 April 2009	60,000	(i) (ii) (iii)	30% on 1 December 2009 30% on 14 April 2010 40% on 15 April 2011	10 years
– on 11 October 2010	2,200	(i) (ii) (iii)	40% on 25 October 2010 30% on 11 October 2011 30% on 11 October 2012	10 years
– on 20 June 2011	7,600 (a)	(i) (ii) (iii)	30% on 19 July 2011 30% on 19 June 2012 40% on 20 June 2013	10 years
– on 5 April 2012	15,400	(i) (ii) (iii)	30% on 5 April 2013 30% on 5 April 2014 40% on 5 April 2015	10 years
– on 24 March 2014	3,200 (b)	(i) (ii) (iii)	30% on 24 April 2014 30% on 24 April 2015 40% on 24 April 2016	10 years
– on 2 July 2014	40,575 (c)		Vesting of the share options is conditional upon the achievement of corporate goals of the company and the individual performance of the respective grantees. The share options of any portion thereof shall lapse if the relevant corporate goals cannot be achieved. Up to 30% of the share options granted to each grantee after April 2015; up to 60% of the share options granted to each grantee after April 2016; all the remaining share options granted to each grantee after April 2017	10 years
– on 21 September 2016	41,350 (d)	(i) (ii) (iii)	30% on 21 September 2017 30% on 21 September 2018 40% on 21 September 2019	10 years
Total share options	170,325			

22 SHARE-BASED PAYMENTS (continued)

(b) SHARE OPTION SCHEME (continued)

(i) (Continued)

(a) 5,200,000 shares are granted to the directors of the Group.

(b) 3,200,000 shares are granted to the directors of the Group.

(c) 4,577,000 shares are granted to the directors of the Group.

(d) 8,450,000 shares are granted to the directors of the Group.

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

	Year ended 31 December			
	2018		2017	
	Weighted average exercise price	**Number of share options (thousands)**	Weighted average exercise price	Number of share options (thousands)
At 1 January	**HKD1.15**	**134,778**	HKD1.62	141,248
Granted	**–**	**–**	–	–
Exercised	**HKD0.44**	**(384)**	HKD0.44	(464)
Forfeited	**HKD0.44**	**(671)**	HKD0.96	(1,651)
Lapsed	**HKD1.37**	**(972)**	HKD1.28	(4,355)
At 31 December	**HKD1.16**	**132,751**	HKD1.15	134,778

The options outstanding at 31 December 2018 had an exercise price in the range of HKD0.44 to HKD2.02 (2017: HKD0.44 to HKD2.02) and a weighted average remaining contractual life of 5.28 years (2017: 6.17 years).

For the year ended 31 December 2018, there were 384,000 share options exercised (2017: 464,000 share options exercised).

22 SHARE-BASED PAYMENTS (continued)

(b) SHARE OPTION SCHEME (continued)

(ii) (Continued)

The fair value of options granted to the directors and selected employees is determined by using the binomial valuation model. The fair value of options granted on 21 September 2016 was HKD0.22 and HKD0.18 per option for the directors and selected employees respectively. The significant inputs into the model were spot share price of HKD0.44 at the grant date, exercise price shown above, volatilities of 55.65%, dividend yield of 1.75%, exercise multiples of 2.47 and 1.6 for directors and selected employees respectively, forfeiture rate of 0.00% for directors and selected employees, and an annual risk-free interest rates of 1.06%. The volatilities were based on the daily historical volatility of the Company. See Note 9 for the total expense recognised in profit or loss for share options granted to directors and employees.

(c) SHARE AWARD SCHEME

On 30 December 2011, the board of directors approved to adopt a Restricted Share Award Scheme (the "Scheme"). Under the Scheme, the Company may grant shares of the Company to certain selected participants at specified consideration.

Pursuant to the Scheme rules, existing issued shares will be purchased by the trustee of the Scheme (the"Trustee") from the market out of funds provided by the Company in accordance with the Scheme rules.

During the year ended 31 December 2012, 47,817,000 shares were acquired by the Trustee through purchases from the open market, at a total cost of approximately RMB49,973,000 (equivalent to HKD61,518,000).

During the year ended 31 December 2013, the Trustee acquired 50,000,000 shares of the Company through purchase from the open market according to the instructions of the board of directors, at a total cost of approximately RMB146,233,000.

During the year ended 31 December 2013, the Company granted restricted shares in respect of a total of 35,917,700 ordinary shares of the Company to selected participants at a price of HKD1.27 each, of which 190,000 restricted shares granted were subsequently cancelled. 17,428,850 of the restricted shares were vested on 20 May 2013 and 18,298,850 of the restricted shares were vested on 20 December 2013.

No shares were acquired by the Trustee under the Scheme for the years ended 31 December 2018 and 2017. As at 31 December 2018, 62,089,300 shares were held by the Trustee under the Scheme (2017: 62,089,300 shares).

The fair value of restricted shares granted to employees is measured with reference to the closing price of the ordinary share of the Company at the grant date and recognised as staff costs with a corresponding increase in the capital reserve within equity.

23 OTHER RESERVES

(a) SHARE PREMIUM

The application of the share premium account is governed by the Companies Law (Revised) of the Cayman Islands. The balance in the share premium account of the Company is distributable to the 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 pay off its debts as they fall due in the ordinary course of business.

(b) OTHER RESERVE

The other reserve represents the difference between the nominal value of share of the subsidiaries acquired over the nominal value of the shares issued by the Company in exchange; the difference between acquisitions of non-controlling interests and entities under common control over the consideration given; and the contribution of technology licenses by a shareholder.

(c) CAPITAL RESERVE

Capital reserve represents the value of employee services in respect of the equity-settled share-based payment as set out in Note 22, waiver of debts by the immediate holding company and capital contribution arising on shareholders' indemnity.

(d) SURPLUS RESERVE

Pursuant to the applicable PRC regulations, PRC entity is required to appropriate 10% of its profit-after-tax (after offsetting prior year losses) to the reserve until such reserve reaches 50% of the registered capital. The transfer to the reserve must be made before distribution of dividends to shareholders. The surplus reserve can be utilised, upon approval by the relevant authorities, to offset accumulated losses or to increase registered capital of the PRC subsidiaries, provided that the balance after such issue is not less than 50% of its registered capital.

(e) EXCHANGE RESERVE

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of operations outside the PRC which are dealt with in accordance with the accounting policies as set out in Note 2.7.

(f) FAIR VALUE RESERVE

The fair value reserve comprises the cumulative net change in the fair value of equity investments at fair value through other comprehensive income held at the end of the reporting period and is dealt with in accordance with the accounting policies in Note 2.13.

24 TRADE AND OTHER PAYABLES

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Trade payables	**1,198,420**	870,457
Amounts due to related companies (Note 32(c))		
— Trade	**603**	15,128
— Non-trade	**230**	258
Bills payable	**638,282**	269,165
Receipts in advance	**572**	218,821
Other payables	**502,779**	387,137
	2,340,886	1,760,966

At 31 December 2018 and 2017, the ageing analysis of the trade payables and bills (including amounts due to related parties of trading in nature) based on invoice date is as follows:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Within 3 months	**948,322**	458,110
3 to 6 months	**502,994**	123,525
6 to 12 months	**136,991**	119,192
Over 1 year	**248,998**	453,923
	1,837,305	1,154,750

As at 31 December 2018 and 2017, all the trade payables, bills payable and other payables of the Group were non-interest bearing and their fair value approximated their carrying amounts due to their short maturities.

