

To the Chairman of Hollysys Automation Technologies Ltd., Mr. Jianfeng He, the Board of Directors, the Chief Executive Officer Mr. Baiqing Shao, Senior Management, and Shareholders,

This is an appeal to Hollysys Automation Technologies Ltd. (Nasdaq: HOLI) to reallocate capital to shareholders with a regular dividend and a share buy back program to improve returns for all shareholders and increase the value of the stock.

Heng Ren Investments LP, a friendly activist investing in U.S.-listed Chinese stocks, believes Hollysys can sustain an earnings payout of 40% that will generate an average annual dividend yield of 4.7% during the next four years. In addition, Hollysys can announce a share buyback of up to \$148 million to return capital to shareholders. There would be more than enough cash for operations available. Even if Hollysys revenue contracted at an extreme 25% per annum in a “hard landing” scenario between FY2017 and FY2019, our analysis shows the Company would still generate \$288 million in cash flow. This resilience is due to the high variability of Hollysys' costs, and its large starting cash position in FY2016.

Heng Ren is a long-time shareholder of Hollysys, an emerging leader in industrial automation, control systems and signaling systems for high-speed rail and subways in China. Although Hollysys' development is impressive, in the eyes of stock market investors, Hollysys still needs to prove itself.

Hollysys stock is undervalued at a Price-to-Earnings (P/E) of only 10.2x FY16 earnings.¹ The global peer average is 15.5x², (trailing 12-month earnings), and peers listed on China's A-share stock markets are valued on average at 100x P/E (trailing 12-month earnings). The latter does not indicate a discount for Chinese stocks in Hollysys' promising sector.

Hollysys stock has languished for two years despite strengthening cash flow generation, especially in the near- and mid-term. Heng Ren believes Hollysys' undervaluation is due to an excessive and growing cash pile that is not being deployed to increase value for shareholders. Implementation of a regular dividend along with a buyback program is a logical remedy that would fix this shortcoming and help improve returns.

Hollysys' strong balance sheet is ripe to be utilized. As of December 31, 2015, Hollysys reported \$276 million in cash with \$35 million in debt. Cash is forecasted to increase by 110% to \$579 million by FY2019. If a regular dividend is implemented, along with a share buyback, we believe it will positively impact shareholder returns and shareholder value (the current market capitalization is \$1.1 billion).

Hollysys' capacity for a regular dividend is only increasing. Heng Ren projects Hollysys' total cash flow (from operations, investments, and financing) will increase 164% from \$44 million in FY2015 to \$116 million in FY2019. This is based on our assumption of annual revenue

¹ Note all price data at \$19.24 as of 7-Mar-16. EPS based on Heng Ren forecasts

² Peers include ABB, Siemens, Rockwell and Schneider Electric

growth of 10% through FY2019, well within historical performance and realistic future expectations. This presents Hollysys a welcome opportunity to distribute excess cash to shareholders. Under the current forecast by Heng Ren at a 40% earnings payout ratio, the average annual dividend yield would be 4.7% through FY2016-19.

This is an extremely attractive stream of income to offer investors who would welcome Hollysys' predictability in a stormy sea of Chinese stocks. Heng Ren believes compensating shareholders with some of this excess cash would grow the investor base, close the discount to its peers and intrinsic value, reduce its excessively high cost of capital, and compound returns for shareholders.

Our view is this regular dividend would help more investors appreciate Hollysys' positive attributes – its cash flow generation, its position in growth sectors and strategic value in China – as many current shareholders do.

Accepting the current status quo of irregular special dividends and stock buybacks will only continue the frustration we all share with the chronic undervaluation of Hollysys and dismissal of its strong balance sheet. Our objective is to seek a remedy to convert this discount factor of excess cash into a valuation positive for all of us.

The following analysis by Heng Ren shows Hollysys has the capacity to become a “dividend aristocrat” – i.e. pay shareholders regular dividends that increase annually – and, if achieved, would help it enjoy a higher valuation. In addition, there is capacity for a disciplined stock buyback program, which would further increase Hollysys' value per share.

For the long-term objective of increasing value for all shareholders commensurate with its underlying financial strength, we at Heng Ren hope our appeal is implemented. The following analysis supports Heng Ren's appeal.

