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**中国神华能源股份有限公司**  
**CHINA SHENHUA ENERGY COMPANY LIMITED**

*(a joint stock limited company incorporated in the People's Republic of China with limited liability)*

**(Stock Code: 1088)**

**2007 POWER PURCHASE AGREEMENTS  
CONTINUING CONNECTED TRANSACTIONS**

**Independent financial adviser to the Independent Board Committee  
and Independent Shareholders**



**SOMERLEY LIMITED**

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A letter from the board of the Company is set out on pages 4 to 10 of this Circular and a letter from the independent board committee of the Company, containing its recommendation to the independent shareholders of the Company, is set out on page 11 of this Circular. A letter from Somerley Limited containing its advice is set out on pages 12 to 18 of this Circular.

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## DEFINITIONS

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*In this circular, the following expressions have the following meanings unless the context requires otherwise:*

“Associates”	shall have the meaning given to it in the Listing Rules;
“Board”	the board of Directors;
“Cap”	the proposed cap for the Transactions for the year ending 31 December, 2007 as set out in the section headed “Cap for the Transaction” of this Circular;
“CLP Guohua”	中國國華電力股份有限公司 (CLP Guohua Power Company Limited), a non-wholly owned subsidiary in which the Company has a 51% equity interest;
“Company”	中國神華能源股份有限公司 (China Shenhua Energy Company Limited), a joint stock limited company incorporated in the PRC with limited liability, the H shares of which are listed on the Stock Exchange;
“Circular”	this circular dated 23 January, 2007 issued by the Company in relation to the Transactions;
“Director(s)”	the director(s), including the independent non-executive directors of the Company;
“Group”	the Company and its subsidiaries;
“Hong Kong”	Hong Kong Special Administrative Region of the People’s Republic of China;
“Independent Financial Adviser”	Somerley Limited, the independent financial adviser advising the Independent Board Committee and Independent Shareholders in respect of the Transactions and the Cap;
“Independent Board Committee”	an independent committee of the Board comprising Messrs. Huang Yicheng, Anthony Francis Neoh and Chen Xiaoyue;
“Independent Shareholders”	all shareholders of the Company;
“Latest Practicable Date”	22 January, 2007, being the latest practicable date prior to the printing of this Circular on which certain information contained herein could be ascertained;
“Listing Rules”	The Rules Governing the Listing of Securities on the Stock Exchange;
“LPPC”	遼寧省電力有限公司 (Liaoning Power Company Limited);

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## DEFINITIONS

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“NCPG”	華北電網有限責任公司 (North China Power Grid Co., Ltd), a state owned enterprise which is owned or controlled by SGCC;
“Panshan Power”	天津國華盤山發電有限責任公司 (Tianjin Guohua Panshan Power Generation Company), a non-wholly owned subsidiary in which the Group has a 50% interest. Panshan Power is accounted for as a subsidiary of the Company as the Group has the right to appoint a majority number of the member of its board of directors;
“Percentage Ratios”	percentage ratios as defined under Rule 14.04(9) of the Listing Rules;
“Power Purchase Agreements”	the yearly power purchase agreements entered into between members of the Group and the Power Purchasers for the supply of power;
“2006 Power Purchase Agreements”	the power purchase agreements entered into by members of the Group with their respective Power Purchasers, in relation to the supply of power in 2006, or where definitive agreements have not been entered into, confirmations setting out the material terms of the relevant power supply;
“Power Purchaser(s)”	each of the power grid companies, namely NCPG, LPPC, SNEPC and ZEPC, which is owned or controlled by SGCC and to which members of the Group supply power;
“PRC”	the People’s Republic of China;
“Prospectus”	the prospectus dated 2 June, 2005 published by the Company in accordance with the Listing Rules for the purpose of its listing in Hong Kong;
“RMB”	the lawful currency of the PRC;
“SERC”	國家電力監管委員會 (State Electricity Regulatory Commission);
“SFO”	The Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong);
“SGCC”	國家電網公司 (State Grid Corporation of China), the controlling shareholder of NCPG and LPPC;
“Shareholder(s)”	holder(s) of Share(s);
“Shares”	share(s) of RMB1.00 each in the capital of the Company;

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## DEFINITIONS

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“Shenhua Group”	神華集團有限責任公司 (Shenhua Group Corporation Limited), the sole promoter and controlling shareholder of the Company;
“SNEPC”	陝西省電力公司 (Shanxi Electric Power Company);
“Stock Exchange”	The Stock Exchange of Hong Kong Limited;
“Suizhong Power”	綏中發電有限責任公司 (Suizhong Power Company Limited), a non-wholly owned subsidiary in which the Company has a 50% interest. Suizhong Power is accounted for as a subsidiary of the Company as the Group has the right to appoint a majority number of the members of its board of directors;
“Transactions”	the supply of power by members of the Group to the Power Purchasers in 2007 pursuant to the terms of the Power Purchase Agreements for 2006, save in respect of the volume and tariff (if applicable) of the power supply; and
“ZEPC”	浙江省電力公司 (Zhejiang Electric Power Company)

*Note:* English names of companies listed above are translations provided for identification purposes only.



**中国神华能源股份有限公司**  
**CHINA SHENHUA ENERGY COMPANY LIMITED**

*(a joint stock limited company incorporated in the People's Republic of China with limited liability)*

**(Stock Code: 1088)**

*Executive Directors:*

Chen Biting  
Ling Wen

*Registered Office:*

Shenhua Tower  
22 Andingmen Xibinhe Road  
Dongcheng District  
Beijing, PRC

*Non-executive Directors:*

Zhang Xiwu  
Zhang Yuzhuo  
Han Jianguo

*Independent Non-executive Directors:*

Huang Yicheng  
Anthony Francis Neoh  
Cheng Xiaoyue

23 January, 2007

*To the shareholders*

Dear Sir or Madam,

**CONTINUING CONNECTED TRANSACTIONS**  
**2007 POWER PURCHASE AGREEMENTS**

**INTRODUCTION**

Reference is made to the announcement of the Company dated 31 December, 2006 in relation to the 2007 Power Purchase Agreements. The Directors announced that until such time as the new Power Purchase Agreements for 2007 are entered into (currently expected to be in the second quarter of 2007), the Company will continue supply of power to the Power Purchasers pursuant to the terms of the Power Purchase Agreements entered into for 2006, save in respect of the volume and tariff (if applicable) of the power supply.