As at 31 December 2018 and 2017, bills payable were secured by certain pledged bank deposits as disclosed in Note 20. All the current trade and other payables are expected to be settled within one year or are repayable on demand.

25 BORROWINGS

		As at 31 December	
		2018	2017
		RMB'000	RMB'000
(a)	Bank loans		
	Secured (i)		
	— Current portion	**524,886**	18,500
	— Non-current portion	**95,000**	–
		619,886	18,500
	Unsecured		
	— Current portion	**1,059,368**	1,411,245
	— Non-current portion	**–**	105,000
		1,059,368	1,516,245
(b)	Unsecured loan from related party (Note 32)		
	— Current portion	**50,000**	–
	— Non-current portion	**480,000**	480,000
		530,000	480,000
(c)	Other loans		
	Secured loan from related party (i) (Note 32)		
	— Current portion	**72,878**	4,580
	— Non-current portion	**–**	2,001
		72,878	6,581
	Senior notes (ii)		
	— Current portion	**838,318**	–
	— Non-current portion	**–**	1,294,690
		838,318	1,294,690
Current borrowings		**2,545,450**	1,434,325
Non-current borrowings		**575,000**	1,881,691
Total borrowings		**3,120,450**	3,316,016

25 BORROWINGS (continued)

(i) As at 31 December 2018, the bank loans and the secured loan from related party were secured by interest in land use rights of approximately RMB25,371,000, property, plant and equipment of approximately RMB29,747,000 and 20% equity interest of Honghua Company, a subsidiary of the Group.

As at 31 December 2017, the bank loans and the secured loan from related party were secured by interest in land use rights of approximately RMB26,043,000, property, plant and equipment of approximately RMB12,630,000, trade and other receivables of approximately RMB10,000,000 and 20% equity interest of Honghua Company, a subsidiary of the Group.

(ii) On 25 September 2014, the Company issued listed senior notes in the aggregate principal amount of USD200,000,000 ("Senior Notes"). The Senior Notes bear interest at 7.45% per annum, payable semi-annually in arrears and will be due in 2019. On 12 February 2018, principle amount of USD77,000,000 were redeemed at a redemption price of 103.725% of the principle amount, plus accrued and unpaid interest, if any, to the redemption date. Upon completion of the redemption, the outstanding principle amount is USD123,000,000.

The Senior Notes are guaranteed by the Group's existing subsidiaries other than those established/incorporated under the laws of the PRC, Honghua America, Sichuan Honghua International (H.K.) Limited and PT. Newco Indo Resources as stated in the Company's offering memorandum on 25 September 2014.

The borrowings at 31 December 2018 bear annual interest ranging from 1.20%-7.45% annually (2017: 1.20%-7.45% annually).

The maturities of the Group's borrowings at respective end of the year are set out as follows:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Within 1 year	**2,545,450**	1,434,325
Between 1 and 2 years	**480,000**	1,326,691
Between 2 and 5 years	**45,000**	555,000
Over 5 years	**50,000**	–
	3,120,450	3,316,016

25 BORROWINGS (continued)

The carrying amount and fair value of the borrowings are as follows:

	As at 31 December	
	2018 RMB'000	2017 RMB'000
Carrying amount		
Bank borrowings	1,679,254	1,534,745
Unsecured loan from related party	530,000	480,000
Secured loan from related party	72,878	6,581
Senior notes	838,318	1,294,690
Fair value		
Bank borrowings	1,663,859	1,557,168
Unsecured loan from related party	533,995	479,450
Secured loan from related party	72,884	7,552
Senior notes	850,176	1,270,048

The fair value of non-current borrowings are estimated based on discounted cash flow approach using the prevailing market rates of interest available to the Group for financial instruments with substantially the same terms and characteristics, which were 4.35%-10.7% as at 31 December 2018 (2017: 4.35%-10.7%) and is within level 2 of the fair value hierarchy.

The carrying amount of current borrowings approximated their fair value, as the impact of discounting was not significant.

The carrying amounts of the Group's borrowings are denominated in the following currencies:

	As at 31 December	
	2018 RMB'000	2017 RMB'000
RMB	1,852,839	3,211,761
USD	1,267,611	104,255
	3,120,450	3,316,016

25 BORROWINGS (continued)

At each balance sheet date, the Group had the following undrawn borrowing facilities:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Fixed rate		
Expiring within 1 year (bank loans and bill facilities)	**3,219,977**	5,381,290

These facilities have been arranged for financing daily operations.

26 DEFERRED INCOME TAX

(a) The analysis of deferred tax assets/(liabilities) is as follows:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Deferred tax assets		
Deferred tax assets to be recovered within 12 months	**112,574**	82,506
Deferred tax assets to be recovered more than 12 months	**149,353**	160,688
	261,927	243,194
Deferred tax liabilities		
Deferred tax liabilities to be settled within 12 months	**(295)**	–
Deferred tax liabilities to be settled more than 12 months	**–**	(11,137)
	(295)	(11,137)
Deferred tax assets (net)	**261,632**	232,057

26 DEFERRED INCOME TAX (continued)

(b) The movement in deferred tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

Deferred tax assets	Write down of inventories RMB'000	Provision for product warranties RMB'000	Unrealised profit on inventories RMB'000	Provision for impairment of receivables RMB'000	Accruals RMB'000	Government grants RMB'000	Tax losses RMB'000	Depreciation difference RMB'000	Impairment provision of property, plant and equipment RMB'000	Unrealised financing income RMB'000	Provision for investment in associates RMB'000	Total RMB'000
At 1 January 2017	15,697	1,209	6,614	68,045	17,034	16,456	295,500	536	6,804	–	–	427,895
Recognised in profit or loss	3,570	419	1,816	(22,928)	5,122	(50)	(141,724)	874	–	–	–	(152,901)
Currency translation differences	–	–	–	(164)	–	–	4,343	–	–	–	–	4,179
Transferred to disposal Group classified as held for sale (Note 33)	–	–	–	–	(2,258)	–	(33,721)	–	–	–	–	(35,979)
At 31 December 2017	19,267	1,628	8,430	44,953	19,898	16,406	124,398	1,410	6,804	–	–	243,194
Recognised in profit or loss	5,421	14,067	(6,333)	17,434	(3,406)	(2,292)	(67,144)	195	134	5,770	54,754	18,600
Currency translation differences	–	–	–	133	–	–	–	–	–	–	–	133
At 31 December 2018	24,688	15,695	2,097	62,520	16,492	14,114	57,254	1,605	6,938	5,770	54,754	261,927

26 DEFERRED INCOME TAX (continued)

(b) (continued)

Deferred tax liabilities	Borrowing costs RMB'000	Interest capitalisation RMB'000	Changes in fair value of FVOCI (2017: AFS) RMB'000	Total RMB'000
At 1 January 2017	(1,531)	(10,663)	–	(12,194)
Credited to profit or loss	1,531	–	–	1,531
Recognised in other comprehensive income	–	–	(474)	(474)
At 31 December 2017	**–**	**(10,663)**	**(474)**	**(11,137)**
Credited to profit or loss	**–**	**10,663**	**–**	**10,663**
Recognised in other comprehensive income	**–**	**–**	**179**	**179**
At 31 December 2018	**–**	**–**	**(295)**	**(295)**

The Group has not recognised deferred income tax assets in respect of tax losses of approximately RMB302,148,000 as at 31 December 2018 (2017: RMB111,767,000) as it is not probable that future taxable profits against which the losses can be utilised in the relevant tax jurisdictions of those entities. These tax losses will be expired in 5 to 20 years.

