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HUA HONG SEMICONDUCTOR LIMITED

華虹半導體有限公司

(Incorporated in Hong Kong with limited liability)

(Stock Code: 01347)

CONNECTED TRANSACTION IN RELATION TO THE 2023 TECHNOLOGY DEVELOPMENT AGREEMENT

THE 2023 TECHNOLOGY DEVELOPMENT AGREEMENT

The Board is pleased to announce that HHGrace, a wholly-owned subsidiary of the Company, has entered into the 2023 Technology Development Agreement with Huali Micro on 1 December 2023, pursuant to which Huali Micro has agreed to provide HHGrace with a non-exclusive licence to use the Technological Know-how together with ancillary technical consulting services in support of Hua Hong Manufacturing's production line of 12-inch (300mm) wafers with 40 nm processes.

IMPLICATIONS UNDER THE LISTING RULES

Huali Micro is 53.85% owned by Huahong Group, a substantial shareholder of the Company. Accordingly, Huali Micro is a connected person of the Company and the entering into of the 2023 Technology Development Agreement constitutes a connected transaction of the Company under Chapter 14A of the Listing Rules.

As one or more of the applicable percentage ratios (as defined in the Listing Rules) in respect of the entering into of the 2023 Technology Development Agreement exceeds 0.1% but is less than 5%, the entering into of the 2023 Technology Development Agreement is subject to the reporting and announcement requirements, but is exempted from the circular and independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

As at the date of this announcement, none of the Directors has material interest in the above transactions. Except Mr. Suxin Zhang, Mr. Junjun Tang and Mr. Guodong Sun, who were required to abstain from voting pursuant to the Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of the Shanghai Stock Exchange, no director was required to abstain from voting at the Board meeting approving such transaction.

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The major terms of the 2023 Technology Development Agreement are set out as below:

Date: 1 December 2023

Parties: (i) HHGrace; and
(ii) Huali Micro

Services Provided: To support Hua Hong Manufacturing's production line of 12-inch (300 mm) wafer with 40 nm processes, Huali Micro agrees to provide the following services:

- (i) a non-exclusive licence to HHGrace and its controlled or consolidated subsidiaries (including Hua Hong Manufacturing) to use the Technological Know-how; and
- (ii) providing ancillary technical consulting services to HHGrace and its controlled or consolidated subsidiaries (including Hua Hong Manufacturing), including procurement consulting services, consulting services on equipment, know-how and software and consulting services on the introduction of Technological Know-how (including online consultation sessions and on-site support).

For the avoidance of doubt, if HHGrace intends to sub-license the Technological Know-how to any connected subsidiary, it shall re-comply with the applicable requirements under Chapter 14A of the Listing Rules.

Payment Terms: HHGrace shall pay Huali Micro a consideration between RMB110 million and RMB180 million (inclusive of tax), which was determined and agreed between the parties on an arm's length basis by making reference to the Valuation Report prepared by the Valuer based on the income approach after implementation of valuation procedures including checking and verification, market research and assessment and estimation and taking into account the market conditions. The consideration shall be paid in accordance with the following timeline:

- (i) 50% of the total amount within 30 days upon receipt of an invoice from Huali Micro; and
- (ii) 50% of the total amount upon receipt of an invoice issued by Huali Micro once the delivery and acceptance are completed in accordance with the terms set out in the 2023 Technology Development Agreement.

REASONS FOR AND BENEFITS OF ENTERING INTO THE 2023 TECHNOLOGY DEVELOPMENT AGREEMENT

As set out in the announcement of the Company dated 18 January 2023 and the circular of the Company dated 24 February 2023, Hua Hong Manufacturing will engage in the business of manufacturing and sale of integrated circuits and 12-inch (300mm) wafers mainly adopting 65/55 nm to 40 nm processes. Thereafter, Hua Hong Manufacturing entered into the Hua Hong Manufacturing EPC Contract in relation to, amongst other things, the construction of a production plant, power facilities and ancillary facilities with a view to developing its own production line to manufacture 12-inch (300mm) integrated circuit chips. For further details, please refer to the announcement of the Company dated 19 May 2023 and the circular of the Company dated 5 June 2023.

