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Qianhai Health Holdings Limited

前海健康控股有限公司

(incorporated in the Cayman Islands with limited liability)

(Stock Code: 911)

SUPPLEMENTAL ANNOUNCEMENT TO ANNUAL RESULTS ANNOUNCEMENT AND ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2022

Reference is made to (i) the announcement (the “**Announcement**”) of Qianhai Health Holdings Limited (the “**Company**”, together with its subsidiaries, the “**Group**”) dated 20 February 2023 regarding the change of auditor of the Company; (ii) the annual results announcement (the “**Annual Results Announcement**”) of the Company for the year ended 31 December 2022 dated 31 March 2023; and (iii) the annual report (the “**Annual Report**”) of the Company published on 27 April 2023. Capitalised terms used herein shall have the same meanings as those defined in the Annual Report unless the context requires otherwise.

The Company would like to supplement the Annual Results Announcement and the Annual Report with the following information in relation to (i) the Electronic Component Business, in particular with respect to back-to-back procurement business; (ii) the provision for inventory and provision for onerous contracts; and (iii) audit procedures performed by McMillan Woods (Hong Kong) CPA Limited (“**McMillan**”), the new auditor of the Company, to address the Audit Issue (as defined below).

ELECTRONIC COMPONENT BUSINESS

Business model and the Group’s comparative advantages on back-to-back procurement

As disclosed on page 22 of the Annual Report, apart from bulk procurement based on the Group’s estimations as to, among others, the general market trends, the Group’s inventory procurement policy also includes back-to-back procurement based on purchase orders confirmed by its customers. Under such business model, the Group generally makes a purchase order only upon receipt of a corresponding order from its customer.

The Group's sales team consists of a seasoned management team with in-depth experience in the electronic components industry. Our Directors, namely Mr. Huang Guanchao, Mr. Lim Tzea and Mr. Chen Li Kuang, possess over 20 years of management experience in international trading and distribution of electronic components. Biographical details of these Directors are set out on pages 10 and 11 of the Annual Report. On the other hand, the Group's sales staff possess 10 to 20 years of experience in the electronic components industry and extensive work experience gained in a Hong Kong-based global electronic components trading and distribution group and other electronic components distributors. Leveraging on the extensive experience of the sales team of the Group, the Group has established an extensive Hong Kong-based global electronic components trading network. As such, the Group has different competitive advantages including (a) having a strong network with suppliers which can ensure a steady supply chain and better inventory control; (b) enhancing the opportunities in receiving regular first-hand information on the latest products; and (c) getting a more competitive price for customers by comparing the prices set by various suppliers and selecting the one who offers a more favourable price.

In addition, the Group has accumulated experience and industrial knowledge to source the right electronic components products at the right timing and the right price which is vital for the Group's operation having considered the volatile pricing of electronic components products. Under the back-to-back procurement business model, the Group makes a purchase order only after there is a corresponding order from customers. The Group liaises with the appropriate supplier to source the required products from them based on its experience and knowledge at the right timing to ensure a favourable price. This minimises the possibility of loss-making sales as the time lag between the Group's receipt purchase orders from customers and the Group's placement of purchase order with suppliers is shortened to avoid the possibility of significant fluctuation in market price of the relevant product.

On the other hand, the Group has accumulated comprehensive market intelligence and knowledge on the requirements of downstream manufacturers by having frequent communication with its customers. As such, the experienced sales team has been able to prompt customers to approach and place sales order with the Group and respond to the specific demand from customers swiftly by sourcing the appropriate electronic components products with suppliers. Moreover, as the Group understands the needs of its customers well, the Group is able to provide, along with its sale of electronic components, to provide additional value-added services, i.e. additional warehousing and quality control services, and consultation and product application advisory services as to different aspects to satisfy customers' specific needs.

The Directors are of the view that the abovementioned comparative advantages of the Group would enable the Group to attract new customers so as to expand its customer base. In addition, the Group has been actively participating in trading fairs to increase its exposure and establish relationships with different potential customers. There has also been continual referral by word of mouth, given the Group's quality services and long-term relationships with the existing customers. These further help expand the Group's customer base.

PROVISION FOR INVENTORY AND PROVISION FOR ONEROUS CONTRACTS

As disclosed in the Annual Report, the Group recognised a one-off provision for inventory of approximately HK\$238.0 million and a one-off provision for onerous contracts of approximately HK\$93.2 million during the Year. Provisions made with respect to inventory and onerous contracts for the Year mainly related to the electronic components products purchased from the Supplier between May and July 2022 (“**Supplier Products**”).