The Directors propose to adopt an annual cap of RMB19,100 million for 2007, which is the same as the annual cap adopted for 2006. As the proposed cap exceeds 2.5% of the applicable size tests under the Listing Rules, the Company must comply with the Independent Shareholders' approval

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## LETTER FROM THE BOARD

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requirements as set out in Rule 14A.48 of the Listing Rules as well as the reporting and announcement requirements in Rules 14A.45 to 14A.47 of the Listing Rules in respect of the Transactions. No shareholder of the Company is required to abstain from voting in the general meeting of the Company for approving the Transactions and the new cap proposed for 2007, as the connected persons in the Transactions, namely NCPG, LPPC and their Associates, are connected persons solely by virtue of NCPG and LPPC's interest in a subsidiary of the Company and not in the Company itself. The Company has obtained from Shenhua Group, which currently holds 81.21% of the issued share capital of the Company, a written approval for the Transactions and the proposed cap for 2007. Pursuant to Rule 14A.43 of the Listing Rules, the Company has applied for, and been granted, a waiver from the Stock Exchange to approve the Transactions, which constitute continuing connected transactions of the Company and the proposed new cap for 2007, on the basis of a written shareholders' approval in lieu of holding a general meeting of the Company.

The Independent Board Committee has been formed to advise the Independent Shareholders in respect of the Transactions and the annual cap for 2007. The Independent Financial Adviser has been appointed as independent financial adviser to the Independent Board Committee and to the Independent Shareholders to advise the Independent Board Committee and the Independent Shareholders on the same.

The main purpose of this Circular is to provide you with, among other things, (i) further information relating to the Transactions and the annual cap for 2007; (ii) the letter of advice from the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders; and (iii) the letter of recommendation from the Independent Board Committee.

### **BACKGROUND**

As disclosed in the Prospectus, one of the Company's indirect non-wholly owned subsidiaries, Panshan Power, supplies power generated by it to one of its own substantial equity holders, NCPG. NCPG currently holds a 25% equity interest in Panshan Power and is a subsidiary of the SGCC. Similarly, one of the Company's direct non-wholly owned subsidiaries, Suizhong Power, supplies power generated by it to one of its own substantial equity holders, LPPC. LPPC currently holds a 25% equity interest in Suizhong Power and is a subsidiary of the SGCC. Pursuant to Rule 14A.11 of the Listing Rules, each of NCPG and LPPC is a connected person of the Company as it is a substantial shareholder of a subsidiary of the Company and accordingly any transaction between NCPG, LPPC, or any of their respective Associates (including its holding company, SGCC, its subsidiaries and fellow subsidiaries) and the Group will constitute connected transactions.

In addition, various other subsidiaries and a branch company of the Company supply power generated by their respective power plants to the Power Purchasers, which are the power grid companies where they are located. The Power Purchasers are owned or controlled, directly or indirectly, by the same parent company, SGCC, and are therefore Associates of a connected person of the Company.

Accordingly, the supply of power by members of the Group to their respective Power Purchasers which are owned or controlled by the SGCC constitute continuing connected transactions of the Company.

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## LETTER FROM THE BOARD

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The Directors propose to adopt an annual cap of RMB19,100 million for 2007, which is the same as the annual cap adopted for 2006. As the proposed cap exceeds 2.5% of the applicable size tests under the Listing Rules, the Company must comply with the Independent Shareholders' approval requirements as set out in Rule 14A.48 of the Listing Rules as well as the reporting and announcement requirements in Rules 14A.45 to 14A.47 of the Listing Rules in respect of the Transactions.

### **PROPOSED DIVESTMENT BY NCPG AND LPPC OF THEIR RESPECTIVE INTERESTS IN PANSHAN POWER AND SUIZHONG POWER**

The PRC government had previously announced plans to restructure the PRC power industry, involving, among other things, the separation of power generating and power transmission businesses. As part of the implementation of this restructuring plan, the SERC had issued on 11 October, 2006 a notice inviting tenders for the acquisition of interests held by certain power grid companies in power generating assets, including the entire equity interest held by NCPG in Panshan Power and LPPC in Suizhong Power. The Group was one of the bidders who had submitted a bid to acquire these interests. The results of the tender process have not yet been announced but it is currently expected that the divestment will be completed by the end of February 2007.

Panshan Power is currently an indirect non-wholly owned subsidiary of the Company. It is held as to 50% by CLP Guohua (a non-wholly owned subsidiary of the Company), 25% by NCPG and 25% by Tianjin Energy Investment Company.

Suizhong Power is currently a non-wholly owned subsidiary of the Company. It is held as to 50% by the Company, 25% by LPPC and 25% by Liaoning Provincial Energy Company.

As each of NCPG and LPPC is a substantial shareholder of a subsidiary of the Company, they and their Associates are connected persons of the Company. However, following the divestment by NCPG and LPPC of their respective interests in Panshan Power and Suizhong Power (whether or not to the Group), they will cease to be a substantial shareholder of a subsidiary of the Company, and therefore cease to be a connected person of the Company. The supply of power pursuant to the Power Purchase Agreements by members of the Group to NCPG, LPPC and their Associates will accordingly cease to be connected transactions for the Company.

