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宏华集团
HONGHUA GROUP

Honghua Group Limited
宏華集團有限公司

(a company incorporated in the Cayman Islands with limited liability)

(Stock code: 0196)

ANNUAL RESULTS ANNOUNCEMENT
FOR THE YEAR ENDED 31 DECEMBER 2018

FINANCIAL HIGHLIGHT

	For the year ended 31 December		
	2018	2017	change
Turnover from continuing operations (RMB'000)	4,205,162	2,175,856	93.2%
Gross profit from continuing operations (RMB'000)	1,082,272	635,093	70.4%
Gross profit margin from continuing operations	25.7%	29.2%	
Operating profit/(loss) from continuing operations (RMB'000)	339,431	(103,374)	428.4%
Profit/(loss) attributable to equity shareholders of the Company (RMB'000)	82,287	(1,239,368)	106.6%
Earnings/(loss) per share			
— Basic (RMB cents)	1.55	(26.5)	105.8%
— Diluted (RMB cents)	1.55	(26.5)	105.8%

The Board does not recommend the payment of dividend for the year ended 31 December 2018.

ANNUAL RESULTS

The Board hereby announces the consolidated results of the Group for the year ended 31 December 2018, together with the comparative figures for the year ended 31 December 2017.

These annual results have also been reviewed by the Audit Committee, comprising solely the independent non-executive Directors, one of whom chairs the Audit Committee.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2018
(All amounts in RMB unless otherwise stated)

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

	<i>Notes</i>	Year ended 31 December	
		2018	2017
		RMB'000	RMB'000
Profit/(loss) attributable to owners of the Company arises from:			
— Continuing operations		92,377	(401,584)
— Discontinued operations		(10,090)	(837,784)
		<u>82,287</u>	<u>(1,239,368)</u>
Profit/(loss) per share from continuing and discontinued operations attributable to owners of the Company <i>(expressed in RMB cents per share)</i>			
Basic profit/(loss) per share	<i>7(a)</i>		
From continuing operations		1.74	(8.59)
From discontinued operations		(0.19)	(17.91)
		<u>1.55</u>	<u>(26.50)</u>
Diluted profit/(loss) per share	<i>7(b)</i>		
From continuing operations		1.74	(8.59)
From discontinued operations		(0.19)	(17.91)
		<u>1.55</u>	<u>(26.50)</u>

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		
<i>Items that may be reclassified to profit or loss</i>		
Change in value of available-for-sale financial assets, net of tax	—	1,423
Currency translation differences	25,164	(86,371)
<i>Items that will not be reclassified to profit or loss</i>		
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)

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

		As at 31 December	
		2018	2017
	<i>Note</i>	RMB'000	RMB'000
ASSETS			
Non-current assets			
Lease prepayments		192,242	218,742
Property, plant and equipment		1,518,266	1,516,225
Payment for acquisition of leasehold prepayment		10,000	37,510
Intangible assets		161,186	146,906
Investments in associates		–	37,169
Investments in joint ventures		35,135	40,389
Deferred income tax assets		261,632	232,057
Financial assets at fair value through other comprehensive income		74,053	–
Available-for-sale financial assets		–	90,192
Trade and other receivables	9	907,304	6,186
Loan to an associate and other related party		1,584,192	–
Other non-current assets		28,165	8,719
Total non-current assets		4,772,175	2,334,095
Current assets			
Inventories	10	1,564,797	1,816,083
Contract assets		42,758	–
Trade and other receivables	9	2,939,969	2,559,988
Loan to an associate and other related party		79,982	–
Current tax recoverable		46	6,595
Assets classified as held for sale		684	–
Financial assets at fair value through other comprehensive income		93,884	–
Pledged bank deposits		137,302	191,140
Cash and cash equivalents		685,500	1,100,292
		5,544,922	5,674,098
Assets of disposal group classified as held for sale		–	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	2017
<i>Note</i>	<i>RMB'000</i>	<i>RMB'000</i>
EQUITY		
Equity attributable to owners of the Company		
Share capital	488,015	487,983
Other reserves	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	49,086	68,624
Borrowings	575,000	1,881,691
Total non-current liabilities	624,086	1,950,315
Current liabilities		
Contract liabilities	241,082	–
Deferred income	45,450	41,268
Trade and other payables	2,340,886	1,760,966
Current income tax liabilities	56,041	67,175
Borrowings	2,545,450	1,434,325
Provisions for other liabilities and charges	145,191	115,671
	5,374,100	3,419,405
Liabilities of disposal group classified as held for sale	–	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

1 GENERAL INFORMATION

Honghua Group Limited (the “Company”) and its subsidiaries (together the “Group”) are principally engaged in manufacturing drilling rigs, offshore engineering, and oil & 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 ACCOUNTING POLICIES

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 the annual report.