As at 31 December 2018, deferred income tax liabilities of approximately RMB65,192,200 (2017: RMB84,561,000) had not been recognised for the withholding tax that would be payable on the unremitted earnings of certain subsidiaries. Unremitted earnings totalled approximately RMB1,303,844,000 as at 31 December 2018 (2017: RMB1,691,239,000). The Group does not intend to remit these unremitted earnings from the relevant subsidiaries in the foreseeable future.

27 PROVISIONS FOR OTHER LIABILITIES AND CHARGES

	Legal claims of former shareholders (i) RMB'000	Legal claims of sales agency (ii) RMB'000	Other legal claims RMB'000	Product warranties RMB'000	Total RMB'000
At 1 January 2017	32,317	–	–	7,861	40,178
Provisions during the year	–	48,725	59,208	11,765	119,698
Utilised during the year	–	–	–	(13,909)	(13,909)
Transferred to disposal group classified as held for sale (Note 33)	–	–	(29,384)	(912)	(30,296)
At 31 December 2017	32,317	48,725	29,824	4,805	115,671
At 1 January 2018	**32,317**	**48,725**	**29,824**	**4,805**	**115,671**
Provisions during the year	**10,063**	**–**	**–**	**52,014**	**62,077**
Utilised during the year	**–**	**–**	**–**	**(1,361)**	**(1,361)**
Currency translation difference	**–**	**(1,372)**	**–**	**–**	**(1,372)**
Disposal of subsidiaries	**–**	**–**	**(29,824)**	**–**	**(29,824)**
At 31 December 2018	**42,380**	**47,353**	**–**	**55,458**	**145,191**

(i) As of 31 December 2005, 728 employees of Oil Drilling Plant (the "original investors"), through 11 representatives who were registered shareholders of Honghua Company, held collectively, 33.63% of Honghua Company's share capital. On 7 January 2006, Honghua Company proceed a shareholder resolution to reduce its registered capital and buy-out the equity interests from these 11 registered shareholders.

Honghua Company entered into a share purchase agreement with the 11 registered shareholders on 12 January 2006, under which, with the written consent of the 11 registered shareholders, it agreed to pay the share purchase price directly to the 728 original investors. The capital reduction process with the competent PRC government authority was completed on 26 April 2006. 64 of the 728 original investors, who collectively invested RMB651,385, refused to accept the payment from Honghua Company and claimed that they were still shareholders.

On 11 December 2007, 57 out of the 64 original investors initiated legal proceedings at the Intermediate Peoples' Court of Chengdu City, Sichuan Province ("Chengdu Intermediate Court"). A deed of indemnity in respect of the dispute and risk dated 15 February 2008 was entered into between some beneficiary owners of the Company (herein as defined "Indemnifiers") in favour of the Group pursuant to which each of the Indemnifiers jointly and severally provide an indemnity to any members of the Group for potential damages that the Company may suffer as result of the legal proceedings initiated by the 57 plaintiffs or the dispute with the 64 individuals.

27 PROVISIONS FOR OTHER LIABILITIES AND CHARGES (continued)

(i) (continued)

On 18 April 2012, Honghua Company received the first instance judgment ((2008) Cheng Min Chu Zi no. 53) from Chengdu Intermediate Court as follows: (1) Honghua Company shall pay to the plaintiffs' the economic loss of RMB20,728,750 and dividend of RMB296,125 together with their respective interests thereon (for the period from 26 April 2006 to the date when the payment is fully paid, based on the current interest rate of one year term loan of the People's Bank of China); (2) Honghua Company shall pay to the plaintiffs' other economic loss of RMB100,000; (3) the plaintiffs' other claims were dismissed. For the proceedings acceptance fee of RMB1,751,549, RMB200,000 shall be borne by the plaintiffs, and RMB1,551,549 shall be borne by Honghua Company.

The management take the view that Honghua Company's repurchase of the equity interest and capital reduction were conducted under the PRC law. Honghua Company therefore filed an appeal to the Sichuan Higher People's Court on 3 May 2012. As a result of the unfavourable judgement made by the court, a provision for the above legal claim of RMB32,317,000 has been made during 2012. Pursuant to the deed of indemnity, the Group has the right to claim from the Indemnifiers the same amount of loss suffered from the legal claim. Accordingly, receivables from the Indemnifiers of the same amount and the corresponding credit to capital reserve (net of tax) have been recognised in the financial statements. There is no impact on both the net assets and cash flow of the Group.

During the year ended 31 December 2014, Sichuan Higher People's Court issued an order (the "Order") ((2012) Chua Ming Zhong Zi No. 442) that the judgement made by Chengdu Intermediate Court of ((2008) Cheng Min Chu Zi No. 53) is set aside and retrial is ordered. The retrial by the court was held in February 2015. On 24 December 2015, Honghua Company received the judgment ((2014) Cheng Min Chu Zi No. 1058 from Chengdu Intermediate Court as follows: (1) within 30 days from the effective date of the judgment, Honghua Company shall pay to the plaintiffs' the economic loss of RMB22,410,740 and dividend of RMB296,125 together with their respective interests thereon; (2) within 30 days from the effective date of the judgment, Honghua Company shall pay to the plaintiffs' other economic loss of RMB130,000; and (3) the plaintiffs' other claims were dismissed. For the court proceeding fee of RMB1,790,273, RMB300,000 of which shall be borne by the plaintiffs, and RMB1,490,273 of which shall be borne by Honghua Company.

Honghua Company filed an appeal to Sichuan Higher People's Court in April 2016 again and the final judgement was made in June 2018. In August 2018, the original investors applied for compulsory execution to the Chengdu intermediate court, and the execution amount was RMB41,765,000. The management made the additional provision for the above legal claim of RMB10,063,000 accordingly. The Group has the right to claim from the Indemnifiers and there is no impact on both net assets and cash flow of the Group.

27 PROVISIONS FOR OTHER LIABILITIES AND CHARGES (continued)

(ii) The legal claims provision of approximately RMB47,353,000 relates to certain legal claims brought against a subsidiary of the Group by a sales agency. The sales agency alleged that it was owed commission in excess of USD18,000,000 in relation to their services to the Group. On 11 April 2017, new judgement was issued by Abu Dhabi Federal Court of Appeals that the Group shall pay approximately USD7,457,000 to such sales agency. The provision was recognised in profit or loss within other losses.

In June 2017, the Group filed an appeal pursuant to the Union Supreme Court of the United Arab Emirates. The final judgement was made in February 2019 and the Group shall pay USD7,457,000, which is the same as that in the previous judgement in April 2017.

28 DEFERRED INCOME

Movement on the deferred income is as follows:

	As at 31 December	
	2018 **RMB'000**	2017 RMB'000
At 1 January	**109,892**	111,330
Government grants related to assets received during the year	**51,108**	14,475
Government grants related to costs received during the year	**133,430**	112,620
Credited to profit or loss	**(199,894)**	(128,533)
At 31 December	**94,536**	109,892
Less: non-current portion	**(49,086)**	(68,624)
Current portion	**45,450**	41,268

29 DIVIDENDS

No dividend was approved or paid in respect of the previous financial year for the year ended 31 December 2018 and 2017.