Sincerely,

Peter Halesworth
Managing Partner
Heng Ren Investments LP

March 8, 2016

Heng Ren Analysis

1) Hollysys Cash Flow Generation is Impressive

Our analysis of reported financial statements reveals Hollysys's capacity to distribute cash to shareholders is considerable. Per Hollysys' 6-K filing with the U.S. Securities and Exchange Commission (SEC) dated February 3, 2016 for the Second Quarter of FY2016, Hollysys had \$276 million in cash and only \$35 million in debt. Heng Ren's analysis shows that with its current and expected cash flow, Hollysys has plenty of capacity to pay shareholders an annual dividend with the following yields – on average 4.7% through FY2019:

	FY 2016E	FY 2017E	FY 2018E	FY 2019E
Actual Dividend Yield	3.9%	4.4%	5.0%	5.5%
Annual Dividend Per Share	\$0.75	\$0.85	\$0.95	\$1.06
Actual Dividend Payment (\$MM)	\$44.4	\$50.2	\$56.4	\$62.7
Payout Ratio	40%	40%	40%	40%

1 Based on Current Market Prices (As of 7-Mar-16)

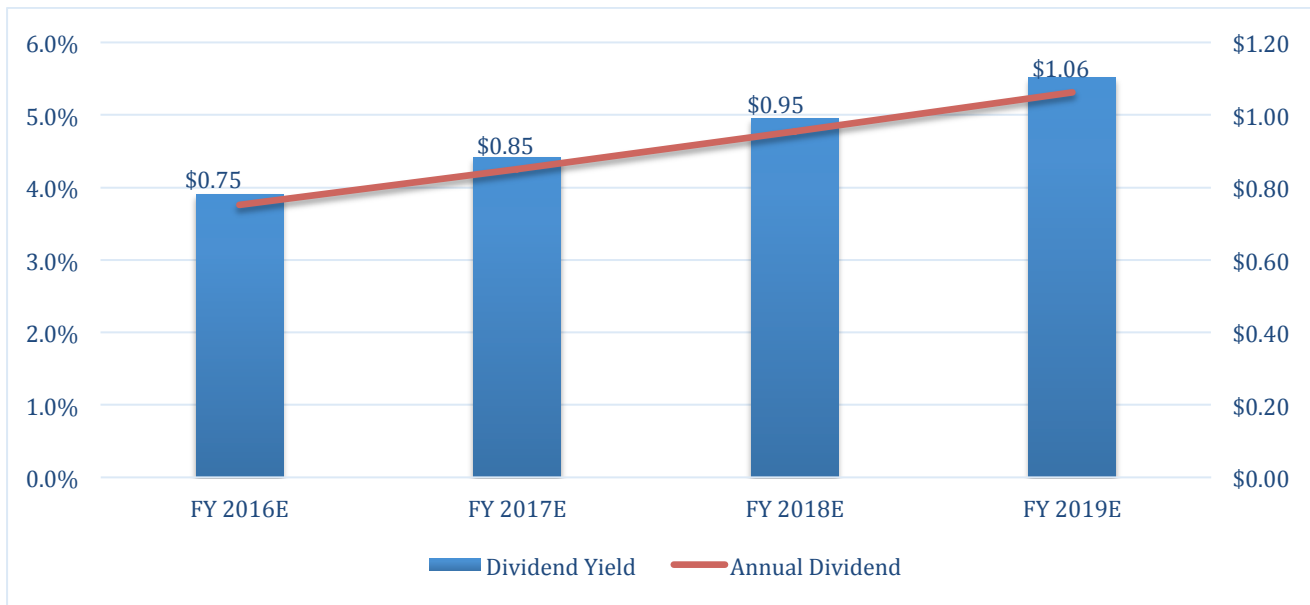
Management should note this is not an attempt by Heng Ren to raid Hollysys' cash. In our analysis, Hollysys retains at a minimum \$75 million in cash each year to cover all financing and investing needs (debt service and capital expenditure) even after dividends. See below:

Free Cash Flow Summary:	2016E	2017E	2018E	2019E
Net Income	\$ 112.2	\$ 126.8	\$ 142.3	\$ 158.4
(+) Depreciation and Amortization	9.8	10.1	10.5	11.3
(+) Cash Flow from Operating Activities	7.7	(25.1)	(27.8)	(29.7)
(+) Cash Flow from Investing Activities	(17.7)	(18.6)	(20.5)	(22.5)
(+) Cash Flow from Financing	(52.1)	(1.3)	(1.4)	(1.6)
Total Cash Flow	\$ 59.9	\$ 92.0	\$ 103.1	\$ 115.9
(+) Beginning Cash	207.8	267.7	359.8	462.9
(-) Minimum Cash	(75.0)	(75.0)	(75.0)	(75.0)
Discretionary Free Cash Flow Available	\$ 192.7	\$ 284.8	\$ 387.9	\$ 503.8



2) Dividend Payout Ratio, Annual Dividend, and Yield for Shareholders

Heng Ren’s analysis indicates between FY2012 and FY2015 there was capacity for a sustainable annual dividend payment of \$25 million. Going forward from FY2016 through FY2019, the dividend can be increased to a sustainable earnings payout ratio of 40%, or an average annual yield of 4.7% during these years.



Post dividend payout in FY2016, Hollysys would still have the capacity to complete a share buyback of \$148 million from “Excess Cash Available After Dividends” circled in red below:

Dividend Payment Capabilities

(US Dollars in Millions, Except per Share)

	Projected Fiscal Year Ended 6/30,			
	FY 2016E	FY 2017E	FY 2018E	FY 2019E
Cash & Equivalents Before Dividends	\$ 267.7	\$ 359.8	\$ 462.9	\$ 578.8
Less: Estimated Minimum Cash Needed	(75.0)	(75.0)	(75.0)	(75.0)
Cash & Equivalents Available to Pay Dividends	192.7	284.8	387.9	503.8
Less: Dividends Paid	(44.4)	(50.2)	(56.4)	(62.7)
Excess Cash Available After Dividends	\$ 148.3	\$ 234.5	\$ 331.5	\$ 441.1

3) Hollysys Stock Valuation – Attractive Upside of 41%

Based on our Discounted Cash Flow (DCF) valuation, Hollysys stock is worth \$27.19 per share, offering 41.3% upside. Consistently paying shareholders a meaningful dividend would draw investor attention to Hollysys' attractive valuation and simultaneously eliminate a negative factor – the underutilization of its strong balance sheet.

For the DCF model, Heng Ren forecasted Hollysys' free cash flow will increase from \$62 million in FY2015 to \$105 million in FY2019. In deriving the per share price, Heng Ren utilized a terminal EBITDA multiple of 10.0x and a very conservative discount rate of 17%.

		Assuming Discount Rate of				
		16.0%	16.5%	17.0%	17.5%	18.0%
Implied Price Per Share (\$)	Exit Multiple					
	8.0x	\$ 23.88	\$ 23.63	\$ 23.37	\$ 23.13	\$ 22.88
	9.0x	25.85	25.57	25.28	25.01	24.74
	10.0x	27.82	27.50	\$ 27.19	26.89	26.59
	11.0x	29.78	29.44	29.10	28.77	28.45
	12.0x	31.75	31.38	31.01	30.66	30.31

4) \$148 Million Capacity for Stock Buyback

Even with an earnings payout of 40% for a regular annual dividend between FY2016 and FY2019, Hollysys would still have substantial ability to buy back stock. For example, in FY2016 alone, after paying 40% of the earnings as dividends and retaining \$75 million in cash for operations, as demonstrated in the earlier sections, Hollysys would still have over \$148 million available to buy back stock.

A stock buyback would not only signal to investors that Hollysys stock is undervalued - it would also increase earnings and dividends on a per share basis and offer more upside to its valuation. For example, with a \$148 million buyback, the FY2017 Price-to-Earnings (P/E) ratio would be lowered to 7.9x (from 9.1x), and the dividend yield would increase to 4.9% (from 4.4%).