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 revised to Note 2.2(b) and (c).

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

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.

2.2 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 financial statements.

(a) Impact on the 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 restated 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 Dec 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

(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	<i>Notes</i>	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:

	<i>Notes</i>	Effect on AFS reserves 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

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	New	Difference
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	–

(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.

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.

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.

(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 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 RMB'000	Reclassification RMB'000	Remeasurement RMB'000	IFRS 15 carrying amount 1 January 2018 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.

3 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 interest 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.

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 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.

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. 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		Parts and components and others		Oil and gas engineering services		Offshore drilling rigs		Total	
	Year ended 31 December		Year ended 31 December		Year ended 31 December		Year ended 31 December		Year ended 31 December	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	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.

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

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	2017
	RMB'000	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.

4 OTHER INCOME

	Year ended 31 December	
	2018 RMB'000	2017 RMB'000
Government grants	23,799	42,641
Repair services income	16,540	23,067
Rental income	43,291	20,448
Sales of scrap materials	6,173	3,035
Others	875	3,461
	<u>90,678</u>	<u>92,652</u>

5 OTHER GAINS/(LOSSES), NET

	Year ended 31 December	
	2018 RMB'000	2017 RMB'000
Insurance compensation	41,930	43,754
Recognition of in deferred income	20,858	17,998
Gain/(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	(7,355)	–
Legal claims of sales agency	–	(48,725)
Other legal claims	–	(29,824)
Donations	–	(228)
Others	3,213	(920)
	<u>43,005</u>	<u>(43,319)</u>

6 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	(29,263)	26,977
Income tax expense	33,897	48,651

(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) Sichuan Honghua Petroleum Equipment Co., Ltd. (“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) Sichuan Honghua Electric Co., Ltd. (“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.

- (v) The tax on the Group's 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: Change in the fair value of equity investments at fair value other comprehensive income	(179)	–
	<u>(179)</u>	<u>–</u>
	<u>(179)</u>	<u>475</u>

7 EARNINGS/(LOSS) PER SHARE

(a) Basic earnings/(loss) per share

The calculation of basic earnings/(loss) per share is based on the 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)	<u>5,293,645</u>	<u>4,677,014</u>
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)

(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)	<u>—</u>	<u>—</u>
Adjusted weighted average number of ordinary shares (diluted) in issue (thousands)	<u>5,293,645</u>	<u>4,677,014</u>
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)

8 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	<u>(715)</u>	<u>(2,296)</u>
	<u>169,005</u>	<u>239,573</u>
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	<u>—</u>	<u>(1,569)</u>
	<u>(5,600)</u>	<u>(25,370)</u>
	<u>163,405</u>	<u>214,203</u>

9 TRADE AND OTHER RECEIVABLES

	As at 31 December	
	2018	2017
	RMB'000	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		
— 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 impairment of 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

- (a) As at 31 December 2018 and 31 December 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.
- (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.
- (h) The creation and release of provision for prepayment 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 <i>RMB'000</i>
Non-current receivables		
Finance leases — gross receivables	80,373	6,337
Unearned finance income	(3,614)	(151)
	<u>76,759</u>	<u>6,186</u>
Current receivables		
Finance leases — gross receivables	182,599	152,044
Unearned finance income	(4,526)	(1,117)
	<u>178,073</u>	<u>150,927</u>
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
	<u>262,972</u>	<u>158,381</u>
Unearned future finance income on finance leases	(8,140)	(1,268)
Net investment in finance leases	<u>254,832</u>	<u>157,113</u>
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
	<u>254,832</u>	<u>157,113</u>
Total	<u>254,832</u>	<u>157,113</u>

- (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.

10 INVENTORIES

	As at 31 December	
	2018	2017
	<i>RMB'000</i>	<i>RMB'000</i>
Raw materials	527,939	615,515
Work in progress	522,983	695,262
Finished goods	513,300	504,769
Goods in transit	575	537
	<u>1,564,797</u>	<u>1,816,083</u>

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
	<i>RMB'000</i>	<i>RMB'000</i>
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	–	(156,065)
	<u>172,690</u>	<u>91,488</u>
At 31 December		

11 TRADE AND OTHER PAYABLES

	As at 31 December	
	2018	2017
	<i>RMB'000</i>	<i>RMB'000</i>
Trade payables	1,198,420	870,457
Amounts due to related companies		
— 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
	<u>2,340,886</u>	<u>1,760,966</u>

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
	<i>RMB'000</i>	<i>RMB'000</i>
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
	<u>1,837,305</u>	<u>1,154,750</u>

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. All the current trade and other payables are expected to be settled within one year or are repayable on demand.

