



## TG Tools – China’s Unknown DS Number One?

February 28, 2022

Following its first “clarification” dated February 16, Tiangong (0826.HK) issued a second “clarification” on February 25. Much as we have expected, except for some further details, the second “clarification” doesn’t really do much to set the record straight. We are, therefore, confident as ever that the company has been doctoring its books since 2017. We maintain our target price at HK\$1.33 for the stock.

Of the 12 listed companies that we have challenged so far, only three of them have managed to retain their auditors. We expect Tiangong’s auditors KPMG to make the right move soon.

In our first report published on February 15, we reveal that Tiangong’s real production volume of die steel (DS) during 2017-20 was only 55% of that claimed by the company historically. So, let’s focus on the real DS volume in the light of the company’s two “clarifications”.

➤ TG Tools ranked as China’s No.1 DS producer in 2019?

Exhibit 1 below shows Tiangong’s total 2020 DS production data from the second “clarification”, which alleges 20.8% of the 178k tons total production volume (including the outsourced 10k tons) came from TG Tools and 10.1% came from TG New Materials<sup>1</sup>. We regard this table as the most misleading piece of information from the two “clarifications”. It creates the impression that TG Tools does not play a significant role in the group’s DS output, and hopes to undermine our assertion that “TG Tools does not produce DS”.

**Exhibit 1 – The most misleading data from the two “clarifications”**

<b>Entity</b>	<b>Volume (tonne’000)</b>
TG Aihe	113
TG Tools New Materials	37
Jurong TG New Materials	18
<b>Total</b>	<b>168</b>

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

Source: Second “clarification”, p.5

<sup>1</sup> We will continue to use the abbreviations adopted in our February 15 report here

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But if we go back to 2019, we can easily spot where the problem is. For 2019, Tiangong has claimed total DS sales of 169.6k tons. It now asserts in p.2 of the second “clarification” that data from the Special Steel Enterprises Association of China (SSEA) showing 84k tons of DS production in 2019 cover only its main subsidiary TG Aihe.

Deducting TG Aihe’s output from the total DS output reported by the Tiangong will give rise to the output of TG Tools<sup>2</sup>. As shown in Exhibit 2 below, TG Tools sold 85.6k tons of DS in 2019, making it the biggest producer in China that year.

<b>Exhibit 2 – TG Tools ranked as China’s No.1 DS producer in 2019?</b>			
<b>Year ended Dec 31 (k tons)</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
Tiangong	137.3	148.6	169.6
- TG Aihe	85.0	89.0	84.0
= TG Tools	52.3	59.6	85.6
TG Tools as % of Tiangong	38.1%	40.1%	50.5%
<b>Top producers sorted by 2019 production volume</b>			
TG Tools	52.3	59.6	85.6
TG Aihe	85.0	89.0	84.0
Dongbei Special Steel Group Co., Ltd.	81.0	68.0	62.0
Pangang Group Jiangyou Changcheng Special Steel Co., Ltd.	35.0	27.0	34.0
Baowu Special Metallurgy	33.0	23.0	24.0
Qilu Special Steel Co.,Ltd.	29.0	28.0	15.0

Sources: SSEA, Tiangong and Emerson Analytics

Exhibit 2 demonstrates that, according to Tiangong’s logic, TG Tools accounted for a substantial portion of Tiangong’s total DS output during 2017-19, and in 2019 it even produced more DS than TG Aihe to become the biggest producer in China. But Tiangong has never disclosed any DS production by TG Tools.

➤ SSEA ignored the country’s No.1 DS producer?

We are convinced that the relevant DS output data published by SSEA pertain to Tiangong and not just to TG Aihe. The reasons are as follows:

- SSEA data clearly attribute them to Tiangong International (天工國際) as a whole, rather than just for TG Aihe;

<sup>2</sup> TG New Materials only undertakes downstream steel processing business. In calculating the output of TG Tools we are ignoring TG New Materials because the output of the upstream producers includes the amount they sell to TG New Materials.

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- If Tiangong as a whole had actually sold 169.6k tons of DS in 2019, then TG Tools was the biggest DS producer in the whole of China. Could SSEA have been ignorant of the number one producer in the country? Were SSEA experts idiots who had no idea what they were doing? We don’t think so. They know a lot about special steel.
- TG Aihe engages in DS and TG Tools engages in high speed steel (HSS) and cutting tools according to annual reports

Exhibit 3 below is taken from Tiangong’s 2020 annual report, stating clearly that TG Aihe engages in DS production and TG Tools engages in HSS and cutting tools production. Did Tiangong forget about the majority of TG Tools’ business?