FY2017	Buyback ¹ (\$m)			
	No buyback	50	100	148
Basic Shares (mm)	59.1	56.5	53.9	51.4
Dil. Shares (mm)	60.6	58.0	55.4	52.9
EPS	\$2.13	\$2.22	\$2.33	\$2.44
EPS Benefit	NA	4.5%	9.6%	14.9%
DPS	\$0.85	\$0.87	\$0.91	\$0.95
Yield (%)	4.4%	4.5%	4.7%	4.9%
P/E	9.1x	8.7x	8.3x	7.9x

¹ Based on Current Market Prices (As of 7-Mar-16)

5) Stress Test of Revenue Contraction - Still Significant Operating Flexibility

Heng Ren also conducted an analysis of Hollysys' ability to continue to pay dividends even with significant contractions in revenue. Under the current scenario, Hollysys would generate a cumulative \$311 million in free cash flow from FY2017 to FY2019. In order to "stress test" the analysis, Heng Ren analyzed the excess cash available if revenue contracted at 25% annually from FY2017-2019.

Even if Hollysys' revenues contracted at 25% annually between FY2017 and FY2019, the Company would still generate a cumulative \$288 million in free cash flow from FY2017 to FY2019. This is due to the company's positive EBITDA and the generation of additional cash flow through lower working capital investment. In this scenario we assumed:

- Revenues would fall annually by 25% starting in FY2017
- Gross margin would fall from 40.3% in FY2015 to 36.1% in FY2019
- EBITDA margin would fall from 25.7% in FY2015 to 15.3% in FY2019
- Days Sales Outstanding would rise from 176 in FY2015 to 195 in FY2019

Free Cash Flow Summary:	2016E	2017E	2018E	2019E
Net Income	\$ 112.2	\$ 75.0	\$ 50.1	\$ 33.2
(+) Depreciation and Amortization	9.8	10.0	10.1	10.5
(+) Cash Flow from Operating Activities	7.7	54.7	42.9	32.6
(+) Cash Flow from Investing Activities	(17.7)	(12.6)	(9.5)	(7.1)
(+) Cash Flow from Financing	(52.1)	(0.8)	(0.5)	(0.3)
Total Cash Flow	\$ 59.9	\$ 126.4	\$ 93.1	\$ 68.9
(+) Beginning Cash	207.8	267.7	394.1	487.2
(-) Minimum Cash	(75.0)	(75.0)	(75.0)	(75.0)
Discretionary Free Cash Flow Available	\$ 192.7	\$ 319.1	\$ 412.2	\$ 481.1

Conclusion

Hollysys has a welcome opportunity to use its strong cash flow and balance sheet to make disciplined distributions to shareholders for all of our benefit. In Heng Ren's analysis it is clear Hollysys has a comfortable amount of cash for operations, and disciplined investment, in initiatives for long-term growth. Paying an annual dividend will announce that Hollysys values shareholders, and is willing to share with them in its rebalancing of Hollysys' capital structure, and use a key advantage - its financial strength - to improve returns for all. A stock buyback will be a strong signal to markets and potential investors that Hollysys stock is extremely undervalued, which all shareholders would probably agree.

Appendix

HOLI - Summary Income Statement

(US Dollars in Millions, Except per Share)

	2013	2014	2015	Projected FYE 6/30,			
				2016E	2017E	2018E	2019E
Net Revenues:							
Integrated Contract Revenue	\$ 328.6	\$ 478.3	\$ 481.0	\$ 505.1	\$ 555.6	\$ 611.1	\$ 672.2
Product Sales	20.5	31.9	39.8	41.8	45.9	50.5	55.6
Revenue from Services	-	11.1	10.6	14.9	17.8	21.4	23.5
Total Net Revenues	349.1	521.3	531.4	561.7	619.3	683.0	751.3
Gross Profit	123.7	175.6	214.4	219.3	242.2	267.5	294.2
Operating Expenses (a)	56.7	64.5	71.1	75.2	82.9	91.4	100.6
Depreciation & Amortization	9.2	12.7	13.2	9.8	10.1	10.5	11.3
EBIT (a)	57.7	98.4	130.1	134.3	149.1	165.6	182.4
Pre-Tax Income (a)	60.6	91.3	125.2	140.2	158.5	177.9	198.0
Net Income Before NCI (a)	52.5	71.5	99.2	112.2	126.8	142.3	158.4
Noncontrolling Interest	0.5	1.8	2.7	1.1	1.3	1.4	1.6
Net Income (a)	\$ 52.0	\$ 69.6	\$ 96.5	\$ 111.0	\$ 125.6	\$ 140.9	\$ 156.8