If the Group is successful in its bid pursuant to the tender process, the acquisition of the interests in Panshan Power and Suizhong Power will constitute a connected transaction for the Company, and the Company will comply with the requirements of Chapter 14A of the Listing Rules in relation thereto.

### **REASONS FOR NOT ENTERING INTO WRITTEN AGREEMENT**

Power supply to power grid companies in the PRC is significantly influenced by state policies. The relevant government authorities in the PRC will determine and announce on a yearly basis the amount of power allocated to each power grid company and the price policies for power supply. This announcement is typically made in the first quarter of each year. Prior to such announcement, it is

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## LETTER FROM THE BOARD

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difficult for the Company to conclude any definitive agreements for power supply with power grid companies. During this interim period until definitive agreements are entered into, industry practice is for supply to continue based on the terms of the previous year contracts, save as to volume and tariff (if applicable).

Rule 14A.35(1) of the Listing Rules requires that the Company enters into written contracts for its connected transactions. In order to comply with the strict requirements of Rule 14A.35(1) in the period before definitive agreements for power supply can be entered into, the Company had in 2006 sought to negotiate with the Power Purchasers an interim agreement to record the industry practice of continuing supply pursuant to the terms of the previous year contracts. However, as such written interim agreements are not industry practice, the Company had experienced significant difficulties in persuading the Power Purchasers to accede to its request.

As NCPG, LPPC and certain of their Associates are currently in the midst of a tender process for the divestment of their power generating assets, the Company considers that it would not be practicable to seek to discuss with them interim agreements for power supply in addition to ongoing negotiations in respect of the tender process. Neither the Company nor its controlling shareholder has any direct or indirect holding in NCPG, LPPC or its Associates, and therefore is not able to compel the entering into of interim agreements.

### **TERMS OF THE 2006 POWER PURCHASE AGREEMENTS**

The principal terms and conditions of the 2006 Power Purchase Agreements are substantially the same apart from some minor differences on matters such as the methods and time for settlement of payments. They are entered into by various members of the Group with their respective Power Purchasers and are for periods of 1 year commencing from 1 January 2006. The principal terms of these agreements are summarised as follows:

1. the price of power supplied to the relevant Power Purchasers is determined and adjusted pursuant to the regulations of the PRC government; and
2. the total amount of power purchased is regulated by the relevant authorities under the principle of equality between all power suppliers and each Power Purchaser.

The price of power supplied under the 2006 Power Purchase Agreements are mostly paid monthly in arrear, by bank transfer or bank bills.

Until such time as the new Power Purchase Agreements for 2007 are entered into (currently expected to be in the second quarter of 2007), the Company will continue supply of power to the Power Purchasers pursuant to the terms of the Power Purchase Agreements entered into for 2006, save in respect of the volume and tariff (if applicable) of the power supply.

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## LETTER FROM THE BOARD

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The terms of the Power Purchase Agreements for 2006 were entered into following arm's length negotiations and taking into account PRC government policies as the amount of supply and its pricing. Therefore, the Directors consider that the supply of power during the interim period in 2007 pursuant to the terms of the Power Purchase Agreements for 2006 will be conducted on normal commercial terms, pursuant to terms that are fair and reasonable so far as the shareholders are concerned, and are therefore in the interests of the Company as a whole.

### CAP FOR THE TRANSACTIONS

The actual values of the power supply by the Group to NCPG, LPPC and their Associates for each of the two years ended 31 December, 2005 and the six months ended 30 June, 2006 and the original caps set for the respective years, are as follows:

<b>Year ended 31 December, 2004</b> <i>(RMB millions)</i>		<b>Year ended 31 December, 2005</b> <i>(RMB millions)</i>		<b>Six months ended 30 June, 2006</b> <i>(RMB millions)</i>	
<b>Actual value</b>	<b>Annual cap</b>	<b>Actual value</b>	<b>Annual cap</b>	<b>Actual value</b>	<b>Annual cap</b>
7,519.7	N/A <sup>(1)</sup>	7,843.0	17,919.0	3,954.16	19,100.0

*Note:*

- (1) The Company was listed on the Stock Exchange on 15 June, 2005. There were therefore no applicable caps for the year ended 31 December, 2004

The Company is in the process of preparing audited financial information for the year ended 31 December, 2006. However, based on management financial information, actual sales pursuant to the power supply arrangements increased in the second half of 2006 as compared with the first half of 2006, principally as a result of increase in capacity from new power generating units which commenced operations in the later part of 2006. Three power generating units of Zheneng Power, and two new power generating units of Cangdong Power, each with an installed capacity of 600MW, commenced operations in May, August and November 2006, and June and December 2006, respectively. This increased the aggregate installed capacity of power plants supplying the Power Purchasers by 52.1 per cent. from 5,760 MW to 8,760 MW. As some of these plants started operation quite late in 2006, a lot of the power generating capacity and output despatch of these new power generating units will only be fully reflected in 2007.

In addition, the Directors expect further new power generating units to commence operations in 2007. One new power generating unit with an installed capacity of 600MW is expected to commence operations in April 2007, and a further five new power generating units with an aggregate installed capacity of 1,860MW are expected to commence operations in the second half of 2007. This will increase the aggregate installed capacity of the power plants supplying the Power Purchasers by 28.1 per cent. from 8,760 MW as at 31 December, 2006 to 11,220 MW.

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## LETTER FROM THE BOARD

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As the tariff and supply allocations for 2007 have not yet been announced by the PRC government, the Directors are not able to make a realistic estimate of the transaction amounts for the year ending 31 December, 2007. Nonetheless, the Company is hoping that the volume of power supply in 2007 will be no less than the level in 2006. In addition, if the applicable tariff for 2007 increases, the total volume of the transaction will correspondingly increase. Taking into account the possibility of an increase in both volume and tariff and the expected increase in installed capacity of the Group's power generating units, and the fact that changes in the applicable government prescribed tariff is difficult to predict, the Company proposes to adopt the annual cap approved for 2006 of RMB19,100 million as the cap applicable for 2007. The Directors are of the view that the proposed cap for 2007 is fair and reasonable in light of the present circumstances.