Although the production line of Hua Hong Manufacturing is currently under construction, to accelerate the research and development and mass production of 12-inch (300mm) wafers with 40 nm processes, Hua Hong Manufacturing would require the Technological Know-how together with ancillary technical consulting services for the development of its production line.

Huali Micro and its subsidiary principally engage in the production of 12-inch (300 mm) wafers adopting processes of 65/55 nm to 28 nm (both inclusive). Therefore, HHGrace also considers that Huali Micro possesses the necessary professional qualifications and extensive experience in providing the Technological Know-how and facilitating the smooth implementation of the work for Hua Hong Manufacturing's production line. Therefore, HHGrace proposes to enter into the 2023 Technology Development Agreement to engage Huali Micro in granting a non-exclusive licence to use the Technological Know-how together with ancillary technical consulting services in support of the 12-inch (300mm) production line of Hua Hong Manufacturing.

Having reviewed the terms of the 2023 Technology Development Agreement, the Directors (including the independent non-executive Directors) are of the view that:

- (a) the terms of the 2023 Technology Development Agreement are fair and reasonable;
- (b) the entering into of the 2023 Technology Development Agreement is on normal commercial terms or better and in the ordinary and usual course of business of the Company; and
- (c) the entering into of the 2023 Technology Development Agreement is in the interest of the Company and its Shareholders as a whole.

VALUATION

The valuation of the Intangible Asset was prepared using income approach as at 31 August 2023 (the "**Valuation Benchmark Date**").

In terms of valuation methodology, the Valuer has considered three generally accepted valuation approaches used for intangible assets, including cost approach, market approach and income approach.

Cost approach is a method that values intangible assets by estimating the replacement cost and the depreciation rate of the intangible assets. The costs of intangible assets include all materialized labor and living labor expenses during the development and possession period. Due to the incompleteness, weak correspondence and virtuality of their costs, the valuation results under the cost approach may not be able to accurately reflect the market values of intangible assets. Therefore, the cost approach is not adopted for the present valuation.

Market approach is a method that determines the values of intangible assets by comparing the intangible assets with the transactions of comparable intangible assets and making corrections. As it is difficult to collect details of transactions of similar intangible assets in the relevant market, the market approach is not adopted for the present valuation.

Income approach is a method that allows the Valuer to capitalise or discount the expected income of the intangible asset to determine its value, which is appropriate to reflect the specific characteristics of the intangible asset. The Valuer adopted the relief-from-royalty method under the income approach to determine the value of the Intangible Asset based on the discounted estimated royalty payments that are expected to be avoided as a result of the Intangible Asset being owned.

The Valuer sets out the major valuation parameters and the key assumptions, including sales commission percentage, forecasted earnings period and discount rate, in arriving at the valuation. The basic model of this evaluation is:

$$P = \sum_{i=1}^n \frac{R_i}{(1+r)^i} \times K \times \lambda$$

In this formula:

P: Value of the Intangible Asset

R_i: Forecasted revenue generated from sales of products (services) using intangible asset in year

K: Sales commission percentage

i: Discount period

r: Discount rate

n: Income period

λ: Contribution ratio of the Intangible Asset among all technology assets

(i) Sales commission percentage

In view of the the market price of the comparable products in the industry and the estimated market share of the proposed construction project, the sales commission percentage is calculated on the basis of the average sales commission percentage multiplied by an adjustment coefficient, being 5.90%.

(ii) Income period

In determination of the income period, the Valuer has analysed the characteristics of the Intangible Assets, taking into account the patent types, the legal protection period and the technology update cycle (whichever is shorter), and the decaying influence of the technology in the future. The income period of the Intangible Assets is from September 2023 to December 2032.