Growth Rates:

Net Revenues	8.5%	49.4%	1.9%	5.7%	10.3%	10.3%	10.0%
Gross Profit	-6.6%	42.0%	22.1%	2.3%	10.4%	10.5%	10.0%
EBITDA	-9.8%	66.0%	28.9%	0.6%	10.5%	10.5%	10.0%
EBIT	-13.3%	70.5%	32.2%	3.2%	11.0%	11.0%	10.2%
Net Income	-5.1%	33.9%	38.6%	15.0%	13.1%	12.2%	11.3%

Margins:

Gross Margin	35.4%	33.7%	40.3%	39.0%	39.1%	39.2%	39.2%
EBITDA	19.2%	21.3%	27.0%	25.7%	25.7%	25.8%	25.8%
EBIT	16.5%	18.9%	24.5%	23.9%	24.1%	24.2%	24.3%
Net Income	14.9%	13.4%	18.2%	19.8%	20.3%	20.6%	20.9%

(a) Excludes Stock based Compensation Expense and one-time gains/losses.



HOLI - Summary Balance Sheet

(US Dollars in Millions, Except per Share)

	Projected FYE 6/30,						
	2013	2014	2015	2016E	2017E	2018E	2019E
Assets:							
Cash	\$ 112.2	\$ 162.2	\$ 207.8	\$ 267.7	\$ 359.8	\$ 462.9	\$ 578.8
Current Assets	455.1	567.7	598.8	626.9	691.2	762.2	838.5
P,P & E	79.5	82.3	80.2	88.3	97.5	108.0	119.8
Other Assets	113.9	114.5	96.8	96.7	95.9	95.4	94.9
Total Assets	<u>\$ 760.7</u>	<u>\$ 926.7</u>	<u>\$ 983.7</u>	<u>\$ 1,079.5</u>	<u>\$ 1,244.3</u>	<u>\$ 1,428.5</u>	<u>\$ 1,631.9</u>
Liabilities & Equity:							
Current Liabilities	\$ 253.5	\$ 385.9	\$ 344.2	\$ 379.8	\$ 418.6	\$ 461.6	\$ 507.7
Total Debt	36.1	28.0	51.0	-	-	-	-
Other Liabilities	39.5	20.8	3.2	3.3	3.7	4.1	4.5
Total Liabilities	329.2	434.6	398.3	383.1	422.3	465.6	512.2
Noncontrolling Interest	1.7	3.6	6.3	6.3	6.3	6.3	6.3
Shareholders' Equity	413.7	488.5	579.1	690.1	815.7	956.6	1,113.4
Total Liabilities & Equity	<u>\$ 744.6</u>	<u>\$ 926.7</u>	<u>\$ 983.7</u>	<u>\$ 1,079.5</u>	<u>\$ 1,244.3</u>	<u>\$ 1,428.5</u>	<u>\$ 1,631.9</u>

HOLI - Summary Cash Flow Statement
(US Dollars in Millions)

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>Projected FYE 6/30,</u>			
				<u>2016E</u>	<u>2017E</u>	<u>2018E</u>	<u>2019E</u>
Net Cash Provided by Operations	\$ 30.6	\$ 83.3	\$ 84.0	\$ 129.7	\$ 111.9	\$ 125.0	\$ 140.0
Net Cash Used in Investing Activities	(12.1)	(25.2)	(39.9)	(17.7)	(18.6)	(20.5)	(22.5)
Net Cash Used in Financing Activities	<u>(2.7)</u>	<u>(8.1)</u>	<u>1.6</u>	<u>(52.1)</u>	<u>(1.3)</u>	<u>(1.4)</u>	<u>(1.6)</u>
Net Change in Cash	15.8	50.0	45.6	59.9	92.0	103.1	115.9
Beginning Cash	96.3	112.2	162.2	207.8	267.7	359.8	462.9
Plus: Increase (Decrease) in Cash	<u>15.8</u>	<u>50.0</u>	<u>45.6</u>	<u>59.9</u>	<u>92.0</u>	<u>103.1</u>	<u>115.9</u>
Ending Cash	\$ 112.2	\$ 162.2	\$ 207.8	\$ 267.7	\$ 359.8	\$ 462.9	\$ 578.8