### REASONS FOR ENTERING INTO AND BENEFITS OF THE TRANSACTIONS

The Power Purchasers are power grid companies and are therefore the principal, if not sole, customers of the power plants operated by the Group. The power supply arrangements under the Power Purchase Agreements are conducted in the normal and ordinary course of business of the Group. According to relevant regulations and governmental policies, the price and amount of the power supply are all determined and adjusted pursuant to the regulations of the PRC authorities. In the circumstances, the Directors believe that no preferential treatment in favour of the connected persons will arise.

### DISCLOSURE AND INDEPENDENT SHAREHOLDERS' APPROVAL REQUIREMENTS

Pursuant to the Listing Rules, entering into the Transactions and adopting the annual cap for 2007 are subject to the reporting, announcement and Independent Shareholders' approval requirements set out in Rules 14A.45 to 14A.48. No shareholder of the Company is required to abstain from voting in the general meeting of the Company for approving the Transactions and the new cap as the connected persons in the Transactions, namely NCPG, LPPC and their Associates, are connected persons solely by virtue of NCPG and LPPC's interest in a subsidiary of the Company and not in the Company itself. The Company has obtained from Shenhua Group, which currently holds 81.21% of the issued share capital of the Company, written approval of the Transactions and the proposed new Cap. Pursuant to Rule 14A.43 of the Listing Rules, the Company has applied for, and been granted, a waiver from the Stock Exchange to approve the Transactions, which constitute continuing connected transactions of the Company and the proposed new Cap for 2007, by way of a written independent shareholders' approval in lieu of holding a general meeting of the Company.

### FURTHER DISCLOSURES

If the proposed divestment by NCPG and LPPC of their respective interest in Panshan Power and Suizhong Power does not conclude on or prior to 28 February, 2007, the Company will make a further announcement to update shareholders as to the status of the tender process and of the Power Purchase Agreements for 2007 as soon as practicable and, in any event, before 15 March, 2007.

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## LETTER FROM THE BOARD

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### ADDITIONAL DISCLOSURE

#### Information on the Group

The Group operates an integrated coal-based energy business in the PRC, including coal production, transportation and sales as well as power generation. The Group also purchases coal from third parties for coal blending and resale.

#### Information on the Power Purchasers

The principal business activity of the Power Purchasers is the operation of power grids.

Please refer to the section headed “Background” above for the relationship of the Power Purchasers with SGCC, which is an Associate of a connected person of the Company, since NCPG and LPPC are subsidiaries of SGCC and NCPG and LPPC are substantial shareholders of Panshan Power, and Suizhong Power, respectively, each, a subsidiary of the Company.

### RECOMMENDATION OF THE INDEPENDENT BOARD COMMITTEE

An Independent Board Committee has been formed to advise the Independent Shareholders in connection with the Transactions and the annual Cap for 2007, and Somerley Limited has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders on the same.

The Independent Financial Adviser considers that the terms of the Transactions and the annual Cap for 2007 proposed are fair and reasonable so far as the Independent Shareholders are concerned and in the interests of the Company and the Shareholders as a whole. The text of the letter of advice from the Independent Financial Adviser containing its recommendation is set out on pages 12 to 18 of this Circular.

The Independent Board Committee, having taken into account and based on the recommendation of the Independent Financial Adviser as set out on pages 12 to 18 of this Circular, considers that the Transactions are conducted on normal commercial terms and are in the ordinary and usual course of business of the Group and the proposed annual Cap for 2007 and the terms of the Transactions are fair and reasonable so far as the Independent Shareholders are concerned, and the entering into of the Transactions is, in the interests of the Company and the Shareholders as a whole. Accordingly, the Independent Board Committee recommends the Independent Shareholders to vote in favour of the Transactions and the proposed annual Cap for 2007 if a shareholders’ meeting is required to be held.

Yours faithfully,  
for and on behalf of the Board  
**Chen Biting**  
*Chairman*



**中国神华能源股份有限公司**  
CHINA SHENHUA ENERGY COMPANY LIMITED

*(a joint stock limited company incorporated in the People's Republic of China with limited liability)*  
**(Stock Code: 1088)**

23 January, 2007

*To: The Independent Shareholders*

Dear Sirs/Madam,

**CONTINUING CONNECTED TRANSACTIONS**

We have been appointed as the Independent Board Committee to advise you in connection with the Transactions. We wish to draw your attention to the letter from Somerley Limited as set out on pages 12 to 18 of this Circular. Terms defined in this Circular shall have the same meanings when used herein, unless the context otherwise requires.

Having considered the information set out in the letter from the Board, the Transactions, the proposed arrangements and annual Cap for 2007 in relation to the Transactions and the advice of Somerley Limited in relation thereto, we are of the view that the Transactions are conducted on normal commercial terms and in the ordinary and usual course of business of the Group, the terms of the Transactions and annual Cap for 2007 are fair and reasonable so far as the Independent Shareholders are concerned and the entering into of the Transactions is in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Shareholders to vote in favour of the Transactions and the proposed arrangement and annual Cap for 2007 if a shareholders' meeting is required to be held.