12 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
Impairment losses on 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	5,190	4,910
— Other services	—	900
Impairment provision of property, plant and equipment	891	—
Other expenses	54,577	104,039
Total cost of sales, distribution costs and administrative expenses	<u>3,905,585</u>	<u>2,195,469</u>

- (i) The amounts do 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).

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) employment, (ii) occupational health and safety, (iii) intellectual property, (iv) customer privacy and (v) anti-corruption. 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*

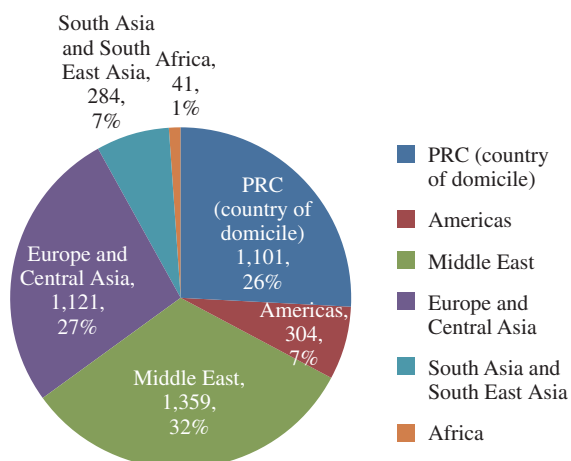
The Group's revenue by geographical area during the Year: (1) The Group's export revenue increased by RMB1,750 million with that for Last Year to approximately RMB3,109 million, accounting for approximately 73.8% of total revenue; (2) Sales revenue in mainland China increased by RMB135 million compared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

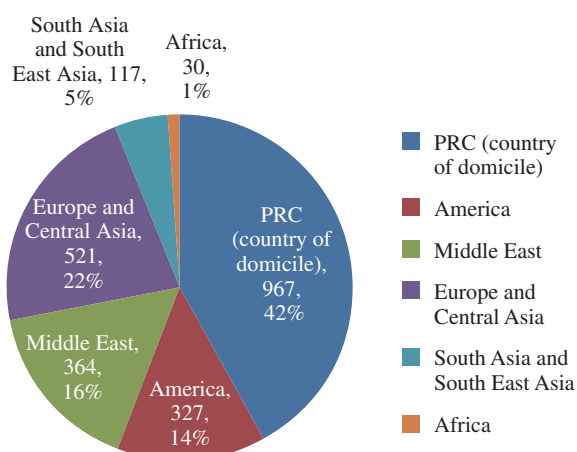
Year ended 31 December 2018

Expressed in RMB'million



Year ended 31 December 2017

Expressed in RMB'million



(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.

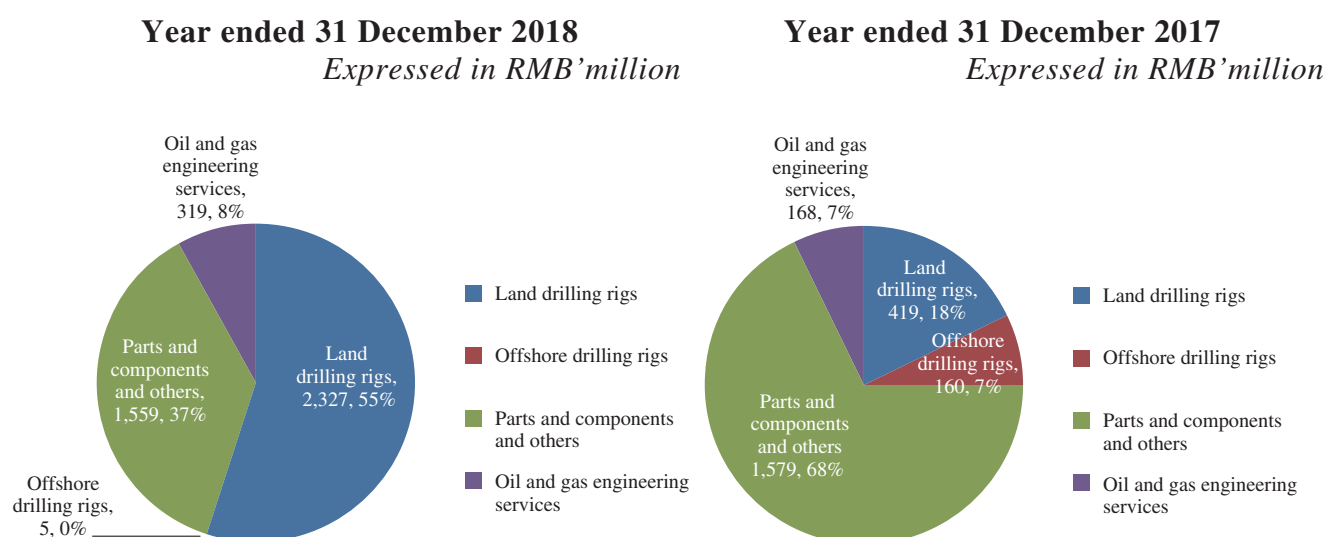
During the Year, the Group's sales revenue from land drilling rigs amounted to approximately RMB2,327 million, representing an increase of RMB1,908 million or 455.4% from approximately RMB419 million for Last Year.