**Exhibit 3 – Annual report discloses TG Aihe engages in DS and TG Tools in HSS and cutting tools**

Name of company	Place and date of incorporation	Proportion of ownership interest		Issued and fully paid-up/ registered capital	Principal activity
		Direct	Indirect		
China Tiangong Company Limited	British Virgin Islands, 14 August 2006	100%	-	USD50,000/ USD50,000	Investment holding
TG Tools	The PRC, 7 July 1997	-	100%	RMB2,148,128,000/ RMB2,148,128,000	Manufacture and sale of <u>high speed steel and cutting tools</u>
TG Aihe	The PRC, 5 December 2003	-	100%	RMB786,155,188/ RMB786,155,188	Manufacture and sale of <u>die steel</u>
China Tiangong (Hong Kong) Company Limited ("CTCL (HK)")	Hong Kong, 13 June 2008	-	100%	HKD1/HKD1	Investment holding

Source: 2020 annual report, p.148

- Filings to government reveal that TG Aihe engages in DS and TG Tools engages in HSS and HSS tools

Exhibit 4 below is reproduced from reports submitted by TG Aihe and TG Tools, respectively, to the Zhenjiang Bureau of Ecology and Environment. Again, TG Aihe describes itself in the report as engaging in DS production, whereas TG Tools says in its report that it engages in the production of HSS and HSS tools.

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**Exhibit 4 – Filings to government reveal TG Aihe engages in DS and TG Tools in HSS and HSS tools**

表1 废物产生情况				
废物产生企业概况 (企业投产时间、主要经营范围及规模)				
天工爱和特钢有限公司于 2003 年 12 月成立, 现有职工 1000 余人, 公司主要进行模具钢生产				
TG Aihe was established in December 2003. Currently, it has about 1,000 employees. The company majors in the production of DS.				
产品及产废情况			产生危险废物情况	
产品名称	主要成分化学名	年产量	废物名称	年产生量
模具钢 DS	铁	10万吨 100k tons	尘灰	800
annual production volume				
表1 废物产生情况				
废物产生企业概况 (企业投产时间、主要经营范围及规模)				
江苏天工工具有限公司始建于 1980 年, 现有职工 3000 余人, 公司主营高速工具钢、和各类高速钢工具钻头丝锥等				
TG Tools was established in 1980. Currently, it has about 3,000 employees. The company majors in the production of HSS and various HSS drill bits and screw taps.				
产品及产废情况			产生危险废物情况	
产品名称	主要成分化学名	年产量	废物名称	年产生量
高速钢 HSS	铁	5万吨 50k tons	尘灰	350
annual production volume				

Sources: <http://sthj.zhenjiang.gov.cn/sthj/file/shbj/zwgk/gfgl/202009/W020200921347966088911.pdf> (left)  
<http://sthj.zhenjiang.gov.cn/sthj/file/shbj/zwgk/gfgl/202009/W020200921340782644910.pdf> (right)

In p.29 of [the October 2018 Environmental Report](#), TG Aihe says “nowadays, the real molten steel output amount approximates 130k t/a”. Thus, the volume of 100k tons by TG Aihe in Exhibit 4 above should relate to DS products.

The volume of 50k tons by TG Tools in Exhibit 4 above should refer to the crude steel output, which would correspond to 37.1k tons of HSS products.

➤ Are Tiangong’s DS and HSS capacity indistinguishable?


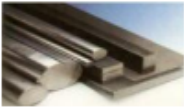
To justify its DS production volume, Tiangong’s second “clarification” says:

*both TG Aihe and TG Tools owned smelting production facilities at the relevant time and have been dynamically allocated to produce DS and HSS according to market demand*

So, Tiangong’s smelting capacity for special steel can not be distinguished into DS and HSS. Strangely, its 2020 interim results presentation makes it clear that the company had 200k tons of DS production capacity and 50k tons of HSS capacity at that time.

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Exhibit 5 – DS production capacity at 200k tons and HSS at 50k tons

Segment	Positioning and properties	Production/ year
 Die Steel	<ul style="list-style-type: none"> <li>✓ “Made in China 2025” focused new materials - <b>Advanced raw materials.</b></li> <li>✓ “Strategic Emerging Industries Key Products and Services Guide Directory” - <b>Advanced steel materials - high-performance industrial die steel.</b></li> </ul>	200,000 tons
 High Speed Steel		50,000 tons

Source: <http://tggi.cn/EN/uploads/soft/2020.pdf>, p.27

In p.29 of the October 2018 Environmental Report, it says “TG Aihe’s designed capacity of molten steel is 300k t/a”. [The July 2021 Environmental Report](#) corroborates this 300k tons of annual production capacity.

Tiangong disclosed 200k tons of DS production capacity to the investment community but 300k tons to the environmental regulators. We suspect the company wanted to show investors a better capacity utilization rate. But regardless, this 200k tons of DS capacity should belong to TG Aihe.

The 50k tons of HSS production capacity in Exhibit 5 is the same as the production volume disclosed by TG Tools in Exhibit 4.

➤ Ex-staff B puts DS output for 2020 at 114k tons and HSS at 50k tons

Our February 15 report contains a dialogue between our investigator and Ex-staff B, a former middle-level manager of Tiangong, in which he reveals the company’s total HSS production and total DS monthly sales volume in 2020. Below in Exhibit 6, we reprint that part of the conversation and add the bit on HSS in red.

The information provided by Ex-staff B is in line with the DS and HSS volume filed by the relevant companies in Exhibit 4.

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## Exhibit 6 – DS at 114k tons and HSS at 50k tons according to Ex-staff B

Emerson investigator: What was your job while at Tiangong?  
 Tiangong Ex-staff B: I was mainly involved in the rolling of steel.  
 .....