Yours faithfully,

for and on behalf of the Independent Board Committee

**Mr. Huang Yicheng**

**Mr. Anthony Francis Neoh**

**Dr. Chen Xiaoyue**

*Independent Non-executive Directors*

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## LETTER FROM INDEPENDENT FINANCIAL ADVISER

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*The following is the letter of advice from Somerley Limited to the Independent Board Committee and the Independent Shareholders, which has been prepared for the purpose of inclusion in this Circular.*



### SOMERLEY LIMITED

10th Floor  
The Hong Kong Club Building  
3A Chater Road  
Central  
Hong Kong

23 January, 2007

*To: the Independent Board Committee and  
the Independent Shareholders*

Dear Sirs,

### **CONTINUING CONNECTED TRANSACTIONS RELATING TO THE 2007 POWER PURCHASE AGREEMENTS**

We refer to our appointment to advise the Independent Board Committee and the Independent Shareholders on the Transactions in relation to the supply of power by members of the Group to their respective Power Purchasers during the interim period in 2007 pursuant to the terms of the 2006 Power Purchase Agreements, for which the Independent Shareholders' approval is being sought subject to an annual cap for the Transactions (the "Cap"). Details of the Transactions and the Cap are set out in the letter from the Board contained in the circular of the Company to the Shareholders dated 23 January, 2007 (the "Circular"), of which this letter forms part. Capitalised terms used in this letter shall have the same meanings as those defined in the Circular.

In 2006, members of the Group entered into the Power Purchase Agreements with their respective Power Purchasers to regulate the supply of power. The Power Purchasers comprise power grid companies which are owned or controlled by SGCC. As at the Latest Practicable Date, NCPG was a 25% substantial shareholder of Panshan Power which is in turn an indirect non-wholly owned subsidiary of the Company. LPPC was a 25% substantial shareholder of Suizhong Power which is a direct non-wholly owned subsidiary of the Company. By virtue of their respective substantial shareholding in Panshan Power and Suizhong, each of NCPG and LPPC is considered a connected person of the Company under the Listing Rules. As the other Power Purchasers are Associates of NCPG and LPPC, the Transactions constitute continuing connected transactions for the Company under the Listing Rules. Pursuant to Rule 14A.35(1) of the Listing Rules, the Company is required to enter into written contracts for its connected transactions. However, industry practice is for annual contracts to be entered into around the end of the first quarter of each year, following the announcement by the PRC government authorities of the amounts of allocations to each power grid company and the pricing policies for power supply. During the interim period until definitive agreements are entered into, industry practice is for supply to continue based on the terms of the previous year contacts, save as to volume and tariff (if applicable). The Company had in 2006 sought

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## LETTER FROM INDEPENDENT FINANCIAL ADVISER

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to negotiate interim agreements with the Power Purchasers but had encountered significant difficulties in persuading the Power Purchasers to accede to its request. Moreover, as NCPG, LPPC and certain of their Associates are currently in the midst of the tender process for the divestment of their power generating assets including their interests in Panshan Power and Suizhong Power, the Company considers that it would not be practicable to seek to discuss with them any formal agreements for power supply during the tender process. The Company has undertaken that its relevant members will supply power to the Power Purchasers in accordance with the terms of the Power Purchase Agreements for 2006 from 1 January, 2007 until the Power Purchase Agreements for 2007 are entered into and become effective or the Transactions do not constitute continuing connected transactions, whichever is earlier.

As the Company anticipates that the applicable Percentage Ratios for the Transactions in respect of the year ending 31 December, 2007 will exceed 2.5% on an annual basis, the Transactions are subject to the reporting, announcement and independent shareholders' approval requirement pursuant to Rule 14A.35 of the Listing Rules. No shareholder of the Company is required to abstain from voting in the general meeting of the Company for approving the Transactions and the Cap as the connected persons in the Transactions, namely SGCC and its Associates, are connected persons solely by virtue of the interests of NCPG and LPPC in a subsidiary of the Company but not in the Company itself. The Company has obtained from Shenhua Group, which currently holds 81.21% of the issued share capital of the Company, the written approval of the Transactions and the Cap. The Company has applied for, and been granted, a waiver from the Stock Exchange to approve the Transactions and the Cap by way of a written independent shareholders' approval in lieu of holding a general meeting of the Company.

The Independent Board Committee, comprising all of the three independent non-executive Directors, namely Mr. Huang Yicheng, Mr. Anthony Francis Neoh and Dr. Chen Xiaoyue, has been established to make a recommendation to the Independent Shareholders as regards whether the Transactions are in the ordinary and usual course of business of the Group and are conducted on normal commercial terms, the terms of the Transactions and the Cap are fair and reasonable so far as the Independent Shareholders are concerned and the entering into of the Transactions is in the interests of the Company and the Shareholders as a whole. We, Somerley Limited, have been appointed to advise the Independent Board Committee and the Independent Shareholders in this regard.

In formulating our opinion, we have relied on the information and facts supplied, and the opinions expressed, by the executive Directors and management of the Company and have assumed that the information and facts provided and opinions expressed to us are true, accurate and complete in all material respects at the time they were made and up to the date of the Circular. We have also sought and received confirmation from the executive Directors that no material facts have been omitted from the information supplied and opinions expressed to us. We have relied on such information and consider that the information we have received is sufficient for us to reach an informed view and have no reason to believe that any material information has been withheld, nor doubt the truth or accuracy of the information provided. We have not, however, conducted any independent investigation into the business and affairs of the Group, nor have we carried out any independent verification of the information supplied.

## PRINCIPAL FACTORS AND REASONS CONSIDERED

In considering whether the terms of the Transactions and the Cap are fair and reasonable so far as the Independent Shareholders are concerned, we have taken into account the principal factors and reasons set out below:

### 1. Background to and reasons for the Transactions

The Group operates an integrated coal-based energy business in the PRC, including coal production, transportation and sales as well as power generation. The Group also purchases coal from third parties for coal blending and resale. At as 31 December, 2006, the Group operates a total of 10 power plants (nine of which are subject to the Transactions) in various provinces in the PRC, with total installed capacity of approximately 11,760 MW and gross power generation of approximately 53.8 billion kwh per annum. Power generated by the respective power plants, after those required for self consumption, are sold to the power grid companies for onward supply to ultimate users. The Power Purchasers are the respective power grid companies and the principal, if not sole, customer of the relevant power plants operated by the Group which are the subject of the Transactions. The 2006 Power Purchase Agreements were entered into with a view to regulating the relationship between the Group and the Power Purchasers.