(iii) Discount rate

The valuation adopts the Capital Asset Pricing Model (“CAPM”) to determine the discount rate. With reference to the Valuation Report, the Valuer has applied the weighted average cost of capital plus a specific risk premium plus an intangible asset risk premium. The nominal discount rate of the Intangible Asset is 19.50%, which is applied to nominal post tax cash flows. The discount period equals to the income period.

(a) Risk-free rate (*rf*)

The Valuer adopted 2.56% as risk-free rate, which is based on the average interest rate of the ten-year government bond.

(b) *Be*

In view of the industry of the valuation target, the Valuer adopted 1.0531 as the beta coefficient based on comparable companies with certain criteria.

(c) Market risk premium

The market risk premium is 8.48%, which is calculated based on the expected market rate of return minus the risk-free rate.

(d) Specific risk premium

Considering the specific risks including the project is a high-tech industrial project, which is characterized by high investment in fixed assets, strong equipment-specific type, the production and operation are greatly affected by the macroeconomic environment and the demand for downstream products, and there are uncertainties in investing in this project, the Valuer has applied an additional 4% specific risk premium.

(e) Intangible asset risk premium

A further 4% intangible asset risk premium is added to reflect the higher risk of the Intangible Assets.

Since the appraisal of the fair value of the consideration in the Valuation Report is reached by adopting the income approach, such valuation constitutes a profit forecast under Rule 14.61 of the Listing Rules. An extract of the Valuation Report containing the principal assumptions (including commercial assumptions on which such profit forecast is based) for preparing such valuation, the letter from Ernst & Young, auditor of the Company, and the letter from the Board in relation to such profit forecast as required under the Listing Rules are set out as Appendices I, II and III incorporated and appended to this announcement respectively.

The following are the qualifications of the Valuer and Ernst & Young:

Name	Qualification
China United Assets Appraisal Group Co., Ltd. (中聯資產評估集團有限公司)	Qualified Asset Valuer in the PRC
Ernst & Young	Certified Public Accountants

IMPLICATIONS UNDER THE LISTING RULES

As at the date of this announcement, Huali Micro is 53.85% owned by Huahong Group, a substantial shareholder of the Company. Accordingly, Huali Micro is a connected person of the Company and the entering into of the 2023 Technology Development Agreement constitutes a connected transaction of the Company under Chapter 14A of the Listing Rules.

As one or more of the applicable percentage ratios (as defined in the Listing Rules) in respect of the entering into of the 2023 Technology Development Agreement exceeds 0.1% but are all less than 5%, the 2023 Technology Development Agreement is subject to the reporting and announcement requirements, but is exempted from the circular and independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

As at the date of this announcement, none of the Directors has material interest in the above transaction. Except Mr. Suxin Zhang, Mr. Junjun Tang and Mr. Guodong Sun, who were required to abstain from voting pursuant to the Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of the Shanghai Stock Exchange, no Director was required to abstain from voting at the Board meeting approving such transaction.

INFORMATION ABOUT THE PARTIES

The Company

The Company primarily focuses on embedded non-volatile memory, power discrete, analog & power management, logic & RF and other specialty technology manufacturing platforms.

HHGrace

HHGrace is a wholly foreign owned enterprise incorporated in the PRC on 24 January 2013 and a wholly-owned subsidiary of the Company. The principal business of HHGrace is to research, develop, manufacture and sell semiconductors as a pure-play foundry.

Huali Micro

Huali Micro is 53.85% owned by Huahong Group, a substantial shareholder of the Company. Huali Micro's principal business is developing and operating a 12-inch (300mm) wafer fab.