No dividend was proposed for the year ended 31 December 2018.

30 CASH GENERATED FROM OPERATIONS

(a) RECONCILIATION OF PROFIT/(LOSS) BEFORE INCOME TAX TO CASH GENERATED FROM OPERATIONS

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Profit/(loss) before income tax included discontinued operations	**119,696**	(1,056,538)
Adjustments for:		
— Depreciation of property, plant and equipment	**149,661**	210,778
— Amortisation of intangible assets and lease prepayments	**36,486**	51,290
— Gain on available-for-sale financial assets	**–**	(1,569)
— Interest income	**(6,594)**	(10,552)
— Interest expense	**161,070**	227,971
— Share of loss from joint ventures and associates	**32,444**	28,968
— (Gain)/loss on disposal of property, plant and equipment	**(1,505)**	5,758
— Loss on disposal and dissolution of subsidiaries and a joint venture	**7,355**	–
— Foreign exchange (gain)/loss	**(31,095)**	24,016
— Equity-settled share-based payment expenses arising from share option schemes and share award scheme	**1,726**	3,293
— Provision for impairment of property, plant and equipment	**891**	300,100
	470,135	(216,485)
Changes in working capital:		
— Decrease in inventories	**137,680**	286,875
— Increase in amount due from customers for contract work	**–**	(142,573)
— (Increase)/decrease in trade and other receivables	**(542,928)**	635,277
— Decrease in pledged bank deposits	**53,838**	368,597
— Increase/(decrease) in trade and other payables	**319,363**	(564,991)
— Decrease in contract assets	**25,082**	–
— Increase in contract liabilities	**22,261**	–
— Increase in provisions for other liabilities and charges	**39,454**	70,688
Cash generated from operations	**524,885**	437,388

30 CASH GENERATED FROM OPERATIONS (continued)

(b) PROCEEDS FROM DISPOSAL OF PROPERTY, PLANT AND EQUIPMENT

In the consolidated statements of cash flows, proceeds from disposal of property, plant and equipment comprise:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Net book amount (Note 16)	**36,362**	12,103
Gains/(losses) on disposal of property, plant and equipment	**1,505**	(5,758)
Proceeds from disposal of property, plant and equipment	**37,867**	6,345

(c) NET DEBT RECONCILIATION INCLUDING DISCONTINUED OPERATIONS

This section sets out an analysis of net debt and the movements in net debt for each of the periods presented.

Net debt	**2018**	2017
	RMB'000	RMB'000
Cash and cash equivalents (Note 20)	**685,500**	1,124,806
Borrowings — repayable within one year (Note 25)	**(2,545,450)**	(1,443,825)
Borrowings — repayable after one year (Note 25)	**(575,000)**	(1,881,691)
Net debt	**(2,434,950)**	(2,200,710)
Cash and cash equivalents (Note 20)	**685,500**	1,124,806
Gross debt — fixed interest rates	**(2,247,984)**	(2,268,526)
Gross debt — variable interest rates	**(872,466)**	(1,056,990)
Net debt	**(2,434,950)**	(2,200,710)

30 CASH GENERATED FROM OPERATIONS (continued)

(c) NET DEBT RECONCILIATION INCLUDING DISCONTINUED OPERATIONS (continued)

	Assets	Liabilities from financing activities		
	Cash and cash equivalents RMB'000	Borrowings due within 1 year RMB'000	Borrowings due after 1 year RMB'000	Total RMB'000
Net debt as at 1 January 2017	544,360	(2,212,922)	(2,086,126)	(3,754,688)
Cash flows	607,509	757,694	129,780	1,494,983
Foreign exchange adjustments	(27,063)	11,403	74,655	58,995
Net debt as at 31 December 2017	1,124,806	(1,443,825)	(1,881,691)	(2,200,710)
Cash flows	(450,504)	(1,031,766)	1,306,691	(175,579)
Foreign exchange adjustments	11,198	(69,859)	–	(58,661)
Net debt as at 31 December 2018	685,500	(2,545,450)	(575,000)	(2,434,950)

(d) CASH OUTFLOW ON DISPOSAL OF SUBSIDIARIES

(i) Disposal of Offshore drilling rigs segment (Note 33)

	2018 RMB'000
Disposal consideration	–
Consideration received in cash and cash equivalents	–
Less: Cash and cash equivalents at the time of the disposal	**(93,736)**
Net cash outflow on disposal of Offshore drilling rigs segment	**(93,736)**

(ii) Disposal of Russia Honghua Co., Ltd

	2018 RMB'000
Disposal consideration	–
Consideration received in cash and cash equivalents	–
Less: Cash and cash equivalents at the time of the disposal	**(3,461)**
Net cash outflow on disposal of Russia Honghua Co., Ltd	**(3,461)**

30 CASH GENERATED FROM OPERATIONS (continued)

(d) CASH OUTFLOW ON DISPOSAL OF SUBSIDIARIES (continued)

(ii) *Disposal of Russia Honghua Co., Ltd* (continued)

The carrying amounts of assets and liabilities of Russia Honghua Co., Ltd as at the date of disposal (30 June 2018) and as at 31 December 2017 were:

	As at 30 June 2018	As at 31 December 2017
ASSETS		
Non-current assets		
Property, plant and equipment	16,448	10,699
Total non-current assets	16,448	10,699
Current assets		
Inventories	–	14,155
Trade and other receivables	214,134	225,607
Cash and cash equivalents	3,461	28,333
Total current assets	217,595	268,095
Total assets	234,043	278,794
LIABILITIES		
Current liabilities		
Trade and other payables	234,043	404,607
Total current liabilities	234,043	404,607
Total liabilities	234,043	404,607

31 COMMITMENTS

(a) CAPITAL COMMITMENTS

Capital expenditure contracted for or authorised but not contracted for at the balance sheet date but not yet incurred is as follows:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Contracted for	**10,346**	42,479
Authorised but not contracted for	**1,455**	3,700
	11,801	46,179

(b) OPERATING LEASE COMMITMENTS

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Within 1 year	**9,807**	39,610
After 1 year but within 5 years	**3,682**	119,337
	13,489	158,947

The Group is the lessee in respect of a number of properties, machinery and equipment held under operating leases. None of the leases include contingent rentals.

32 RELATED-PARTY TRANSACTIONS

Related parties are those parties that have the ability to control the other party or exercise significant influence in making financial and operating decisions. Parties are also considered to be related if they are subject to common control.

The following is a summary of the significant transactions carried out between the Group and its related parties in the ordinary course of business during the years ended 31 December 2018 and 2017, and balances arising from related party transactions as at 31 December 2018 and 2017.