In light of the respective principal activities of the Group and the Power Purchasers, we consider that the Transactions are entered into in the ordinary and usual course of business of the Group and the Power Purchasers. We also consider that given the significance of the Power Purchasers as the main or sole customer for the respective power plants of the Group, the continuous supply of power during the interim period in 2007 pursuant to the terms of 2006 Power Purchaser Agreements are in the interests of the Group and the Shareholders as a whole.

### 2. Principal terms of the Transactions

The principal terms and conditions of each of the 2006 Power Purchase Agreements are substantially the same, apart from some minor differences on matters such as the methods and timing for settlement of payments. Each of the 2006 Power Purchase Agreements is for a period of one year commencing from 1 January, 2006. Pursuant to the terms of the 2006 Power Purchase Agreements, the price of power supplied to the relevant Power Purchasers is determined and adjusted according to the regulations of the PRC government. The amount of power supplied is allocated and regulated by the relevant authorities under the principle of equality between all power suppliers and each power grid company, and will be determined and announced by the relevant government authorities or relevant power grids on a yearly basis around the first quarter of each year. We have been advised by the management of the Company that there has been no changes to these policies after 2006.

Given that the price of power is regulated by and fixed in accordance with the pricing policies promulgated by the relevant PRC authorities from time to time which is uniform to all power plants in the same district, we consider that the supply of power during the interim period in 2007 pursuant to the terms of 2006 Power Purchaser Agreements will be conducted on normal commercial terms

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## LETTER FROM INDEPENDENT FINANCIAL ADVISER

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which would be no less favourable to the Group than those offered to independent third parties. Based on the above, we consider that the terms of Transactions, which allow the Group to supply power to the Power Purchasers on terms no less favourable to the Group than those offered to independent third parties, are fair and reasonable.

### 3. The Cap

Power supply to power grid companies in the PRC is significantly influenced by state policies. The relevant government authorities in the PRC will determine and announce on a yearly basis the amount of power allocated to each power grid company and the price policies for power supply. Such announcement is normally expected in the first quarter of each year and the tariff and supply allocations for 2007 have not yet been announced as at the Latest Practicable Date. Accordingly, the Directors are not able to make a realistic estimate of the transaction amounts for the year ending 31 December, 2007. As advised by the management of the Company, they are hoping that the volume of power supply will be no less than the level in 2006. In order to provide flexibility for growth in volume and the possible continuous increase in on-grid tariff in 2007, the Company proposes to adopt the annual cap of RMB19,100 million for 2007.

In assessing the reasonableness of the Cap, we have discussed with the management of the Company the above basis. We have also discussed with them their estimation of the price and volume of power to be supplied to the Power Purchasers and the anticipated growth in the Group's power generating capacity for the purpose of setting the Cap. We have also reviewed the historical data of power supply to the Power Purchasers.

Set out below are the total sales of power by the Group to the Power Purchasers for each of the financial years ended 31 December, 2004, 2005 and 2006:

	Year ended 31 December,		
	2004	2005	2006
	(RMB million)	(RMB million)	(RMB million) (unaudited)
Total sales of power to the Power Purchasers	7,519.7	7,843.9	11,107.6 (Note)
Percentage change compared to preceding year		+4.3%	+41.6%

*Note: The figure was based on the management accounts of the Company and is subject to changes upon finalisation of audit of the Company for the year ended 31 December, 2006.*

The 4.3% increase in the total sales of power in 2005 was largely due to the combined effects of the rise in the on-grid tariff as regulated by the relevant PRC authorities and the approximately 2.0% decrease in the amount of power sold in 2005 compared with 2004. The substantial increase of 41.6% in the total sales of power in 2006 was mainly attributable to the additional power generating capacity of the power plants of the Group, in particular, as a result of the commencement of operations of five new power generating units of Zheneng Power and Cangdong Power. We are advised by the management of the Company that sales of power of approximately RMB2.07 billion were attributable to the power generating capacity increased in 2006.

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Although the supply allocations of power to each power grid company for 2007 have not yet been determined, the Directors have made an estimation on the total supply of power to the Power Purchasers for the purpose of setting the Cap for the year ending 31 December, 2007, taking into account the projected power generating capacity of the power plants of the Group. As mentioned above, five new power generating units of the Group commenced operations in 2006, including three power generating units of Zheneng Power, each with an installed capacity of 600 MW, which commenced operations in May, August and November 2006 respectively and two power generating units of Cangdong Power, each with an installed capacity of 600 MW, which commenced operations in June and December 2006. The power generating capacity and output dispatch of these two power plants will only be fully reflected in 2007. Taking into account the above-mentioned total sales of power of approximately RMB2.07 billion attributable to the additional power generating capacity, the management estimates that total sales of power of approximately RMB6.14 billion could be derived from these additional power generating units in full year 2007. In addition, the management expects that one new power generating unit with an installed capacity of 600 MW will commence operation in April 2007 and five other new power generating units, with an aggregate installed capacity of 1,860 MW, are expected to commence operations in the second half 2007. With these new power generating units, the management estimates that the total power generating capacity and output dispatch of the power plants will increase by approximately 28.1% from 2006 to 2007. Further sales of approximately RMB0.81 billion are expected to be generated from such additional power generating capacity in 2007. The Directors are hoping that the volume of allocated power supply will be no less than the level in 2006. Taking into account the additional power generating capacity of the Group and the strong economic growth in the PRC which may have positive effect on the demand for power, we consider that the aforesaid estimation of the Directors is reasonable.