DEFINITIONS

In this announcement, the following words have the following meanings unless the context requires otherwise:

“2023 Technology Development Agreement”	the technology development agreement entered into between HHGrace and Huali Micro on 1 December 2023
“Board”	the board of directors of the Company
“Company”	Hua Hong Semiconductor Limited, a company incorporated in Hong Kong with limited liability on 21 January 2005, the Shares of which are listed on the main board of the Stock Exchange and the Science and Technology Innovation Board of the Shanghai Stock Exchange
“connected person(s)”	has the meaning as ascribed to it under the Listing Rules
“Director(s)”	the director(s) of the Company
“HHGrace”	Shanghai Huahong Grace Semiconductor Manufacturing Corporation (上海華虹宏力半導體製造有限公司), a wholly foreign-owned enterprise incorporated in the PRC on 24 January 2013 and a wholly-owned subsidiary of the Company
“Hong Kong”	Hong Kong Special Administrative Region of the PRC
“Hua Hong Manufacturing”	Hua Hong Semiconductor Manufacturing (Wuxi) Co., Ltd.* (華虹半導體製造(無錫)有限公司), a company incorporated in the PRC on 17 June 2022 and a non-wholly-owned subsidiary of the Company
“Hua Hong Manufacturing EPC Contract”	the agreement dated 19 May 2023 entered into between Hua Hong Manufacturing, Shanghai Construction No. 4 (Group) Co., Ltd. (上海建工四建集團有限公司) and The IT Electronics Eleventh Design & Research Institute Scientific and Technological Engineering Corporation Limited (信息產業電子第十一設計研究院科技工程股份有限公司) in relation to the engineering, procurement and construction work of Hua Hong Manufacturing’s production line of 12-inch (300 mm) wafers mainly adopting 65/55 nm to 40 nm processes

“Huahong Group”	Shanghai Huahong (Group) Co., Ltd. (上海華虹(集團)有限公司), a company incorporated in the PRC on 9 April 1996 as Shanghai Hua Hong Microelectronics Co., Ltd. and renamed as Shanghai Huahong (Group) Co., Ltd. in 1998, and a substantial shareholder of the Company. It is ultimately owned as to 58.76%, 15.64%, 15.64% and 9.96% by Shanghai SASAC, Shanghai International Group Corporation Limited (上海國際集團有限公司), Shanghai Guosheng Group Co., Ltd (上海國盛(集團)有限公司) and INESA (Group) Co., Ltd. (上海儀電(集團)有限公司), respectively, all of which are wholly-owned subsidiaries of Shanghai SASAC
“Huali Micro”	Shanghai Huali Microelectronic Co. Ltd. (上海華力微電子有限公司), a company incorporated in the PRC on 18 January 2010 which is 53.85% owned by Huahong Group, and a connected person of the Company
“Listing Rules”	The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
“PRC”	the People’s Republic of China, but for the purposes of this announcement only, excludes Hong Kong, Macau and Taiwan
“RMB”	Renminbi, the lawful currency of the PRC
“Shanghai SASAC”	Shanghai Municipal State-owned Assets Supervision and Administration Commission (上海市國有資產監督管理委員會)
“Shareholders”	holder(s) of Shares
“Shares”	shares of the Company
“Stock exchange”	The Stock Exchange of Hong Kong Limited
“subsidiary”	has the meaning as ascribed to it under the Listing Rules
“substantial shareholder”	has the meaning as ascribed to it under the Listing Rules
“Technological Know-how” or “Intangible Asset”	the 40 nm logic technology and technological know-how as well as all intellectual property rights included thereunder (including but not limited to patents and technological secrets) of Huali Micro
“US\$”	United States dollar, the lawful currency of the United States

“Valuation Report”	the asset valuation report in respect of the non-exclusive licence to use the Technological Know-how owned by Huali Micro dated 29 November 2023 prepared by the Valuer
“Valuer”	China United Assets Appraisal Group Co., Ltd. (中聯資產評估集團有限公司)
“%”	per cent

By order of the Board
Hua Hong Semiconductor Limited
Mr. Suxin Zhang
Chairman and Executive Director

Hong Kong, 1 December 2023

As at the date of this announcement, the Directors of the Company are:

Executive Directors

Suxin Zhang (*Chairman*)

Junjun Tang (*President*)

Non-executive Directors

Guodong Sun

Jun Ye

Independent Non-executive Directors

Stephen Tso Tung Chang

Kwai Huen Wong, JP

Long Fei Ye

* *For identification purposes only*

APPENDIX I

EXTRACT OF THE VALUATION REPORT CONTAINING THE PRINCIPAL ASSUMPTIONS ON WHICH THE VALUATION BY INCOME APPROACH WAS MADE

Note: Unless the context otherwise defines, “client” represents HHGrace and “appraiser” represents the Valuer in this appendix.