Name of party	Relationship
Guanghan Hongtai Business Trading Co., Ltd. (廣漢市宏泰商貿有限公司) ("Hongtai")	Hongtai is a party of which spouses of certain directors and management have equity interests
Sichuan Deep & Fast Oil Drilling Tools Co., Ltd. (四川深遠石油鑽井工具有限公司) ("Sichuan Shenyuan")	Sichuan Shenyuan is a party of which the spouse of a director has equity interests
Aerospace Science & Industry Financial Leasing Co,. Ltd. (航天科工金融租賃有限公司) ("ASFIL")	ASFIL is the joint venture of CASIC
Aerospace Science & Industry Finance CORP (航天科工財務有限責任公司) ("ASFIC")	ASFIC is the subsidiary of CASIC
HH Egyptian Company	Joint venture
Honghua (Shenzhen)	Joint venture
Honghua (Jiangsu)	Associate
Honghua (Shanghai)	Associate
Jiangsu Hongjieding Energy Technology Co., Ltd. ("Jiangsu Hongjieding")	Controlled by a director of the Group

32 RELATED-PARTY TRANSACTIONS (continued)

(a) SIGNIFICANT RELATED PARTY TRANSACTIONS

	Year ended 31 December	
	2018 RMB'000	2017 RMB'000
Purchases of parts and components		
— Hongtai	7,398	9,719
— Other related companies	56	–
	7,454	9,719
Sales of drilling rigs, parts and components		
— ASFIL	517,241	255,744
— HH Egyptian Company	8,875	574
	526,116	256,318

(i) Besides the related party sales transactions as disclosed above, according to the tripartite agreements signed by the Group, Honghua (Shenzhen) and ASIFL, for the year ended 31 December 2018, the Group sold products amounted to approximately RMB517,241,000 (2017: RMB255,744,000) to ASIFL, meanwhile, ASIFL has provided finance lease and operating lease to Honghua (Shenzhen).

According to the tripartite agreements signed by the Group, Honghua (Shenzhen) and third party leasing companies, for the year ended 31 December 2018, the Group sold products amounted to approximately RMB36,637,000 (2017: RMB267,094,000) to those third party leasing companies, meanwhile, those third party leasing companies have provided finance lease to Honghua (Shenzhen), and the risk and rewards of those products have been transferred to Honghua (Shenzhen).

After the completion of the above transactions, Honghua (Shenzhen) and the subsidiaries of the Group have entered into operating lease agreements which leased the above mentioned products to the subsidiaries of the Group, and then the subsidiaries of the Group have leased those products to third party companies. For the year ended 31 December 2018, the total operating lease expense incurred charged to the profit or loss from the lease agreements above by the Group was approximately RMB56,283,000 (2017: RMB3,903,000).

32 RELATED-PARTY TRANSACTIONS (continued)

(a) SIGNIFICANT RELATED PARTY TRANSACTIONS (continued)

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Consulting service provided		
— Honghua (Shenzhen)	**2,670**	6,851
Operating lease expenses		
— Honghua (Shenzhen)	**56,283**	3,903
Loans to		
— HH Egyptian Company	**–**	61

The loans to related party have no fixed repayment terms and did not subject to interest in 2017. No provision was made against the loans.

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Loans from		
— ASFIC (Note 32(d)(i))	**120,000**	480,000
Disposal of discontinued operations		
— Jiangsu Hongjieding (Note 33)	**–**	–

32 RELATED-PARTY TRANSACTIONS (continued)

(b) AMOUNTS DUE FROM RELATED COMPANIES

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Trade (Note 18)		
— Joint ventures	**110,821**	48,560
— Associates	**79,049**	–
— Other related companies	**160,000**	25,512
	349,870	74,072
Non-trade (i) (Note 18)		
— Associates (i)	**1,565,023**	22,553
— Joint ventures	**108,327**	323
— Other related companies (i)	**113,682**	14,372
	1,787,032	37,248

(i) As at 31 December 2018, the current loan to an associate and other related party is RMB79,982,000 and non-current loan to an associate and other related party is RMB1,584,192,000 (Note 33). The other amounts due from other related companies are unsecured, interest-free and repayable on demand. No provision was made against the amounts due from related companies as at 31 December 2018 and 2017.

32 RELATED-PARTY TRANSACTIONS (continued)

(c) AMOUNTS DUE TO RELATED COMPANIES

	As at 31 December	
	2018 RMB'000	2017 RMB'000
Trade (Note 24)		
— Joint ventures	–	308
— Other related companies	603	14,820
	603	15,128
Non-trade (Note 24)		
— Joint ventures	–	258
— Associates	188	–
— Other related companies	42	–
	230	258

The amounts due to related companies are unsecured, interest-free and have no fixed repayment terms.

(d) BORROWINGS (NOTE 25)

	As at 31 December	
	2018 RMB'000	2017 RMB'000
— ASFIC (i)	600,000	480,000
— Honghua (Shenzhen) (ii)	2,878	6,581
	602,878	486,581

(i) As at 31 December 2018, the loans from ASFIC were secured by property, plant and equipment of about RMB21,185,000 (2017: RMB0). The loans from ASFIC bear fixed interest rate of 4.35%, of which RMB120,000,000 will be due for repayment in 2019, and RMB480,000,000 will be due for repayment in 2020.

(ii) As at 31 December 2018, the loans from Honghua (Shenzhen) were secured by property, plant and equipment of about RMB5,100,000 (2017: RMB8,923,000). The loans from Honghua (Shenzhen) bear fixed interest rate of 1.75% and are due for repayment in August 2019.

32 RELATED-PARTY TRANSACTIONS (continued)

(e) AMOUNTS DUE FROM CERTAIN SHAREHOLDERS

The amounts due from certain shareholders as at 31 December 2018 is an amount of approximately RMB42,380,000 (2017: RMB32,317,000), being the amount indemnified by certain shareholders in relation to a legal claim (Note 27).

(f) KEY MANAGEMENT COMPENSATION

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Basic salaries, allowances and other benefits in kind	**7,430**	6,750
Contributions to defined contribution retirement schemes	**455**	458
Discretionary bonus	**4,570**	3,084
Share-based payments	**–**	661
	12,455	10,953

33 DISCONTINUED OPERATIONS

(i) DESCRIPTION

According to the announcement dated 27 December 2017, the Group intended to dispose offshore drilling rigs segment, through public tender to be conducted on the Shanghai United Assets and Equity Exchange, (a) its 100% indirect equity interest in Honghua (Jiangsu), a wholly- owned subsidiary of the Group, (b) its 100% indirect equity interest in Honghua (Shanghai), a wholly-owned subsidiary of the Group, (c) its entire 70% indirect equity interest in Hong Kong Tank Tek Limited, and the Group's indirect creditor's rights against them. The assets and liabilities related to those entities were presented as disposal group classified as held for sale in the Group's annual financial statements for the year ended 31 December 2017.

In 2018, the Group signed agreements with Jiangsu Hongjieding and Honghua (Shanghai) with the following key transaction terms:

(a) The Group agreed to sell its 51% equity interests in both Honghua (Jiangsu) and Honghua (Shanghai) for a cash consideration of RMB1 respectively;

(b) The Group agreed to sell its 25% equity interests in FSP LNG B.V. and 70% equity interests in Hong Kong Tank Tek Limited for a cash consideration of USD1 respectively;

(c) The Group agreed to sell its 30% equity interests in Prime FSP, LLC for a cash consideration of USD1.

The Group also entered debt repayment agreements with Honghua (Jiangsu) and Hong Kong Tank Tek Limited respectively, pursuant to which Honghua (Jiangsu) and Hong Kong Tank Tek Limited shall repay the existing debt, together with relevant interest to the Group after the completion of the above equities transfer. The debts are secured by equity interests held by Jiangsu Hongjieding in offshore drilling rigs segment as well as total assets of Honghua (Jiangsu) and Honghua (Shanghai). The Group recorded these debts as "loan to an associate and other related party" (Note 3.1(b)).