The Group has risk management and internal control systems in place to minimise the risk exposure on purchase price of the products that it purchases and to safeguard its assets. For example, the Group would monitor the market price of the relevant products every week, and may not make any further procurement in the event that the market price is lower than the purchase price quoted from the Group’s suppliers. In addition, according to the Group’s inventory procurement policy, there is a combination of (i) back-to-back procurement based on purchase orders confirmed by its customers; and (ii) bulk procurement based on the Group’s estimations as to, among others, the general market trends. The Group would review and assess its product portfolio and product mix from time to time in order for the inventories in stock to be in line with the demand of the Group’s customers based on their feedback and market information collected, and thus to minimise the risk of having any aging inventories and/or onerous contracts.

When the market price of the relevant products is stable or is in an increasing trend, with no adverse factors that cause the Group to believe the market price of the relevant products would decrease upon subsequent receipt thereof, the Group would make bulk procurement with an expectation that the Group would be able to make subsequent profitable sales. On the other hand, when the market price of the relevant products falls below its purchase price, the Group would generally decide to (i) stop making further bulk purchase and subsequent sales of products that were previously purchased through bulk purchase; and (ii) shift its sales focus from sales of products previously bought in bulk purchase to sales of products on back-to-back basis in order to minimise the possibility of loss-making sales, and maximise the chance of making profitable sales. Despite that it is the Group’s intention not to sell any product that was bought at a higher purchase price at the time when the market price thereof was lower, the Group may sell such products in the event that the Group considers such sales are necessary to generate cash flow to satisfy capital required for purchase of further products and to support general working capital needs.

When the market price of the product that the Group previously purchased falls below the purchase price of such product, the Group would consider making the appropriate provision after considering the factors, basis and assumptions that were listed out in (i) the paragraph headed “Key audit matters” under the section headed “Independent Auditor’s Report” in the Annual Report; and (ii) notes 2.19 and 2.20 to the consolidated financial statements of the Company for the year ended 31 December 2022.

Given that (i) the Directors consider more appropriate to re-sell inventories later when their market price resumes at profitable level, instead of at a price that is below the purchase price, in order to safeguard the best interests of the Company and its shareholders as a whole, resulting in the Group shifting sales focus to profitable sales of electronic components products purchased on back-to-back basis during the period between July and December 2022 as there was a significant slowdown of semi-conductor industry in second half of 2022, instead of selling the Supplier Products; and (ii) the subsequent sales of the Supplier Products are necessary to generate cash flow to satisfy capital required for purchase of further products and to support general working capital needs, the Directors are of the view that the risk management and internal control systems of the Company are effective to assess and manage the risk exposure on purchase price of its products in general.

In addition, having considered that (i) it is in the ordinary and usual course of business for the Group to place purchase contracts with its suppliers and re-sell the same to the Group's customers; (ii) the terms and conditions of the purchase contracts placed with the suppliers of the Group are in line with the industry norm; and (iii) the Group had been able to re-sell the electronic components products purchased from its suppliers to its customers since the commencement of the Electronic Components Business in 2019 and during the Year in general which proves that there was genuine demand in the electronic components products that the Group purchased, the Directors are of the view that:

- (a) it is commercially reasonable for the Group to place purchase contracts with the suppliers;
- (b) the terms and conditions of the purchase contracts with the Group's suppliers are fair and reasonable;
- (c) it is in the interests of the Company and its shareholders as a whole for procuring electronic components products either in bulk or back-to-back basis; and
- (d) the Directors have generally fulfilled their obligations to safeguard the Group's assets.

AUDIT PROCEDURES

As disclosed in the Announcement, RSM Hong Kong (“**RSM**”) resigned as the auditor of the Company since RSM was not able to perform the reperformance of counting according to their planned level and extent (the “**Audit Issue**”). Hence, RSM considered that they were unable to discharge their responsibilities and complete the audit as auditor.

In view of the above difficulties, McMillan designed certain audit procedures to address the Audit Issue which are summarised below:

Procedures taken	Results of audit procedures
<p>Understanding the operation of the Group’s warehouse, including (i) making enquiry with the Group’s warehouse supervisor; (ii) obtaining walkthrough of the goods-receipt and delivery procedures; and (iii) touring around the warehouse.</p>	<p>McMillan confirmed the situation is in-line with the Group’s representation and the Audit Issue, that (i) the products in the warehouse are mainly wafers and similar products (the “Products”); (ii) the goods received are not unpacked for verification of quantity and conditions; (iii) the cautious labels found on the Products stated the Products must be stored under a required range of temperature and humidity level, and unpackaging of the polypropylene bags of the Group’s inventory items (“Unpackaging”) can only perform inside a dust-free control room; and (iv) there is no dust-free control room in the Group’s warehouse. Other than the above, the Products were arranged in an orderly manner and there was no significant weakness noted by McMillan.</p>
<p>Observation of physical counting by the Group.</p> <p>Before the physical counting, McMillan received the inventory listing of the Products as of 23 February 2023, and performed the below procedures during the physical counting:</p> <ul style="list-style-type: none"> – Checked the identity of the Group’s warehouse staff (“Counters”) against listing of payroll; – Tested whether the Counters have sufficient knowledge about the inventories; – Reconfirmed with the Counters if the inventory listing before counting was final and conclusive; 	<p>No discrepancy was noted during the observation of physical counting. Coverage of the physical count amounted to 78.15% based on the unadjusted carrying amount of the inventory. The result is satisfactory.</p>