(I) General Assumptions

1. *Transactional Assumption*

The transaction assumption assumes all assets to be valued are in the course of transaction and the valuation assessed by the appraiser is based on simulated market including terms of transaction of such assets. The transaction assumption is one of the most fundamental assumptions for conducting asset valuation.

2. *Open Market Assumption*

The open market assumption assumes that the parties to the assets transaction or the proposed assets transaction in the market have equal bargaining power and have the opportunities and time to obtain sufficient market information in order to make a rational and informed judgment on the assets, including their functions, uses and transaction prices. The basis of open market assumption is that the assets can be traded openly in the market.

3. *Asset Going-concern Assumption*

The asset going-concern assumption means that the valuation method, parameters and basis shall be determined on the premise that the valued assets will be continuously used in consistence with their current functions and methods, scale, frequency and environment of application, or used on the basis of certain changes thereof.

(II) Special Assumptions

1. It is assumed in this valuation that the external economic environment remains unchanged and there are no significant changes in current macroeconomic conditions of the country;
2. This valuation of the assets is based on the premise of the actual stock as at the valuation benchmark date, and the valid domestic prices as at the valuation benchmark date are used as the basis for the prevailing market prices of such intangible assets;

3. It is assumed in this valuation that all basic information and financial information provided by the client and the title holder are true, correct and complete;
4. The scope of valuation shall only be limited to the declaration form of valuation provided by the client and the title holder, without taking into consideration any possible contingent assets or liabilities not included in the lists provided by the client and the title holder;
5. The impact of inflation has not been considered in arriving at the parameter values in this valuation;
6. There are no material changes to tax-related policies of relevant intangible asset products;
7. The management team of the future holder of the intangible assets will perform its duties satisfactorily and continue to maintain the business as a going-concern under a reasonable business operation model;
8. This valuation is conducted based on product sales revenue provided by the client, without considering the impact of the changes in specific production business scale attached to the future intangible assets and the changes in conditions on the value of the intangible assets;
9. It is assumed in this valuation that the related state policies on the development of the integrated circuit manufacture industry remain unchanged, and the client made their forecast on the sales revenue of the future products in the intangible asset portfolios on this basis;
10. It is assumed in this valuation that the client's judgments on technology, product application prospects and development trends in the Hua Hong Wuxi Project and the actual future situation have no significant differences. The valuation subject shall implement the report as planned. The total investment in the Hua Hong Manufacturing construction project is US\$6.7 billion. The client is committed to construct a 12-inch integrated circuit chip production line that reaches a capacity of 83,000 chips per month, which supports the application of technologies in emerging areas such as automotive, industrial etc; and
11. It is assumed in this valuation that the contribution ratio of the appraisal technology is reasonable. The appraised technology refers to the main technology used during the manufacturing processes of the integrated circuit products of HHGrace only. The contribution ratio of each technology among all technology assets has been determined based on the interview with professional staff of the client and the advice from the client.

If there is any change in the aforesaid conditions, the valuation results shall become invalid.

APPENDIX II LETTER FROM ERNST & YOUNG

REPORT FROM REPORTING ACCOUNTANTS ON THE DISCOUNTED CASH FLOW FORECAST IN CONNECTION WITH THE VALUATION OF THE NON-EXCLUSIVE LICENSE VALUE PROJECT TO UTILISE THE TECHNOLOGICAL KNOW-HOW OWNED BY SHANGHAI HUALI MICROELECTRONIC CO. LTD.