The disposal was completed on 31 December 2018. Both Honghua (Jiangsu) and Honghua (Shanghai) has become associates of the Group with zero net book value (Note 12) as at 31 December 2018.

33 DISCONTINUED OPERATIONS (continued)

(ii) FINANCIAL PERFORMANCE AND CASH FLOW INFORMATION

The financial performance and cash flow information of the discontinued operations are as follows:

	Year ended 31 December	
	2018	2017
	RMB'000	RMB'000
Revenue	**4,999**	149,804
Other losses	**(703)**	(29,001)
Expenses	**(34,913)**	(830,796)
Loss before income tax	**(30,617)**	(709,993)
Income tax expense	**10,823**	(124,393)
Loss after income tax of discontinued operations	**(19,794)**	(834,386)
Gain on sale of the subsidiaries after income tax	**6,731**	–
Loss from discontinued operations	**(13,063)**	(834,386)
Other comprehensive income from discontinued operations	**(1,901)**	1,609
Net cash inflow/(outflow) from operating activities	**18,030**	(170,737)
Net cash outflow from investing activities	**(60,139)**	(27,378)
Net cash inflow/(outflow) from financing activities	**111,331**	(500)
Net increase/(decrease) in cash generated by discontinued operations	**69,222**	(198,615)

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
Consideration received or receivable:		
Cash	**–**	–
Fair value of loan to an associate and other related party	**1,664,174**	–
Total disposal consideration	**1,664,174**	–
Carrying amount of net assets sold	**(1,657,443)**	–
Profit on sale before income tax	**6,731**	–
Income tax expense	**–**	–
Gain on sale after income tax	**6,731**	–

33 DISCONTINUED OPERATIONS (continued)

(iii) DETAILS OF THE SALE OF THE DISCONTINUED OPERATIONS

At the time of the disposal, the fair value of loan to an associate and other related party was determined to be approximately RMB1,664,174,000. It has been recognised as financial assets at amortised cost.

The carrying amounts of assets and liabilities as at the date of disposal (31 December 2018) and as at 31 December 2017 were:

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
ASSETS		
Non-current assets		
Lease prepayments	**176,960**	152,842
Property, plant and equipment	**1,071,937**	808,141
Payment for acquisition of leasehold prepayment	**104,785**	110,656
Intangible assets	**163,669**	90,807
Deferred income tax assets	**36,973**	35,979
Trade and other receivables	**48,292**	130,830
Other non-current assets	**2,703**	218
Total non-current assets	**1,605,319**	1,329,473
Current assets		
Inventories	**125,229**	76,819
Trade and other receivables	**239,454**	303,469
Amount due from customers for contract work	**–**	324,076
Contract assets	**327,885**	–
Pledged bank deposits	**22,330**	–
Cash and cash equivalents	**93,736**	24,514
Total current assets	**808,634**	728,878
Total assets	**2,413,953**	2,058,351

33 DISCONTINUED OPERATIONS (continued)

(iii) DETAILS OF THE SALE OF THE DISCONTINUED OPERATIONS (continued)

	As at 31 December	
	2018	2017
	RMB'000	RMB'000
LIABILITIES		
Current liabilities		
Trade and other payables	**747,451**	479,378
Borrowings	**–**	9,500
Provisions for other liabilities and charges	**9,059**	30,296
Total current liabilities	**756,510**	519,174
Total liabilities	**756,510**	519,174

34 CONTINGENCIES

On June 2018, the Group received a Notification of Proceeding served by the Court pursuant to which Shanghai Shangshi International Trade (Group) Co., Ltd. (上海上實國際貿易（集團）有限公司) (the "Plaintiff") commenced a legal proceedings against Honghua (Jiangsu) as the first defendant and Honghua China as the second defendant.

Pursuant to the civil complaint, the plaintiff signed the purchase agency contract with Honghua (Jiangsu) in 2015 pursuant to which, the Plaintiff was engaged by Honghua (Jiangsu) to purchase equipment and materials. The purchase was guaranteed by Honghua China. The Plaintiff alleged that, up to now, Honghua (Jiangsu) and Honghua China should pay the Plaintiff RMB320,693,000 for the materials and equipment procurement costs, agency fee and respective interests thereon.

On 5 August 2015, Honghua (Jiangsu) and LNG Power Shipping Co., Ltd. ("LNG Power Shipping") entered into a shipbuilding contract pursuant to which Honghua (Jiangsu) shall build and sell to LNG Power Shipping 200 sets of LNG power ships. Due to the fact that the payment by LNG Power Shipping for the ships was not paid in the progress as expected and due to the project management of LNG Power Shipping , the progress of the shipbuilding was delayed, resulting in Honghua (Jiangsu)'s failure to pay the Plaintiff relevant fees on time.

On 17 October 2018, Plaintiff requested that Honghua (Jiangsu) and Honghua China should pay compensation of RMB190,289,000 for payment overdue.

As at 31 December 2018, Honghua (Jiangsu) has already made the liabilities for above the materials and equipment procurement costs and agency fee of RMB302,140,000. For the interest and compensation requested, the Group believed that the possibility of paid-out was relatively low by considering the legal opinion as well as evidence gathered.

35 BALANCE SHEET AND RESERVE MOVEMENT OF THE COMPANY

BALANCE SHEET OF THE COMPANY

	Note	As at 31 December 2018 RMB'000	2017 RMB'000
ASSETS			
Non-current assets			
Intangible assets		–	23,285
Investments in subsidiaries		3,357,027	3,365,819
Total non-current assets		3,357,027	3,389,104
Current assets			
Other receivables		1,554	1,604
Amounts due from subsidiaries		1,139,152	1,526,386
Cash and cash equivalents		1,600	2,376
Total current assets		1,142,306	1,530,366
Total assets		4,499,333	4,919,470
EQUITY			
Equity attributable to owners of the Company			
Share capital		488,015	487,983
Other reserves	(a)	3,755,104	3,587,166
Accumulated losses	(a)	(602,839)	(497,507)
Total equity		3,640,280	3,577,642

35 BALANCE SHEET AND RESERVE MOVEMENT OF THE COMPANY (continued)

BALANCE SHEET OF THE COMPANY (continued)

	Note	As at 31 December 2018 RMB'000	2017 RMB'000
LIABILITIES			
Non-current liabilities			
Borrowings		–	1,294,690
Current liabilities			
Borrowings		838,318	–
Other payables		20,735	47,138
Total liabilities		859,053	1,341,828
Total equity and liabilities		4,499,333	4,919,470

The balance sheet of the Company was approved by the Board of Directors on 28 March 2019 and was signed on its behalf:

Director

Director

35 BALANCE SHEET AND RESERVE MOVEMENT OF THE COMPANY (continued)

(a) RESERVE MOVEMENT OF THE COMPANY

	Share capital RMB'000	Share premium RMB'000	Other reserve RMB'000	Capital reserve RMB'000	Exchange reserve RMB'000	Shares held for share award scheme RMB'000	Accumulated losses RMB'000	Total RMB'000
Balance at 1 January 2017	300,983	2,349,292	389,691	99,673	(135,320)	(124,618)	(345,126)	2,534,575
Loss for the year	–	–	–	–	–	–	(152,381)	(152,381)
Other comprehensive income	–	–	–	–	(239,364)	–	–	(239,364)
Total comprehensive income	–	–	–	–	(239,364)	–	(152,381)	(391,745)
Issue of new ordinary shares	186,961	1,247,436	–	–	–	–	–	1,434,397
Shares issued under share option scheme	39	199	–	(65)	–	–	–	173
Equity-settled share-based transactions	–	–	–	242	–	–	–	242
Balance at 31 December 2017	487,983	3,596,927	389,691	99,850	(374,684)	(124,618)	(497,507)	3,577,642
Balance at 1 January 2018	**487,983**	**3,596,927**	**389,691**	**99,850**	**(374,684)**	**(124,618)**	**(497,507)**	**3,577,642**
Loss for the year	**–**	**–**	**–**	**–**	**–**	**–**	**(105,332)**	**(105,332)**
Other comprehensive income	**–**	**–**	**–**	**–**	**167,652**	**–**	**–**	**167,652**
Total comprehensive income	**–**	**–**	**–**	**–**	**167,652**	**–**	**(105,332)**	**62,320**
Shares issued under share option scheme	**32**	**169**	**–**	**(53)**	**–**	**–**	**–**	**148**
Equity-settled share-based transactions	**–**	**–**	**–**	**170**	**–**	**–**	**–**	**170**
Total transactions with owners, Recognised directly in equity	**32**	**169**	**–**	**117**	**–**	**–**	**–**	**318**
Balance at 31 December 2018	**488,015**	**3,597,096**	**389,691**	**99,967**	**(207,032)**	**(124,618)**	**(602,839)**	**3,640,280**

36 BENEFITS AND INTERESTS OF DIRECTORS

(a) DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

The remuneration of every director and the chief executive is set out below:

For the year ended 31 December 2018:

Emoluments paid or receivable in respect of a person's services as a director, whether of the Company or its subsidiary undertakings.

Name	Fees RMB'000	Basic salaries, allowances and other benefits in kind RMB'000	Contributions to defined contribution retirement scheme RMB'000	Discretionary bonuses RMB'000	Equity-settled share-based payment expenses RMB'000	Total RMB'000
Chairman and Executive Director						
Chen Yajun (resigned with effect from 24 August 2018)	–	460	39	–	–	499
Jin Liliang (appointed with effect from 24 August 2018)	–	287	24	507	–	818
Executive Directors						
Zhang Mi	–	631	–	1,186	–	1,817
Ren Jie (Chief executive officer)	–	613	57	753	–	1,423
Non-executive Directors						
Chen Wenle	–	–	–	–	–	–
Han Guangrong	–	–	–	–	–	–
Independent Non-executive Directors						
Liu Xiaofeng	211	–	–	–	–	211
Qi Daqing (resigned with effect from 1 January 2018)	–	–	–	–	–	–
Wu Yuwu (appointed with effect from 1 January 2018)	203	–	–	–	–	203
Chen Guoming	110	–	–	–	–	110
Su Mei	110	–	–	–	–	110
Pan Zhaoguo	152	–	–	–	–	152
Chang Qing	101	–	–	–	–	101
Total	887	1,991	120	2,446	–	5,444

36 BENEFITS AND INTERESTS OF DIRECTORS (continued)

(a) DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

The remuneration of every director and the chief executive is set out below:

For the year ended 31 December 2017:

Emoluments paid or receivable in respect of a person's services as a director, whether of the Company or its subsidiary undertakings:

Name	Fees RMB'000	Basic salaries, allowances and other benefits in kind RMB'000	Contributions to defined contribution retirement scheme RMB'000	Discretionary bonuses RMB'000	Equity-settled share-based payment expenses RMB'000	Total RMB'000
Chairman and Executive Director						
Chen Yajun	–	809	44	–	–	853
Executive Directors						
Zhang Mi	–	558	–	599	23	1,180
Ren Jie	–	680	59	354	147	1,240
Liu Zhi (resigned with effect from 29 March 2017)	–	754	57	84	14	909
Non-executive Directors						
Chen Wenle	–	–	–	–	–	–
Han Guangrong	–	–	–	–	–	–
Independent Non-executive Directors						
Liu Xiaofeng	200	–	–	–	45	245
Qi Daqing	200	–	–	–	45	245
Chen Guoming	100	–	–	–	32	132
Su Mei	100	–	–	–	–	100
Pan Zhaoguo	150	–	–	–	–	150
Chang Qing	100	–	–	–	–	100
Total	850	2,801	160	1,037	306	5,154

36 BENEFITS AND INTERESTS OF DIRECTORS (continued)

(b) DIRECTORS' RETIREMENT BENEFITS AND TERMINATION BENEFITS

For the years ended 31 December 2018 and 2017, no special retirement and termination benefits plans to the directors for the year except for the plans to all the Group's employees mentioned in Note 9. No other retirement and termination benefits were paid to or receivable by those directors in respect of their other services in connection with the management of the affairs of the Company or its subsidiary undertaking.

(c) CONSIDERATION PROVIDED TO THIRD PARTIES FOR MAKING AVAILABLE DIRECTORS' SERVICES

During the year ended 31 December 2018, the Company did not provide any consideration to any third party for making available director's services (2017: nil).

(d) INFORMATION ABOUT LOANS, QUASI-LOANS AND OTHER DEALINGS IN FAVOUR OF DIRECTORS, CONTROLLED BODIES CORPORATE BY AND CONNECTED ENTITIES WITH SUCH DIRECTORS

During the year ended 31 December 2018, no loans, quasi-loans or other dealings in favour of directors of the Company, controlled bodies corporate by and connected entities with such directors (2017: nil).

(e) DIRECTORS' MATERIAL INTERESTS IN TRANSACTIONS, ARRANGEMENTS OR CONTRACTS

Save for contracts amongst group companies and the interests in transactions, arrangements or contracts mentioned in Note 32, no other significant transactions, arrangements and contracts in relation to the Group's business to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

37 FINANCIAL INSTRUMENTS BY CATEGORY

The Group holds the following financial instruments:

Financial Assets	Notes	As at 31 December 2018 RMB'000	2017 RMB'000
Financial assets at amortized cost			
— Trade and bills receivables	18	**2,841,884**	1,986,242
— Finance lease receivables	18	**189,016**	108,822
— Other receivables (include non-trade amounts due from related parties)	18	**346,873**	45,830
— Loan to an associate and other related party	3.1(b)	**1,664,174**	–
— Pledged bank deposits	20	**137,302**	191,140
— Cash and cash equivalents	20	**685,500**	1,100,292
Financial assets at fair value through other comprehensive income			
— Bank acceptance bill receivable	3.3(c)	**78,462**	–
— Investment in unlisted companies at FVOCI	3.3(c)	**89,475**	–
— Available-for-sale financial assets	3.3(c)	**–**	90,192
		6,066,323	3,448,446

Financial liabilities	Notes	As at 31 December 2018 RMB'000	2017 RMB'000
Liabilities at amortized cost			
Trade and other payables (exclude payroll and welfare payables, other tax payables and receipts in advance)	24	**2,195,750**	2,191,551
Borrowings	25	**3,120,450**	3,316,016
Provisions for other liabilities and charges	27	**145,191**	115,671
		5,461,391	5,623,238

The Group's exposure to various risks associated with the financial instruments is discussed in Note 3. The maximum exposure to credit risk at the end of the reporting period is the carrying amount of each class of financial assets mentioned above.