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



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.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the Year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's Shares.

CLOSURE OF REGISTER OF 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.

AUDIT COMMITTEE

The Audit Committee comprises all the Independent Non-executive Directors with written terms of reference in compliance with the Listing Rules. The Audit Committee is responsible for reviewing and supervising the adequacy and effectiveness of the Group's financial reporting system, internal control systems and risk management system and associated procedures and providing advices and recommendations to the Board. The Audit Committee shall hold at least two meetings a year and review opinions of internal auditors, matters in respects of internal control, risk management and financial reporting. The Audit Committee has reviewed the consolidated financial statements of the Group for the year ended 31 December 2018 and the accounting principles and practices adopted by the Group during the Year.

The Audit Committee is also responsible for reviewing the compliance of the corporate governance issues, the corporate governance report and the corporate governance policy.

COMPLIANCE WITH THE CORPORATE GOVERNANCE CODE

Except for the deviation as mentioned below, the Company has complied with the code provisions as set out in the Corporate Governance Code in Appendix 14 to the Listing Rules ("CG Code") throughout the year ended 31 December 2018.

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

The Company is committed to enhance its corporate governance practices appropriate to the conduct and growth of its business and to review its corporate governance practices from time to time to ensure that they comply with the statutory and professional standards and the requirements under the Listing Rules and align with their latest developments.

For improving work efficiency, the nomination committee was dismissed with effect from 19 March 2013. The Board shall review its own structure, size and composition (including taking into account of the board diversity policy of the Company) regularly to ensure that it has a balance of expertise, skills, experience and diversity of board members appropriate for the requirements of the business of the Company.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted its own code of conduct regarding Directors' dealings in the Company's securities (the "Company 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 the Directors have confirmed that they have complied with the Company Code and the Model Code throughout the year ended 31 December 2018.

PUBLICATION OF ANNUAL RESULTS ANNOUNCEMENT AND ANNUAL REPORT FOR 2018

This announcement is published on both the websites of the Company (www.hh-gltd.com) and of the Stock Exchange (www.hkexnews.hk). The annual report of the Company for the year ended 31 December 2018 will be dispatched to shareholders of the Company and published on the aforesaid websites in due course.

DEFINITION

"Annual General Meeting"	: the annual general meeting of the Company which will be held on Wednesday, 19 June 2019
"Audit Committee"	: the audit committee of the Company
"Board"	: the Board of Directors of the Company
"CG Code"	: Corporate Governance Code set out in Appendix 14 to the Listing Rules
"Code for Securities Trading"	: code for securities trading adopted by the Company since 21 January 2008
"Company"	: Honghua Group Limited
"Directors"	: directors of the Company
"During the Year"	: for the year ended 31 December 2018
"Group", "Honghua" or "We"	: the Company and its subsidiaries

“HK\$” or “HK dollars”	: Hong Kong dollars, the lawful currency of Hong Kong
“Hong Kong”	: the Hong Kong Special Administrative Region of the PRC
“Last Year”	: for the year ended 31 December 2017
“Listing Rules”	: the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (as amended from time to time)
“Model Code”	: Model Code for Securities Transactions by Directors of Listed Issuers set out in Appendix 10 to the Listing Rules
“PRC” or “China”	: the People’s Republic of China, unless the context requires otherwise, reference in this announcement of the PRC or China excludes Hong Kong, the Macau Special Administrative Region of the PRC and Taiwan
“RMB”	: Renminbi, the lawful currency of the PRC
“Share(s)”	: ordinary shares issued by the Company, with a nominal value of HK\$0.10 each
“Stock Exchange”	: The Stock Exchange of Hong Kong Limited
“US”	: the United States of America, including its territories and possessions
“US\$”	: United States dollars, the lawful currency of the US

On behalf of the Board
Honghua Group Limited
Jin Liliang
Chairman

Hong Kong, 28 March 2019

As at the date of this announcement, the executive directors of the Company are Mr. Jin Liliang (Chairman), Mr. Zhang Mi and Mr. Ren Jie, the non-executive directors of the Company are Mr. Han Guangrong and Mr. Chen Wenle, and the independent non-executive directors of the Company are Mr. Liu Xiaofeng, Mr. Chen Guoming, Ms. Su Mei, Mr. Poon Chiu Kwok, Mr. Chang Qing and Mr. Wu Yuwu.