To the Directors of Hua Hong Semiconductor Limited

We have been engaged to report on the arithmetical accuracy of the calculations of the discounted cash flow forecast (the “**Forecast**”) on which the valuation dated 29 November 2023 prepared by China United Assets Appraisal Group Co., Ltd. in respect of the non-exclusive license to utilise the process technological know-how owned by Shanghai Huali Microelectronics Corporation (the “**Intangible Asset**”) as at 31 August 2023 is based. The valuation is set out in the announcement of Hua Hong Semiconductor Limited (the “**Company**”) dated 1 December 2023 (the “**Announcement**”) in connection with the acquisition of the Intangible Asset. The valuation based on the Forecast is regarded by The Stock Exchange of Hong Kong Limited as a profit forecast under paragraph 14.61 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**Listing Rules**”).

Directors’ responsibilities

The directors of the Company (the “**Directors**”) are solely responsible for the Forecast. The Forecast has been prepared using a set of bases and assumptions (the “**Assumptions**”), the completeness, reasonableness and validity of which are the sole responsibility of the Directors. The Assumptions are set out on Appendix I to the Announcement.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants (“**HKICPA**”), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

Our firm applies Hong Kong Standard on Quality Control 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Reporting Accountants' responsibilities

Our responsibility is to express an opinion on the arithmetical accuracy of the calculations of the Forecast based on our work. The Forecast does not involve the adoption of accounting policies.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised) *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* issued by the HKICPA. This standard requires that we plan and perform our work to obtain reasonable assurance as to whether, so far as the arithmetical accuracy of the calculations are concerned, the Directors have properly compiled the Forecast in accordance with the Assumptions adopted by the Directors. Our work consisted primarily of checking the arithmetical accuracy of the calculations of the Forecast prepared based on the Assumptions made by the Directors. Our work is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing issued by the HKICPA. Accordingly, we do not express an audit opinion.

We are not reporting on the appropriateness and validity of the Assumptions on which the Forecast are based and thus express no opinion whatsoever thereon. Our work does not constitute any valuation of the Intangible Asset. The Assumptions used in the preparation of the Forecast include hypothetical assumptions about future events and management actions that may or may not occur. Even if the events and actions anticipated do occur, actual results are still likely to be different from the Forecast and the variation may be material. Our work has been undertaken for the purpose of reporting solely to you under paragraph 14.62(2) of the Listing Rules and for no other purpose. We accept no responsibility to any other person in respect of our work, or arising out of or in connection with our work.

Opinion

Based on the foregoing, in our opinion, so far as the arithmetical accuracy of the calculations of the Forecast is concerned, the Forecast has been properly compiled in all material respects in accordance with the Assumptions adopted by the Directors.

Ernst & Young

Certified Public Accountants

Hong Kong

1 December 2023

APPENDIX III LETTER FROM THE BOARD

To: Listing Division

The Stock Exchange of Hong Kong Limited
12th Floor,
Two Exchange Square,
8 Connaught Place,
Central,
Hong Kong

Dear Sirs or Madams,

Company: Hua Hong Semiconductor Limited (the “Company”)

Re: Profit Forecast – Letter of Confirmation as required under Rule 14.62(3) of the Listing Rules

We refer to the announcement of the Company dated 1 December 2023 (the “**Announcement**”).

Capitalised terms used herein shall have the same meanings as those defined in the Announcement unless otherwise defined.

We also refer to the Valuation Report prepared by the Valuer based on the income approach, which constitutes a profit forecast under Rule 14.61 of the Listing Rules.

The Board has reviewed the bases and assumptions of the valuation regarding the non-exclusive licence to use the Technological Know-how owned by Huali Micro with the Valuer, for which valuation the Valuer is solely responsible. The Board has also considered the report dated 29 November 2023 issued by Ernst & Young, the auditor of the Company, confirming that, so far as the arithmetical accuracy of the calculations of the discounted cash flows forecast (the “**Forecast**”) on which the valuation is based and concerned, the Forecast has been properly complied in all material respects in accordance with the assumptions set out in the Valuation Report.

On the basis of the foregoing, we are of the opinion that the valuations prepared by the Valuer have been made after due and careful enquires.

By order of the Board
Hua Hong Semiconductor Limited
Mr. Jun Ye
Non-executive Director

1 December 2023