38 TRANSACTIONS WITH NON-CONTROLLING INTERESTS

ACQUISITION OF ADDITIONAL INTEREST IN SUBSIDIARIES

In January and August 2017, the Group acquired additional 2.54% of the interest of Honghua Electric for a total purchase consideration of approximately RMB14,655,000. The total carrying amount of the non-controlling interests in Honghua Electric on the dates of acquisition was approximately RMB129,298,000. The Group recognised a decrease in non-controlling interests of approximately RMB16,420,000 and an increase in equity attributable to owners of the Group of approximately RMB1,765,000.

In June 2017, the Group acquired an additional 5.47% of the interest of Honghua International Co., Ltd. for a purchase consideration of approximately RMB14,480,000. The carrying amount of the non-controlling interests in Honghua International Co., Ltd. on the date of acquisition was approximately RMB44,327,000. The Group recognised a decrease in non-controlling interests of approximately RMB16,165,000 and an increase in equity attributable to owners of the Group of approximately RMB1,685,000.

FIVE-YEAR FINANCIAL HIGHLIGHTS

	2018 RMB'000	2017 RMB'000	2016 RMB'000	2015 RMB'000	2014 RMB'000
Consolidated Statement of profit or loss					
Revenue	**4,205,162**	2,175,856	2,147,592	4,219,253	7,812,537
Cost of sales	**(3,122,890)**	(1,540,763)	(1,789,716)	(3,272,716)	(6,182,994)
Gross profit	**1,082,272**	635,093	357,876	946,537	1,629,543
Distribution costs	**(313,211)**	(232,616)	(369,608)	(472,764)	(637,567)
Administrative expenses	**(469,484)**	(422,090)	(589,195)	(584,016)	(688,464)
Net impairment losses on financial and contract assets	**(93,829)**	(133,094)	–	–	–
Other income	**90,678**	92,652	126,732	(77,504)	100,312
Other gains/(losses), net	**43,005**	(43,319)	9,210	(9,863)	(7,326)
Operating profit/(loss)	**339,431**	(103,374)	(464,985)	(42,602)	396,498
Finance expenses - net	**(163,405)**	(214,203)	(77,496)	(261,835)	(273,018)
Share of net losses of associates and joint ventures accounted for using the equity method	**(32,444)**	(28,968)	(418)	2,718	186
Profit/(loss) before income tax	**143,582**	(346,545)	(542,899)	(301,719)	123,666
Income tax expenses	**(33,897)**	(48,651)	25,428	35,853	(13,499)
Profit/(loss) from continuing operations	**109,685**	(395,196)	(517,471)	–	–
Discontinued operations					
Loss from discontinued operations	**(13,063)**	(834,386)	(109,778)	–	–
Profit/(loss) for the year	**96,622**	(1,229,582)	(627,249)	(265,866)	110,167
Profit/(loss) attributable to:					
— Owners of the company	**82,287**	(1,239,368)	(609,689)	(252,207)	91,787
— Non-controlling interests	**14,335**	9,786	(17,560)	(13,659)	18,380
Profit/(loss) per share from continuing and discontinued operations attributable to owners of the Company (expressed in RMB cents per share)					
Basic profit/(loss) per share	**1.55**	(26.50)	(19.18)	(7.93)	2.89
Diluted profit/(loss) per share	**1.55**	(26.50)	(19.18)	(7.93)	2.87
Dividend					
Dividends declared and paid	**–**	–	–	–	–
Dividends declared and paid per share	**–**	–	–	–	–
Dividend proposed after balance sheet date	**–**	–	–	–	–
Dividend proposed after balance sheet date per share	**–**	–	–	–	–

	2018 RMB'000	2017 RMB'000	2016 RMB'000	2015 RMB'000	2014 RMB'000
Consolidated Balance Sheet					
Total non-current assets	**4,772,175**	2,334,095	4,415,887	4,791,979	5,238,168
Total current assets	**5,544,922**	7,732,449	6,851,879	8,390,361	10,260,172
Total assets	**10,317,097**	10,066,544	11,267,766	13,182,340	15,498,340
Total current liabilities	**5,374,100**	3,938,579	5,022,637	6,001,637	8,205,237
Total non-current liabilities	**624,086**	1,950,315	2,161,677	2,406,517	2,329,333
Total liabilities	**5,998,186**	5,888,894	7,184,314	8,408,154	10,534,570
Total equity	**4,318,911**	4,177,650	4,083,452	4,774,186	4,963,770
Key financial ratios					
Profitability					
Gross margin from continuing operations	**25.7%**	29.2%	16.7%	22.4%	20.9%
EBITDA margin	**11.7%**	(24.0%)	(13.4%)	7.4%	9.1%
Net margin	**2.0%**	(57.0%)	(28.4%)	(6.0%)	1.2%
Return					
Return on average equity	**2.0%**	(31.3%)	(14.4%)	(5.4%)	1.90%
Return on average assets	**0.8%**	(11.6%)	(5.0%)	(1.8%)	0.60%
Liquidity					
Current ratio	**1.03**	1.96	1.36	1.40	1.25
Quick ratio	**0.74**	1.50	0.94	1.04	0.89
Turnover					
Turnover of average trade and bills receivable	**191**	172	453	304	155
Turnover of average trade and bills payable	**174**	128	348	321	184
Turnover of average inventory	**198**	160	378	287	170
Gearing					
Total debts/Total assets	**30.2%**	32.9%	38.2%	35.4%	33.1%
Total liabilities/Total assets	**58.1%**	58.5%	63.8%	63.8%	68.0%
EBIT/Interest expenses	**2.07**	(3.56)	(2.38)	(0.16)	1.57

Note:

Profitability

Gross margin	=	Gross profit/Revenue
EBITDA	=	profit/(Loss) from operations + Share of net losses of associates and joint ventures accounted for using the equity method + Depreciation + Amortisation
EBITDA margin	=	EBITDA/Revenue
Net margin	=	(Loss)/profit attributable to equity shareholders of the Company/Revenue

Return

Return on average assets	=	(Loss)/profit attributable to equity shareholders of the Company/Average assets
Return on average equity	=	(Loss)/profit attributable to equity shareholders of the Company/Average equity attributable to equity shareholders of the Company

Liquidity

Current ratio	=	Current assets/Current liabilities
Quick ratio	=	(Current assets – Inventory)/Current liabilities

Turnover

Turnover of average trade and bills receivable	=	365.25*Average trade and bills receivable/Revenue
Turnover of average trade and bills payable	=	365.25*Average trade and bills payable/Cost of sales
Turnover of average inventory	=	365.25*Average inventory/Cost of sales

Gearing

Total debts/Total assets	=	(Long term interest-bearing borrowings + Short term interest-bearing borrowings)/Total assets
Total liabilities/Total assets	=	Total liabilities/Total assets
EBIT/Interest expenses	=	(profit/(Loss) from operations + Share of net losses of associates and joint ventures accounted for using the equity method)/Interest expenses (including the interest expense capitalised into assets under construction)

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HONGHUA GROUP LIMITED