Emerson investigator: For Tiangong as a whole, how much HSS can it produce a year?  
 Tiangong Ex-staff B: For HSS, the output volume in 2020 was a bit over 50k tons.  
 Emerson investigator: More than 50k tons?  
 Tiangong Ex-staff B: Correct.  
 .....

Emerson investigator: For DS, how much sales volume are you doing a year?  
 Tiangong Ex-staff B: In terms of sales volume, steel plates amount to 5,000-6,000 tons a month last year, whereas steel bars are about 2,000-3,000 tons.  
 Emerson investigator: So, they’re mostly steel plates and steel bars?  
 Tiangong Ex-staff B: Yes. There’re also some forged products, about 1,000-2,000 tons a month.

Source: Emerson Analytics

➤ Isn’t Tiangong one of the “over 10 exporters followed by the author”?

Our February 15 report shows that Tiangong’s 2019 export volume, which we deduced from the company’s disclosure, exceeded the national total.

## Exhibit 7 – Tiangong DS exports exceed national total in 2019 (k tons)

Year ended Dec 31	2019	2020
China total	75.9	58.5
Tiangong	77.4	54.6
Tiangong market share	102%	93%

Sources: Tiangong and Emerson Analytics

Tiangong’s second “clarification” has this to say:

*2020 national export figure (and the deduced 2019 figure) was a summation of export figures of a selection of over 10 exporters followed by the author of an article published by Mysteel.com, not a national figure.*

Following in-depth discussions with the author, [the relevant article](#) arrives at the national total by adding up the export amounts of a dozen top exporters and then extrapolating a total for all DS manufactures in

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China. The total is therefore on the high side because some of the smaller plants may not have exports at all. Tiangong’s 2019 DS export volume was even bigger than this national total!

Even if the numbers published by Mysteel.com only covered some exporters, as Tiangong insists in the second “clarification”, the company’s logic contains a fatal flaw. The author told us Tiangong was one of the exporters followed by the author. A simple question then is: how can a part be bigger than the sum of which it is a part?

➤ Where does 181.7k tons of DS sales volume in 2020 come from?

Our February 15 report notes that Tiangong’s DS sales volume in 2020 was 181.7k tons. The second “clarification” says that “The company did not reported (*sic*) 181.7k tons of DS production volume in its annual reports (*sic*) for 2020; the figure was estimated by the Report based on its assumptions and ‘investigation’”.

It is true that Tiangong’s 2020 annual report does not contain the 181.7k tons number. But the 2020 sales volume can be easily found. Exhibit 8 below shows 2020 DS sales volume at 181.827k tons in Tiangong’s 2020 final results presentation reproduced by a popular mainland investment website and 181.69k tons from a broker’s research report. We have taken a number slightly more advantageous to the company.

**Exhibit 8 – DS sales volume in 2020**



	2018	2019	2020
<b>模具钢 DS</b>			
营收 (亿元)	20.95	22.21	23.51
毛利 (亿元)	5.13	5.75	6.61
毛利率 (%)	24.50%	25.90%	28.10%
销量 (万吨)	14.857	16.957	18.169
Sales volume (0,000 tons)	1.41	1.31	1.294
<b>高速钢</b>			
营收 (亿元)	7.82	7.91	7.75
毛利 (亿元)	1.67	1.98	2.18
毛利率 (%)	21.40%	25.00%	28.10%
销量 (万吨)	2.46	2.46	2.27
价格 (万元/吨)	3.18	3.21	3.41

Source: <https://www.gelonghui.com/news/506658> (left)  
<https://max.book118.com/html/2021/1117/5012041032004112.shtml>, p.20 (right)

➤ Data from the July 2021 Environmental Report were those of 2015?

In the July 2021 Environmental Report, TG Aihe discloses its current scrap steel and rare metals consumption of 132.7k tons in total. The second “clarification” asserted that “the ‘current’ raw material input data were those of 2015” based on a play of Chinese phrase “original (原有)”:

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- The second “clarification” translates the phrase “與項目有關的原有環境污染問題” into “Original Environmental Pollution Issues of the Project”, but in reality it means “environmental pollution issues of existing project related to the Project”;
- The second “clarification” refers to an environmental report submitted in 2016 as the “original” report.

The paragraph in p.26 of the July 2021 Environmental Report says: “The existing project and its environmental procedures including environmental approval and acceptance are fulfilled in the following conditions.” Obviously, the data on the consumption of major raw materials pertain to those for 2020 rather than 2015. Tiangong’s explanation contradicts common sense.

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## Disclaimer

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We are determined to expose as much of the fraud in the Chinese stock market as we can. The most widespread and serious fraud is probably that undertaken by listed companies, in fabricating non-existent businesses and stealing shareholders money, among other tricks.

In exposing these crimes we challenge the listed companies to prove the integrity of their announcements and financial statements. The listed companies, of course, want everybody to believe that their announcements and financial statements are true. Their auditors, employees, independent directors, lawyers, shareholders and even the general public all hope that these announcements and financial statements are true.

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