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CAPITAL

June 11, 2020

Mr. Daniel Yu-Cheng Wang,
Executive Vice President and Chief Financial Officer
Hua Hong Semiconductor
288 Halei Road, Zhangjiang Hi-Tech Park,
Shanghai, China, 201203

Dear Mr. Wang,

Greetings from Hong Kong. We hope you and your company are well. As a shareholder of Hua Hong Semiconductor (the "Company") since 2014, we sincerely appreciate the value that the Company has created over the years. We are also grateful for management's regular and open communication with us, which has showcased your leadership qualities and management's executive capabilities. In the spirit of openness, we would like to make some observations that you might already be aware of, and we hope that by considering them Hua Hong might further enhance shareholder value in the years ahead.

1. Investor communication and information disclosure

a. Investor relations section in the annual report and newsletter update

As a best practice, companies are increasingly adding an investor relations section to their annual reports. We believe that adding this section would further improve Hua Hong's communication with investors. Furthermore, the Company publishes frequent business and industry updates on its corporate website. Hua Hong has the opportunity to combine these updates into a regular investor newsletter, as other companies do, to further enhance investor interaction. We highly recommend that the Company to consider these best practices.

b. Raw materials and supply chain management disclosure

We believe that additional information on key raw materials, suppliers and procurement processes/practices would allow investors to better understand the Company's positioning in the semiconductor supply chain. This would not only fulfil the environmental aspects of the increasing ESG requirement, but would also allow investors to assess the Company's business risk in light of growing U.S.–China trade tension.

c. **Shanghai Huali disclosure and opportunities**

According to company filings since 2010, the Company has made an investment in Shanghai Huali Microelectronics ("HLMC"), a 6.3 percent stake that is worth roughly USD205 million. Reviewing Huali's production capacity, process technologies, and recent deal transactions in the industry, we believe that Huali's market value to be significantly higher than its acquisition cost. If reflected on the balance sheet, the Company's book value might increase by over 15 percent. We recommend that the Company improves disclosure on this investment so that investors can better gauge its true worth.

2. **Improve return on equity through share buyback**

The Company's ROE has recently fallen to 3.6 percent. We note that this is temporary due to higher capital expenditure and increasing depreciation cost. Our analysis suggests that the Company's ROE will normalize at roughly 13 percent in 2 years when its new production facility ramps up. However, global peers have an average ROE of 15 percent or better. To be competitive with them in attracting new investors, we recommend that the Company explores a share buyback program. Based on our free cash flow and balance sheet calculations, the Company has room to deploy USD250 million in the program. If this exercise were to take place, ROE would reach the industry average.

3. **Increasing liquidity to attract a larger investor base**

Our discussions with a number of investment funds suggest that increasing the Company's share float would greatly improve the stock's liquidity and investor interest. The Company currently has a public float of 34 percent, with the remaining 64 percent held by strategic and long-term investors. We understand that the China National IC Fund is a strategic partner, and we would like to ask whether Sino Alliance and NEC are also strategic partners. One option is to work with these shareholders to see if they are willing to place shares on the open market to improve liquidity. Alternatively, the Company could repurchase shares from one or more of them. We believe these actions could create more investor demand and/or shareholder value, leading to stronger stock performance.

In light of SMIC's recently announced intention to dual-list on the Shanghai exchange, the Company might also consider this option to increase liquidity. While the average P/B ratio for comparable semiconductor stocks in the A-Share market is over 6x, and the Company only trades at 1.3x, this would greatly narrow the valuation gap between the two markets.

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We look forward to continuing our constructive dialogue. If you have any questions regarding our proposals, please do not hesitate to contact us.

Many thanks for your kind attention.

Sincerely,

Ronald Chan
Chief Investment Officer
Chartwell Capital Limited

William Tsang
Head of Research / Portfolio Manager
Chartwell Capital Limited