Procedures taken	Results of audit procedures
<ul style="list-style-type: none"> – Instructed the Counters to count the item of inventory and unpacked the boxes on List to Floor basis in accordance with McMillan’s predetermined samples selected; – Instructed the Counters to count the item of inventory and unpacked the boxes on Floor to List basis in accordance with McMillan’s predetermined number of target; – Checked the descriptions and quantity of those items of inventory being counted against the inventory listing; – Recorded and photo shooting of the serial numbers appeared on the packing of each item of inventory being counted for further verification work; – Obtained supporting document for the latest movements of the warehouse immediately before the inventory count; and – Agreed the count result with the Counters and endorsed on the inventory listing. 	
<p>Confirmations were sent to customers and suppliers of the Group to confirm the year-end amounts due and the volume of transaction during the Year, with appendix detailing the serial numbers of the goods supplied from the suppliers.</p>	<p>Over 99% confirmations sent were received with no discrepancy.</p>
<p>Interviews with the major customers and suppliers of the Group, as to confirm:</p> <ul style="list-style-type: none"> – The industry norms of the goods-receipt and goods delivery procedures as a trader, whether Unpackaging is required; 	<p>Interviews were arranged successfully with 76% of customers and 98% of suppliers based on the transaction amount for the Year.</p> <p>Unpackaging is not necessary in the industry, and certain customers suggested that the Products may no longer be marketable after Unpackaging.</p>

Procedures taken	Results of audit procedures
<ul style="list-style-type: none"> – For Products supplied to the major customers, including those subsequent to 31 December 2022, any defected products were supplied to the major customers. 	<p>The customers confirmed that no abnormal level of defects were noted or returned to the Group ever happened.</p>
<p>McMillan engaged a third-party testing company in the PRC to perform the Unpackaging of two bags of selected Products.</p> <p>McMillan sent a representative to site visit the testing company and performed the follows:</p> <ul style="list-style-type: none"> – Matched the serial number of the Products and confirmed these are items selected by McMillan; and – Walk-through the laboratory and witnessed the Unpackaging. 	<p>McMillan witnessed the Unpackaging procedure and received confirmation from the testing company that the quantity and specification of the samples tested matched the description of the selected Products.</p>

Having considered the satisfactory results obtained by McMillan during performing its audit procedures, in particular:

- (i) it is confirmed that the cautious labels found on the Products stated the Products must be stored under a required range of temperature and humidity level, and Unpackaging can only be performed inside a dust-free control room;
- (ii) it is confirmed that there is no dust-free control room in the Group’s warehouse;
- (iii) the observation of relatively high coverage of physical counting of inventory at the Group’s warehouse is found to be satisfactory;
- (iv) major customers and suppliers of the Group confirmed that Unpackaging is not necessary in the industry, and certain customers suggested that the Products may no longer be marketable after Unpackaging; and
- (v) McMillan witnessed the Unpackaging procedures and received confirmation from the testing company that the quantity and specification of the samples tested matched the description of the selected Products,

despite the fact that McMillan did not unpack any other Products during its audit process of the Company's consolidated financial statements for the Year, apart from the abovementioned Unpackaging of two bags of selected Products, McMillan is of the view that the abovementioned audit procedures have sufficed their audit work with respect to inventory count in order for them to discharge their responsibilities and complete the audit as auditor. In addition, there had been no material adverse findings therefrom upon completion of the audit procedures taken by McMillan to address the Audit Issue, McMillan, and the Audit Committee concurs, that the Audit Issue has been fully addressed.

The above additional information does not affect other information contained in the Annual Results Announcement and the Annual Report. All other information in the Annual Results Announcement and the Annual Report remains unchanged.

By order of the Board
Qianhai Health Holdings Limited
Huang Guanchao
Chairman

Hong Kong, 7 June 2023

As at the date of this announcement, the non-executive Directors are Mr. Huang Guanchao, Mr. Lim Tzea, Mr. Chen Kaiben and Mr. Chen Qi; the executive Director is Mr. Chen Li Kuang and the independent non-executive Directors are Mr. Li Wei, Mr. Yuen Chee Lap Carl and Mr. Leung Chun Tung.