The weighted average on-grid tariff of electricity (exclusive of the value-added tax) continued to rise in the last few years, recording increases of approximately 5.7% in 2004, 7.4% in 2005 and 8.2% in 2006. Although the on-grid tariff of electricity showed continuous increase in previous years, we agree with the Directors' view that no realistic prediction could be made regarding the level of tariff as it is regulated by the government.

Taking into account all the above factors and uncertainty, the Cap for 2007 is proposed to be set at RMB19,100 million, which represents an increase of approximately 72% from the total sales of power to the Power Purchasers of approximately RMB11.1 billion (subject to audit) in 2006. Given that the power industry is a regulated industry in China and the on-grid tariff is subject to adjustments by the relevant PRC authority and supply allocation to each power grid company is yet to be determined, we consider the Cap provides a comfortable buffer to cater for any future upward adjustments in tariff and uncertainty on supply allocations which are not within the control of the Group. The Cap also provides for allowances should the demand for power by the Power Purchasers continue to grow within the capacity of the Group's power plants, and the six new power generating units of the power plants commence operations earlier than expected.

Having considered the basis on which the Cap is determined as described above, we are of the view that the Cap is fair and reasonable.

### 4. Conditions of the Transactions

The conduct of the Transactions are subject to a number of conditions which include, among other things:

- (i) the Cap for power supply to the Power Purchasers for the year ending 31 December, 2007 will not exceed RMB19,100 million;
- (ii) the independent non-executive Directors must review the Transactions and confirm in the Company's annual report and accounts that the Transactions have been entered into (a) in the ordinary and usual course of business of the Company; (b) either on normal commercial terms or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than terms available to or from independent third parties; and (c) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the Shareholders as a whole;
- (iii) the auditors of the Company will, in accordance with Rule 14A.38 of the Listing Rules, review the Transactions and provide a letter to the Directors (a copy of which will be provided to the Stock Exchange at least 10 business days prior to the bulk printing of the annual report of the Company) confirming that the Transactions (a) have received the approval of the Board; (b) are in accordance with the pricing policies of the Company; (c) have been entered into in accordance with the relevant agreements governing the Transactions; and (d) have not exceeded the Cap;
- (iv) the Company will allow and will procure that the Power Purchasers shall allow the auditors of the Company sufficient access to the relevant records of the Transactions for the purpose of the auditors' review as referred to in paragraph (iii) above. The Board must state in the annual report whether its auditors have confirmed the matters stated in Rule 14A.38 of the Listing Rules; and
- (v) the Company will comply with the applicable provisions of the Listing Rules governing connected transactions in the event that the total amount of the Transactions exceeds the Cap, or that there is any material amendment to the terms of the Transactions.

In light of the conditions attached to the Transactions, in particular, (i) the restriction of the value of the Transactions by way of the Cap; and (ii) the ongoing review by the independent non-executive Directors and auditors of the Company of the terms of the Transactions and the Cap not being exceeded, we are of the view that appropriate measures will be in place to govern the conduct of the Transactions and safeguard the interests of the Independent Shareholders.

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## LETTER FROM INDEPENDENT FINANCIAL ADVISER

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### OPINION

Having taking into account the above principal factors, we consider that the Transactions are in the ordinary and usual course of business of the Group and are conducted on normal commercial terms. We also consider that the terms of the Transactions and the Cap are fair and reasonable so far as the Independent Shareholders are concerned and the entering into of the Transactions is in the interests of the Company and the Shareholders as a whole.

Yours faithfully,  
for and on behalf of  
**SOMERLEY LIMITED**  
**Beatrice Lung**  
*Director*

## 1. RESPONSIBILITY STATEMENT

This Circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Group. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this Circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, there are no other facts the omission of which would make any statement herein misleading.

## 2. DIRECTORS' INTERESTS

As at the Latest Practicable Date:

- 2.1 none of the Directors or chief executive of the Company has any interests or short positions in the shares, underlying shares or debentures of the Company or any associated corporation (within the meaning of Part XV of the SFO) which were (i) required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO; (ii) required pursuant to section 352 of the SFO to be entered in the register referred to therein; or (iii) required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the Company and the Stock Exchange;
- 2.2 none of the Directors, supervisors, proposed Directors or proposed supervisors has any direct or indirect interest in any assets which have since 31 December, 2005 (being the date to which the latest published audited financial statements of the Company were made up) been acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group; and
- 2.3 none of the Directors or any of their respective associates has interests in the businesses, other than being a director of the Company and/or its subsidiaries and their respective associates, which compete or are likely to compete, either directly or indirectly, with the businesses of the Company and its subsidiaries as required to be disclosed pursuant to the Listing Rules.

## 3. SUBSTANTIAL SHAREHOLDERS

As at the Latest Practicable Date, and so far as is known to the Directors and chief executive of the Company, the following persons had the following interests or short positions in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or was directly or indirectly interested in ten per cent or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company:

## Interests in the Company

Name of shareholder	Capacity	H/domestic shares	Nature of interest	No. of H/domestic shares held	Percentage of H/domestic shares over	Percentage of
					all issued H/domestic shares respectively (%)	total share capital of the Company (%)
Shenhua Group Corporation Limited	Beneficial owner	Domestic	Long Position	14,691,037,955	100.00	81.21
Merrill Lynch Europe Intermediate Holdings	Interest of controlled corporation	H	Long Position	518,705,000	16.93	2.87
		H	Short Position	518,705,000	16.93	2.87
Merrill Lynch Europe PLC	Interest of controlled corporation	H	Long Position	518,705,000	16.93	2.87
		H	Short Position	518,705,000	16.93	2.87
Merrill Lynch Holdings Limited	Interest of controlled corporation	H	Long Position	518,705,000	16.93	2.87
		H	Short Position	518,705,000	16.93	2.87
ML UK Capital Holdings	Interest of controlled corporation	H	Long Position	518,705,000	16.93	2.87
			Short Position	518,705,000	16.93	2.87

Name of shareholder	Capacity	H/domestic shares	Nature of interest	No. of H/domestic shares held	Percentage of H/domestic shares over	Percentage of total share capital of the Company
					all issued H/domestic shares respectively (%)	
Merrill Lynch (Asia Pacific) Limited	Interest of controlled corporation	H	Long Position	459,525,000	15.00	2.54
Merrill Lynch International Holdings Inc.	Interest of controlled corporation	H	Long Position	459,525,000	15.00	2.54
Merrill Lynch International Incorporated	Interest of controlled corporation	H	Long Position	459,525,000	15.00	2.54
AllianceBernstein L.P. (Formerly know as Alliance Capital Management L.P.)	Interest of controlled corporation	H	Long Position	340,900,530	10.03	1.88
JPMorgan Chase & Co	Interest of controlled corporation	H	Long Position	303,298,392	8.92	1.68
		H	Lending Pool	126,416,692	3.72	0.70
Merrill Lynch & Co., Inc.	Interest of controlled corporation	H	Long Position	218,980,866	6.44	1.21
Kerry Holdings Limited	Interest of controlled corporation	H	Long Position	207,582,000	6.11	1.15
Genesis Asset Managers, LLP	Investment manager	H	Long Position	204,000,500	6.00	1.13
Genesis Fund Managers, LLP	Investment manager	H	Long Position	204,000,500	6.00	1.13
Taurus Investments SA	Beneficial owner	H	Long Position	155,612,000	5.08	0.86

**4. EXPERT**

- 4.1 The following are the qualifications of the professional adviser who has given the Company an opinion or provided advice referred to or contained in this Circular:

<b>Name</b>	<b>Qualifications</b>
Somerley Limited	A corporation, licensed to carry out type 1 (dealing in securities), type 4 (advising on securities), type 6 (advising on corporate finance) and type 9 (asset management) regulated activities for the purposes of the SFO.

- 4.2 As at the Latest Practicable Date, the Independent Financial Adviser has no shareholding interest in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for any securities in any member of the Group.
- 4.3 The Independent Financial Adviser has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter of advice and references to its name in the form and context in which they respectively appear.
- 4.4 As at the Latest Practicable Date, the Independent Financial Adviser did not have any interest, direct or indirect, in any assets which have been acquired or disposed of by or leased to any member of the Group, or which are proposed to be acquired or disposed of by or leased to any member of the Group since 31 December, 2005, the date to which the latest published audited financial statements of the Company were made up.

**5. SERVICE CONTRACTS**

As at the Latest Practicable Date, none of the Directors has entered into, with any member of the Group, a service agreement which is not terminable within one year without payment of compensation (other than statutory compensation).

**6. NO MATERIAL ADVERSE CHANGE**

The Directors are not aware of any material adverse changes in the financial or trading position of the Group since 31 December, 2005 (being the date to which the latest published audited consolidated financial statements of the Group were made up).

**7. PROCEDURES FOR DEMANDING A POLL BY SHAREHOLDERS**

Pursuant to the articles of association of the Company, at any general meeting of shareholders a resolution shall be decided on a show of hands unless a poll is demanded, before or after any vote by show of hands. A poll can be demanded by (i) the chairman of the meeting; (ii) at least two shareholders entitled to vote present in person or by proxy; or (iii) one or more shareholders present in person or by proxy and representing 10 per cent or more of all shares carrying the right to vote at the meeting.

Unless a poll be so demanded, a declaration by the chairman that a resolution has on a show of hands been carried, unanimously, or carried by, a particular majority, or lost, and an entry to that effect in the minutes of the meeting shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour of or against such resolution.

The demand for a poll may be withdrawn by the person who made such a demand.

A poll demanded on the election of the chairman of the meeting, or on a question of adjournment of the meeting, shall be taken forthwith. A poll demanded on any other question shall be taken at such time as the chairman of the meeting directs, and any business, other than that upon which a poll has been demanded may be proceeded with, pending the taking of the poll. The result of the poll shall be deemed to be a resolution of the meeting at which the poll was demanded.

## 8. DIRECTORS' INTERESTS

- 8.1 There is no contract or arrangement entered into by any member of the Group subsisting at the Latest Practicable Date in which any Director is materially interested and which is significant in relation to the business of the Group.
- 8.2 The following Directors also serve as a director or employee of Shenhua Group or its subsidiaries:

Director	Name of company	Position
Chen Biting	Shenhua Group	Chairman of the board of directors
Zhang Xiwu	Shenhua Group	General manager
Zhang Yuzhuo	Shenhua Group	Vice general manager
	中國神華煤製油有限公司 (China Shenhua Coal Liquefaction Company Limited), a subsidiary of Shenhua Group	Chairman of the board of directors
Ling Wen	神華財務有限公司 (Shenhua Finance Company Limited), a subsidiary of Shenhua Group in which the Company has a 32.89 per cent. equity interest	Chairman of the board of directors
Han Jianguo	Shenhua Group	Vice general manager

Save as disclosed above, none of the Directors is a director or employee of a company which has an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company pursuant to the provisions of Divisions 2 and 3 of Part XV of the SFO.

**9. DOCUMENTS AVAILABLE FOR INSPECTION**

Copies of the following documents are available for inspection during normal business hours at the offices of Herbert Smith, 23rd Floor, Gloucester Tower, 11 Pedder Street, Central, Hong Kong up to and including 5 February, 2007:

- 9.1 the Power Purchase Agreements for 2006;
- 9.2 the letter from the Independent Financial Adviser, the text of which is set out in this circular at pages 12 to 18; and
- 9.3 the annual report of the Company for the year ended 31 December, 2005 and the interim report of the Company for the six months ended 30 June, 2006.